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TELECOPY COVER LETTER

April 22, 1999

Please deliver the following pages to:

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ADDITIONAL MESSAGE:

Attached are comments on the January 21, 1999 Notice of Proposed Rulemaking - Accounting Relief for Marginal Properties. An original of these comments is being mailed today via certified mail.

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March 18, 1999

Mr. David S. Guzy, Chief
Rules and Publications Staff
Minerals Management Service
Royalty Management Program
Post Office Box 25165
Mail Stop 3021
Building 85 Denver Federal Center
Denver, Colorado 80225

Re: Notice of Proposed Rulemaking
Accounting Relief for Marginal Properties
64 Fed. Reg. 3360 dated January 21, 1999

Dear Mr. Guzy:

The undersigned trade association and companies are pleased to have the opportunity to comment in the above referenced proposed rulemaking. The IPAA is a national trade association representing independent oil and natural gas producers in the 33 producing states. As such, they are impacted by the proposed rule. These companies are lessees and payors who report and pay federal royalties. Having participated in the congressional dialogue surrounding the passage of the Federal Oil and Gas Royalty Simplification and Fairness Act (FOGRSFA), these commenters are keenly aware of the objective to prolong the life of marginal properties by reducing the administrative burden on lessees and operators.

With respect to the provisions in the proposed rule regarding the need for notification, rather than approval, MMS is to be commended for not proposing the more burdensome and expensive approval process. However, the below signed commenters believe that the rule and proposed procedures can be made more efficient and can be applied more broadly to

better effectuate Congressional intent. In an effort to work with MMS to that end, the signatories offer the following comments.

I. FOGRSFA

On August 13, 1996 the Federal Oil and Gas Royalty Simplification and Fairness Act (FOGRSFA), was signed into law by President Clinton. The Act provided relief for marginal properties under the following provisions:

Sec. 7 Alternatives for Marginal Properties

"(a) DETERMINATION OF BEST INTERESTS OF STATE CONCERNED AND THE UNITED STATES.--The Secretary and the State concerned, acting in the best interests of the United States and the State concerned to promote production, reduce administrative costs, and increase net receipts to the United States and the States, shall jointly determine, on a case by case basis, the amount of what marginal production from a lease or leases or well or wells, or parts thereof, shall be subject to a prepayment under subsection (b) or regulatory relief under subsection (c). If the State concerned does not consent, such prepayments or regulatory relief shall not be made available under this section for such marginal production: *Provided*, That if royalty payments from a lease or leases, or well or wells are not shared with any State, such determination shall be made solely by the Secretary."

* * *

"(c) ALTERNATIVE ACCOUNTING AND AUDITING REQUIREMENTS -- Within one year after date of the enactment of this section, the Secretary or the delegated State shall provide accounting, reporting, and auditing relief that will encourage lessees to continue to produce and develop properties subject to subsection (a): *Provided,* That such relief will only be available to lessees in a State that concurs, which concurrence is not required if royalty payments from the lease or leases or well or wells are not shared with any State. Prior to granting such relief, the Secretary and, if appropriate, the State concerned shall agree that the type of marginal wells and relief provided under this paragraph is in the best interest of the United States and, if appropriate, the State concerned."

II. Definition of "Marginal Property" -

The most critical issue in the rule proposal is the definition of "marginal property". While there is a need to understand and consider MMS' administrative efforts required to implement the rule, it does not seem necessary or advisable to have a single definition of "marginal property" to be utilized in all States for all purposes. One can conclude that Congress did not intend MMS to adopt a nationwide definition for all States, all properties and all purposes. The rule cites Section 6, but Section 6 contains the following qualifying language:

> *"unless the Secretary, together with the State concerned, determines that a different production is more appropriate".*

The rule correctly points out that Congress, contrary to its action in Section 6, did not define "marginal property" in Section 7. Section 7 states:

> *"The Secretary and the State concerned...shall jointly determine, on a case by case basis, the amount of what marginal production from a lease or leases or well or wells...shall be subject to pre-payment...or regulatory relief..."*

The undersigned Trade Association and companies advocate an expansion of the definition of marginal production with separate criteria for onshore and offshore production. Recognizing that fluctuation will occur in the economic state of the industry (i.e. price fluctuations) a flexible definition of marginal production would provide incentive to increase the ultimate recovery of these resources. An elimination of these provisions at higher levels would provide assurance that these incentive programs are in place during economic downturns. Considering that flexibility in what constitutes a "marginal property" would better fulfill Congressional intent. We make the following specific recommendations:

1. The 15 barrels of oil and 90 mcf level of production should be made a starting point for onshore leases, but flexibility should be provided to determine a different level where appropriate;

2. The methodology for calculating the applicable production level should be simple and consistent for the various types of relief. Royalty rate should not be a part of the methodology. The rules as currently drafted are confusing as to how calculations should be made to determine eligibility;

3. Considering that MMS possesses all of the production and agreement information necessary to determine which leases and units would be eligible, it would seem to make sense for MMS to simply publish the list of eligible properties. To this end, production data which comprises the "base period" must be available to MMS sufficiently in advance to be able to publish such a list. A base period of August 1 through July 31 would facilitate the process for MMS, States and industry;

4. If MMS publishes such a list, a lessee or designee should be able to simply notify MMS via a special reporting code that it would be reporting a lease under a marginal property reporting methodology; and

5. MMS requested comment on "whether separate levels should be established for offshore leases". The undersigned companies and trade association believe that higher production levels in the Gulf of Mexico are needed to effectuate the purposes of Section 7.

III. Section 204.203 - Cumulative Royalty Reports and Payment Relief Option.

This accounting issue was specifically discussed in the Congressional debate. Considering the comments above on production levels, the filing of reports on marginal properties should occur on only an annual or at most, a semi-annual basis for the level of 15 BOE or less, or 90 Mcf or less.

IV. Section 204.204 - Net Adjustment Reporting Relief.

The "net adjustment" reporting issue has been specifically discussed in numerous venues and task forces for a number of years. It is our understanding that MMS has been and continues to move toward permitting "net adjustments" for all royalty reporters. While it certainly needs to be readily available for marginal properties, it also is appropriate across the board for non marginal properties. Considering the lengthy history on this issue, it seems somewhat counter intuitive to classify net adjustment reporting as "relief" under this rule with a notification requirement that does not now exist.

V. Section 204.205 - Rolled-Up Reporting Relief Option.

Like IV above, this accounting procedure has been the topic of numerous groups and task forces over the last few years. Combining all selling arrangements makes sense not just

for marginal properties, but for most all properties. Again, classifying this option as "relief" with a notification requirement seems to be less than what can best fulfill the purposes of the legislation.

VI. Section 204.206 - Alternate Valuation Option

The idea of simplified valuation is a sound one. However, the statement that the method "must approximate royalties payable under the valuation regulations in 30 CFR part 206" is somewhat troublesome. Considering the litigation surrounding the existing regulations, and the potential for dispute with the proposed oil valuation regulations, this language would appear to impose an almost unsurmountable hurdle. A suggested alternative is that the valuation method must approximate the value of production at the lease."

The rule proposal does not specify the time within which the MMS must respond to the lessee's or designee's request for an alternate valuation determination. Because the State must respond to the MMS in 30 days, should not the MMS be required to respond to the lessee or designee within 30 days after receiving notice from the State?

VII. Section 204.207 - Audit Relief

Like the two options stated immediately above, this is an admirable objective. It is our understanding, however, that current audit strategy includes emphasis on more significant production and that marginal production is seldom audited because it is not cost effective to do so.

As to reliance on independent certified audits, the critical issue is the obligation of the independent auditor prior to signing the required certification to MMS. It would not be cost effective for companies to have auditors perform detailed audits of low production leases or wells. However, a general review may be more acceptable.

VIII. More Creativity and Flexibility in Rules Desirable

As the current oil price crisis demonstrates, more creative and flexible approaches are needed to prolong production for marginal wells. The rules should encourage, not inhibit lessees and States to find innovative and cost effective methods of dealing with marginal properties. With computerized payments systems, reporting procedures may only make sense if done system wide, on a State-by-State basis or perhaps field-wide. There is little, if any incentive for a lessee to spend resources that will have very limited application. The

rules as drafted are more narrow, and as a consequence, more burdensome than necessary. The options would have much greater appeal if they could be applied much more broadly. One thought on how this could be achieved is by utilizing phrases such as "marginal production also includes that production which the highest official in the State has designated as marginal" or, that option could be applied to "marginal production and other production in the same unit, field or area where the production is predominantly marginal". Making the rules have greater application and flexibility would be of substantial benefit.

The undersigned Trade Association and companies appreciate the opportunity to comment on this important provision of FOGRSFA and look forward to continuing to work with MMS and the States on it implementation. Please call if you have any questions or if we can be of assistance.

Sincerely,

Patsy Bragg

Patricia Dunmire Bragg
on behalf of

Independent Petroleum Association of America
Anadarko Petroleum Corporation
Chevron U.S.A. Production Company
Coastal Oil & Gas Corporation
Conoco, Inc.
Devon Energy Company
Dugan Production Company
Enron Oil & Gas Company
Kerr-McGee Corporation
Marathon Oil Company
Texaco, Inc.
Vastar Resources, Inc.