

to calculate a non-arm's-length allowance rate. Therefore we had to make several broad assumptions in order to estimate the impact of the proposed rule. We assumed that 50 percent of all allowances are non-arm's-length. We also assumed that over the life of the pipeline, allowance rates are made up of $\frac{1}{3}$ rate of return on undepreciated capital investment, $\frac{1}{3}$ depreciation expenses and $\frac{1}{3}$ operation, maintenance and overhead expenses. During FY 2001 royalty payors reported transportation allowance deductions of \$45,363,394 for Federal oil production. Based on our assumptions, if $\frac{1}{2}$ of the allowance deductions are non-arm's-length, then \$22,681,697 of the total allowances fell in this category. If $\frac{1}{3}$ of the allowance is made up of the rate of return, this equals \$7,560,565. Therefore, we estimated that increasing the basis for the rate of return by 50 percent could result in additional allowance deductions of \$3,780,283 ($\$7,560,565 \times .50$). Our review of transportation allowances deducted from oil royalties in the States of Wyoming, Colorado, Utah, and New Mexico revealed minimal amounts deducted from onshore leases. Therefore, we assumed that this entire increase would impact offshore royalties only.

(ii) Allow Line Loss as a Component of a Non-Arm's-Length Transportation Allowance

For offshore production, we based this estimate on the total offshore oil royalties for FY 2001 of \$2,069,450,791. We assumed that 50 percent of all allowances are non-arm's-length, and that oil pipeline losses are 0.2 percent of the volume of the production. Therefore, before making the further adjustments discussed below, we estimated this change could result in additional transportation allowances of \$2,069,451 per year ($\$2,069,450,791 \times .50 \times .002$). For onshore production we used total onshore oil royalties for FY 2001 of \$252,575,890. We assumed that 50 percent of all allowances are non-arm's-length, and that oil pipeline losses are 0.2 percent of the volume of the production. Therefore, before making the further adjustments discussed below, we estimated this change could result in additional transportation allowances of \$252,576 per year ($\$252,575,890 \times .50 \times .002$).

We also needed to recognize that substantial volumes of offshore production are taken in kind and are not subject to the regulations regarding transportation. We estimated that between 50,000 barrels of oil per day (BOPD) and 180,000 BOPD may be

taken in kind. The wide variance in this estimate is caused by the approximately 130,000 BOPD which may be taken in kind and placed into the Strategic Petroleum Reserve. Based on daily offshore Federal production of 222,100 BOPD, the amount of oil transportation subject to these regulations could range from a high of 77 percent of the production to a low of 19 percent of the production. [$(222,100 - 50,000) / 222,100 = 77\%$; $(222,100 - 180,000) / 222,100 = 19\%$]. Applying the high and low range factors for oil taken in kind, this could result in additional transportation allowance deductions for offshore leases ranging from \$393,196 ($\$2,069,451 \times 19\%$) to \$1,593,477 ($\$2,069,451 \times 77\%$) per year.

(iii) Allow Quality Bank Administration Fees As a Component of an Arm's-Length and a Non-Arm's-Length Transportation Allowance

For offshore oil production, we based our estimate on the total offshore oil royalty volume for FY 2001 of 81,066,567 barrels. We also estimated that quality bank administrative fees were \$0.002 per barrel. We estimated that allowing such fees could result in additional offshore transportation allowances of \$162,133 ($81,066,567 \times \0.002) per year before considering the effects of oil taken in kind. Applying the high and low range factors for oil taken in kind, this could result in additional transportation allowance deductions ranging from \$30,805 ($\$162,133 - 19\%$) to \$124,842 ($\$162,133 - 77\%$) per year. For onshore production we used the onshore royalty volume for FY 2001 of 9,496,181 barrels. Allowing such fees could result in additional allowances of \$18,992 ($9,496,181 \times \0.002).

(iv) Allow Line Fill As a component of an Arm's-Length and a Non-Arm's-Length Transportation Allowance

For offshore oil production, we based this estimate on the total offshore oil royalty volume for FY 2001 of 81,066,567 barrels. We estimated that line fill costs ranged from \$0.02 to \$0.05 per barrel. We then estimated that this factor could result in additional transportation allowances of \$1,621,331 ($81,066,567 \times \0.02) to \$4,053,328 ($81,066,567 \times \0.05) before considering the effects of oil taken in kind. Applying the high and low range factors for oil taken in kind, this could result in additional offshore transportation allowance deductions ranging from \$308,052 ($\$1,621,331 \times 19\%$) to \$3,121,062 ($\$4,053,328 \times 77\%$) per year. For Onshore production we estimated that this factor could result in additional transportation allowances of \$189,924

($9,496,181 \times \$0.02$) to \$474,809 ($9,496,181 \times \$0.05$).

Allow the Cost of a Letter of Credit As a Component of an Arm's-Length Transportation Allowance

Again we assumed that 50% of allowances were at arm's length. We again based the estimate on the total offshore oil royalty volume for FY 2001 of 81,066,567 barrels. We estimated that letter of credit costs ranged from \$0.02 to \$0.05 per barrel. We thus estimated that this could result in additional transportation allowances of \$810,666 ($81,066,567 \times \$0.02 \times .5$) to \$2,026,664 ($81,066,567 \times \$0.05 \times .5$). Applying the high and low range factors for oil taken in kind, this could result in additional offshore transportation allowance deductions ranging from \$154,027 ($\$810,666 \times 19\%$) to \$1,560,531 ($\$2,026,664 \times 77\%$) per year. For Onshore production we estimated that this factor could result in additional transportation allowances of \$94,962 ($9,496,181 \times \$0.02 \times .5$) to \$237,405 ($9,496,181 \times \$0.05 \times .5$).

(vi) Royalty Reduction Summary, items (i)–(v)—Additional Deductions for Allowances

We estimate that between \$4,666,363 and \$10,180,195 in additional transportation allowances could be deducted from OCS lease royalties based on an increased rate of return and permissibility of line losses for non-arm's-length allowances; permissibility of quality bank administration fees and line fill costs for both arm's-length and non-arm's-length allowances; and permissibility of letter of credit costs for arm's-length allowances. Also, for these same items we estimate that between \$556,454 and \$983,782 of additional transportation allowances may be deducted from Onshore Federal lease royalties.

(3) Cost—Administration—

(i) System Modifications To Reflect NYMEX Pricing Basis

We believe any increases in administrative costs related to changes in non-arm's-length valuation procedures would be minimal. These procedures involve NYMEX prices, which are readily available at no cost from numerous sources. They also involve determination of spot price differentials at various locations. We believe that anyone who uses the non-arm's-length provisions of the current rule already has access to the needed publications and exchange agreements. For some lessees, modification of computer programs related to royalty