U.S. Department of the Interior
Minerals Management Service
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NEWS RELEASE

FOR RELEASE:	February 5, 1998	**CONTACT:**	Michael L. Baugher (303) 231-3162 Anne-Berry Wade (202) 208-3985

MMS PROPOSES FURTHER AMENDMENTS TO FEDERAL CRUDE OIL VALUATION RULE

The U.S. Department of the Interior's Minerals Management Service (MMS) will publish in tomorrow's ***Federal Register*** a supplementary proposed rule that would amend the regulations establishing the value of oil from Federal leases.

In issuing the supplementary proposed rule, MMS Director Cynthia Quarterman said, "As a whole, this rule addresses the primary concerns of many of the oil and gas companies who have to calculate and pay royalty on crude oil produced from Federal leases. At the same time, it provides assurance to the Federal and State royalty recipients that value will be based on the best indicators of market value available for any given area of the country."

She further explained that, "It quite simply bases royalty value on the gross proceeds received when oil is sold under an arm's-length contract and on index pricing or other benchmarks in cases when oil is not sold under an arm's-length contract."

The proposed rule is the culmination of two earlier proposed rules, comments received, and several workshops held to gain input from constituents. In developing this proposed rule, MMS adhered to five basic principles of royalty valuation:

Royalty must be based on the value of production at the lease.

The rule provides for royalty payments based on no more than the value of production at the lease. Where index prices are used to establish value, actual transportation costs, location differentials, and quality adjustments would be applied in arriving at the value at the lease.

For arm's-length contracts, royalty obligations should be based on gross proceeds.

The MMS believes that gross proceeds received under the lessee's or its affiliate's arm's-length contracts remain the superior measure of market value, and clarifies this provision in the rule.

For other than arm's-length contracts, index prices are the best measure of value in most areas of the country.

MMS believes that index prices are the best indicator of the lease value for oil not sold at arm's length in areas other than the Rocky Mountains. For all areas of the country except the Rocky Mountains, MMS is proposing the use of spot prices,

adjusted for quality and location. MMS has retained its previous proposal to use Alaska North Slope spot prices for production from California and Alaska. While comparisons show that spot and NYMEX adjusted values are essentially the same, spot prices have the added benefit of being established closer to the lease, thereby eliminating one step in calculating the differential. Only in the Rocky Mountain Area where the production is remote from major market centers and the spot market is thinly traded is MMS proposing a series of benchmarks, including NYMEX, for valuing production not sold at arm's length.

The lessee has a duty to market at no cost to the lessor.

Federal lease terms require the lessee to market production at no cost to the lessor. MMS has been consistently upheld on the position that such costs do not result in a value greater than the value of production. The proposed rule is consistent with that position.

Customized regulations for unique producing areas are preferable to a "one size fits all" approach.

Because California and Alaska and the Rocky Mountain Area exhibit particular oil marketing characteristics, MMS does not believe in a single regulatory approach. The proposed rule recognizes the geographic differences in the marketplace and proposes different royalty valuation standards for three distinct parts of the country.

Other news on the Federal oil rule.

- Economic analyses of the rule's effects show that about two-thirds of production in the Gulf of Mexico, which accounts for the largest share (76.7%) of Federal oil production, would be subject to index pricing.
- In the Rocky Mountain Area , where only 8.5% of the Federal oil is produced, value for about two-thirds of production would remain on gross proceeds.
- In California and Alaska, which account for 14.8% of Federal oil production, MMS believes that index-based valuation would apply to about three-quarters of the production.
- Overall, about one-third of Federal production nationwide is sold arm's length; the other two-thirds of the production would be valued using index prices or benchmarks.
- Form MMS-4415 would be greatly simplified with clearer instructions, fewer respondents, and fewer locations for reporting oil aggregation. Using spot prices rather than NYMEX for most areas of the country would also remove one of the adjustments to the index price.
- The comment period closes on March 23, 1998 . You may send comments to: David S. Guzy, Chief, Rules and Publications Staff, Royalty Management Program, Minerals Management Service, P.O. Box 25165, MS 3021, Denver, Colorado 80225-0165; or E-mail David.Guzy@mms.gov.
- MMS is planning to hold hearings to obtain public input on the proposed changes in this rule.

MMS will publish announcement of those sessions in the Federal Register.

MMS is the federal agency that manages the Nation's natural gas, oil, and other mineral resources on the Outer Continental Shelf, and collects, accounts for and disburses about $4 billion in revenues each year from federal offshore mineral leases and from onshore mineral lease on federal and Indian lands.

Editor's note: The ***Federal Register*** Notice can be found on the MMS website under the "What's New" heading.

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MMS Internet website address: **http://www.mms.gov**
24 hour Fax-on-Demand Service:(202) 219-1703

Procedures Under Second Supplementary Proposed Federal Crude Oil Valuation Regulations Geographical Area Comparison

VALUATION PROCEDURE	CALIFORNIA/ ALASKA	ROCKY MOUNTAIN AREA	REST OF COUNTRY
Oil sold under an arm's-length contract* *** Including sales to affiliates who resell at arm's-length**	Gross proceeds determines value unless: 1) Contract doesn't reflect total consideration 2) Value is not reasonable due to misconduct 3) Oil is disposed of under an exchange agreement, except one or more arm's-length exchange agreements, then value based on the resale after the exchange(s) 4) Oil is disposed of under a non-competitive crude oil call	Same	Same
Oil NOT sold under an arm's-length contract	Value is based on spot price for Alaska North Slope crude, adjusted for location and quality	Value is based on first-applicable of following: 1) MMS-approved tendering program 2) Weighted average of lessee's/affiliate's arm's-length sales or purchases from the field/area 3) NYMEX-based price, adjusted for location and quality 4) MMS-established alternative method	Value is based on spot price for the market center nearest the lease (e.g., St. James, Louisiana, or Midland, Texas) adjusted for location and quality
Location, quality, and transportation adjustments	Actual rates or MMS-published rates from market centers to aggregation points Actual costs of transportation and quality adjustments based on pipeline quality banks, from aggregation points to leases Simplified Form MMS-4415 requires: 1) Information only on exchanges involving Federal oil and only from market centers to aggregation points 2) Less data elements than earlier form 3) One-third less aggregation points	Same	Same