federal register

Thursday
January 15, 1987

Part V

Department of the Interior

Minerals Management Service

30 CFR Parts 202, 203, 206, 207, 210, and 241

Revision of Oil Product Valuation Regulations and Related Topics; Proposed Rulemaking

S-094999 0120(07)(14-JAN-87-14:38:58)
F4717.fmt...[16.30]...1-2-86

DEPARTMENT OF THE INTERIOR

Minerals Management Service

30 CFR Parts 202, 203, 206, 207, 210, and 241

Revision of Oil Product Valuation Regulations and Related Topics

AGENCY: Minerals Management Service (MMS), Interior (DOI).

ACTION: Notice of proposed rulemaking.

SUMMARY: This proposed rulemaking provides for the amendment and clarification of regulations governing valuation of oil for royalty computation purposes. The amended and clarified regulations govern the methods by which value is determined when computing oil royalties and net profit shares under Federal (onshore and Outer Continental Shelf) and Indian (Tribal and allotted) oil and gas leases (except leases on the Osage Indian Reservation, Osage County, Oklahoma).

DATES: *Comments must be received on* or before April 15, 1987. Hearings are scheduled as follows:

1. March 4, 1987, 8:30 AM to 4:00 PM, Denver, Colorado.
2. March 17, 1987, 8:30 AM to 4:00 PM, New Orleans, Louisiana.

ADDRESSES: Written comments may be mailed to Minerals Management Service, Royalty Management Program, Rules and Procedures Branch, Denver Federal Center, Building 85, P.O. Box 25165, Mail Stop 660, Denver, Colorado, 80225, Attention: Dennis C. Whitcomb.

The hearings will be held at the following locations:

1. Denver—Sheraton Denver Airport Hotel, 3535 Quebec Street, Denver, Colorado.
2. New Orleans—Airport Holiday Inn, 2929 Williams Boulevard, Kenner, *Louisiana.*

FOR FURTHER INFORMATION CONTACT: Dennis C. Whitcomb, (303) 231-3432, (FTS) 326-3432.

SUPPLEMENTARY INFORMATION: The principal authors of this proposed rulemaking are John L. Price, Scott L. Ellis, Thomas J. Blair, Stanley J. Brown, and William H. Feldmiller, of the Royalty Valuation and Standards Division of the Minerals Management Service; and Peter J. Schaumberg of the Office of the Solicitor, Washington, DC.

I. Introduction

On January 9 and 10, 1986, the first meeting of the Royalty Management Advisory Committee (RMAC) was held in Lakewood, Colorado. (See Notice of Meeting, 50 FR 52385, Dec. 23, 1985.) The RMAC, which is composed primarily of representatives from States, Indian Tribes and allottees, and the coal, oil, and gas industry, was charged with the responsibility of advising the Secretary of the Interior about the form and content of changes to Minerals Management Service (MMS) regulations governing the value, for royalty purposes, of coal, oil, and gas production from Federal and Indian leases.

At the first RMAC meeting, the Committee asked the Secretary to withhold promulgation of proposed valuation regulations until the Committee has an opportunity to review the issues and make its recommendations. The Secretary agreed to the request, and in response to the Committee's request, MMS made available to RMAC its latest drafts of regulations governing the valuation of coal, oil, and gas, and those governing transportation and processing allowances. At the same time, MMS made copies of those same draft regulations available to the public (51 FR 4507, Feb. 5, 1986; and 51 FR 7811, March 6, 1986). Public comment on the drafts was requested both in written form and at a public meeting held in Lakewood, Colorado, on March 18 and 19, 1986.

The RMAC formed three working panels to review the draft coal, oil, and gas rules, and the transportation and processing rules related to each product. Between January and October 1986, the various working panels held several meetings to review the draft rules. The working panel meetings were published in the Federal Register and the meetings were open to members of the public, many of whom participated actively.

Each of three working panels prepared a detailed set of recommendations to RMAC. These were reviewed at the RMAC meetings held July 28-30, 1986, and October 20-22, 1986. The RMAC was unable to approve the reports of both the oil and the gas panels for transmission to the Secretary, which, by the terms of RMAC's charter, required a two-thirds vote of the Committee membership. The RMAC did approve, for submission to the Secretary, a set of recommendations regarding certain of the provisions contained in the coal valuation regulations.

The MMS representatives were present at, and participated in, all meetings of RMAC and the working panels. As a consequence of the extensive discussion between members of the groups representing the States, Indians, and the industries, and the detailed written recommendations prepared by the working panel's MMS's task of drafting proposed valuation regulations was enhanced significantly. In preparing these proposed regulations, MMS carefully considered all of the discussions that occurred at the various meetings, regardless of whether they were adopted in any of the three working panel reports or by the full Committee. The MMS also considered the written and oral comments from the public on the draft rules and the resolution presented to the Secretary by RMAC. The MMS appreciates the hard work and dedication of a large number of people who were willing to work toward the common goal of clarifying and improving the regulations governing the valuation, for royalty purposes, of coal, oil, and gas production from Federal and Indian leases.

The policy of the Department of the Interior is, whenever practicable, to afford the public an opportunity to participate in the rulemaking process. Accordingly, interested persons may submit written comments, suggestions, or objections regarding the proposed rule to the location identified in the ADDRESSES section of this preamble. Comments must be received on or before April 15, 1987. Two public hearings will be held on the dates and at the locations identified in the DATES AND ADDRESSES sections of this preamble.

II. Purpose and Background

The MMS is proposing to revise the current regulations regarding the valuation of oil to accomplish the following:

1. Clarification and reorganization of the existing regulations at 30 CFR Parts 202, 203, 206, 207, 210, and 241.
2. Creation of regulations consistent with the present organizational structure of the Department of the Interior.
3. Placement of the oil royalty valuation regulations in a format compatible with the valuation regulations for all leasable minerals.
4. Clarification that royalty is to be paid on all consideration received by lessees, less applicable transportation allowances, for production removed or sold from the lease.
5. Creation of regulations to guide the lessee in the determination of allowable transportation costs for oil to aid in the calculation of proper royalty due the lessor.

Structurally, these regulations include the reorganization and redesignation of Parts 202, 203, 206, 207, and 210. Each part is reorganized by redesignating "Subpart B—Oil and Gas, General" as "Subpart B—Oil, Gas, and OCS Sulfur, General" "Subpart C—Oil and Gas, Onshore" as "Subpart C—Federal and Indian Oil" and "Subpart D—Oil, Gas and Sulfur, Offshore" as "Subpart D—Federal and Indian Gas."

Also, a number of sections would be renumbered and/or moved to a new subpart. In addition, §§ 202.51, 202.54, 202.55, 202.102, 206.101, 206.102, 206.103, 206.104, 206.105, 207.1, 207.4, and 210.55 would be added to the appropriate subparts.

This proposed rule is to be applied prospectively. It would supersede all existing oil royalty valuation directives contained in numerous Secretarial, Minerals Management Service, and U.S. Geological Survey Conservation Division (now Bureau of Land Management, Onshore Operations Division) orders directives, regulations and NTL's (Notice to Lessees) issued over past years. Specific guidelines governing reporting requirements *consistent with the oil valuation* regulations will be incorporated into the MMS Payor Handbook subsequent to the issuance of final rulemaking in the Federal Register.

For the convenience of oil and gas lessees, payors, and the public, the following chart summarizes the effects *of these proposed rules.*

Regulation changes	Descriptions
I. Redesignations:	
1. Subparts E, F, G, and H of Part 241 are redesignated as Subparts F, G, H, and I respectively.	This administrative action permits the insertion of a new Subpart E-"Solid Minerals, General" in this Part.
2. Sections 202.150, 202.151, and 202.152 are redesignated as §§ 202.100, 202.53, and 202.52, respectively. Section 203.150 is redesignated as § 203.50. Section 206.104 is redesignated as § 202.101.	This administrative action more appropriately locates within 30 CFR the information contained in these sections.
3. Sections 207.3 and 207.4 are redesignated as §§ 207.2 and 207.3 respectively.	This renumbering is required by the deletion of the old §§ 207.1 and 207.2
4. Sections 210.300 and 210.301 are redesignated as §§ 210.350 and 210.351, respectively.	This action corresponds to the redesignation of Subpart G as Subpart H (see Item 1, above).
II. Deletions:	
1. Subpart H-"Indian Lands" is removed from Part 241.	Oil royalty valuation for Indian Lands is now covered by Subpart C—Federal and Indian Oil.
2. Sections 201.100 through 202.103 are removed from Subpart B of Part 202.	These sections cover activities now governed by BLM.
3. Section 203.100 is removed from Subpart C.	This section covers an activity now governed by BLM operations personnel.
4. Section 206.103 is removed from Subpart C of Part 206.	This section has been rewritten and relocated in the regulations as Subparts C and D of Part 206.
5. Sections 207.1, 207.2, 207.5, 207.6 and 207.7 are removed from Subpart A of Part 207 (Note.—Sections 207.3 and 207.4 are redesignated as 207.2 and 207.3—see Redesignations).	The subject matter of these Sections is addressed elsewhere in the regulations. They are, therefore, redundant and have been removed to avoid confusion.
6. Sections 210.100 through 210.105, 210.150 and 210.151 are removed from Subpart C and D, respectively, of Part 210.	These requirements of §§ 210.100 and 210.101 are now covered by Part 207, as amended. Sections 210.102, 210.103 and 210.104 are no longer applicable (these forms are no longer in use). § 210.105 has been replaced by new § 210.55.
7. Paragraph 241.100(c) is removed from Subpart C of Part 241.	Section 241.100(c)(1) is no longer applicable (this form is no longer in use).
III. Additions:	
1. The following subparts are added to Part 207. Subpart A—General Provisions. Subpart B—Oil, Gas and OCS Sulfur, General [Reserved]. Subpart C—Federal and Indian Oil [Reserved]. Subpart D—Federal and Indian Gas [Reserved]. Subpart E—Solid Minerals, General [Reserved]. Subpart F—Coal [Reserved]. Subpart G—Other Solid Minerals [Reserved]. Subpart H—Geothermal Resources [Reserved]. Subpart I—OCS Sulfur [Reserved].	Separate subparts have been added to Part 207 to make it consistent with other parts of 30 CFR Chapter II and to provide both structure and space for future expansion of this portion of the regulations.
2. Subpart E-Solid Minerals, General [Reserved] is added to Part 241.	This new subpart provides space for future regulations of general applicability to all solid minerals.
3. Sections 202.51, 202.54, 202.55, and 202.102 are added to Part 202. Sections 206.101, 206.102, 206.103, 206.104, and 206.105 are added to Part 206.	Thes new sections provide oil valuation standards and procedures.
4. Sections 207.1 and 207.4 are added to Part 207.	These new sections reference the definitions in Part 206 and set forth certain recordkeeping requirements.
5. Section 210.55 is added to Part 210.	This will replace § 210.105.
IV. Amendments:	
1. Parts 202, 203, 206, 210 and 241 are amended by retitling the following Subparts: Subpart B retitled, "Oil, Gas and OCS Sulfur, General". Subpart C retitled "Federal Indian Oil [Reserved]". Subpart D retitled "Federal and Indian Gas [Reserved]".	These subparts have been retitled in order to organize them on a commodity basis (oil vs. gas, etc.) rather than emphasizing location (onshore vs. offshore) as was done formerly.

MMS believes the proposed valuation methods would yield a reasonable and long-term maximum rate of return for both Federal and Indian leases. The basic premise underlying this methodology is that value is best determined by the interaction of competing market forces—the 7/8ths or 4/5ths owner is going to negotiate the best deal he can to further his own interests, advancing those of the royalty owner as well. This would add certainty to the market place and assure maximum, long-term revenues to all parties concerned. Comments are especially requested on this issue.

The proposed rules in § 206.100 would expressly recognize, however, that where the provisions of any Indian lease, or any statute or treaty affecting Indian leases, are inconsistent with the regulations, then the lease, statute, or treaty would govern to the extent of the inconsistency. The same principle would apply to Federal leases.

A separate oil definitions section applicable to the royalty valuation of oil is included in this proposed rulemaking in Part 206. All definitions contained under each subpart of Part 206 shall be applicable to the regulations contained in Parts 202, 203, 207, 210, and 241.

III. Section-by-Section Analysis

Proposed § 202.51, Scope and definitions, is an introductory section stating that Part 202 would be applicable to all Federal and Indian leases except leases on the Osage Indian Reservation. This section also references the definitions contained in Part 206.

Proposed § 202.52, Royalties, would provide that royalty shall be paid at the rate specified in the lease unless the Secretary reduces, or in the case of OCS leases, reduces or eliminates, the amount of royalty specified in the lease. This regulation also would specify that for all of Subchapter A of Chapter II, the term "royalty(ies)" would be construed to encompass the term "net profit share(s)." This was done to avoid cumbersome wording when having to refer to a royalty payment computation versus a computation of a net profit share payment.

Proposed § 202.53, Minimum royalty, states that, for leases which provide for minimum royalty payments, the lessee must pay the minimum royalty as specified in the lease.

Proposed §§ 202.54 and 202.55 set forth general obligations of the lessee and MMS which are based upon other regulations in Title 30 and Title 43.

Proposed § 202.100, Royalty on oil, sets forth general policies regarding what oil is subject to royalty. Proposed § 202.100(a) provides that oil includes condensate separated from gas without processing and that royalty must be paid in value unless MMS requires payment in-kind. Proposed § 202.100(b) states that all oil is subject to royalty except oil lost which BLM or MMS, as appropriate, has determined was unavoidably lost, or oil that is used on, or for the benefit of, the lease. Accordingly, royalty would be due on oil avoidably lost or waste and oil from which compensatory royalty has been determined to be due as a result of drainage, as determined by BLM for onshore oil and gas operations, or by MMS for offshore oil and gas operations. This is consistent with section 308 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1756). Oil used for the benefit of a lease, which is royalty free, includes oil used in lease equipment on communitized areas or unit areas when the lease is committed to a communitization agreement or unitization agreement and oil used off-lease for the benefit of the producing lease when such off-lease use is permitted by BLM or MMS, as appropriate. If the provisions of any lease are inconsistent with this section, the lease terms would govern. An example is a lease issued pursuant to section 6 of the OCS Lands Act which requires royalty to be paid on lease-use products.

Proposed § 202.101, Royalty rates on oil: sliding- and step-scale leases (public land only), formerly § 206.104, would be retained and essentially unchanged. This section is primarily concerned with the determination of countable wells for sliding- and step-scale royalty rate leases. It is anticipated that in the future this regulation will be redesignated in Title 43 of the Code of Federal Regulations because it is operational in nature.

Proposed § 202.102, Standards for reporting and paying royalties on oil, sets forth the criteria for reporting the volumes of oil on which royalty is due.

Part 206 of the proposed regulations would include the rules for valuation of oil for royalty payment purposes.

Proposed § 206.100, Purpose and scope, is an introductory section stating that Subpart B would be applicable to oil produced from all Federal and Indian leases, except leases on the Osage Indian Reservation. The term "Federal leases" includes leases on the OCS. Paragraph (b) would incorporate the principle that if the specific provisions of any lease, statute, or treaty are inconsistent with the regulations, then the lease, statute, or treaty provisions would govern to the extent of the inconsistency. This principle would apply to existing leases as well as leases executed after the effective date of the regulations. Paragraph (d) would require all oil determined by BLM to have been avoidably lost or wasted from an onshore lease, all oil determined by BLM to have been drained from an onshore lease from which compensatory royalty is due, and all oil determined by MMS to have been avoidably lost from an offshore lease to be valued in accordance with Part 206. Paragraph (e) would express MMS royalty policy that royalties are owed on insurance compensation for oil unavoidably lost.

Proposed § 206.101, Definitions, sets forth definitions applicable to the proposed oil valuation regulations. Most definitions applicable to oil are straightforward and self-explanatory. A few definitions, however, require further explanation.

"Arm's-length contract" would be defined as a contract or agreement between independent, nonaffiliated persons. The definition would further provide that two persons are affiliated if one person controls, is controlled by, or is under common control with another person, *or* if one person owns an interest (regardless of the amount), either directly or indirectly, in another person. This definition is important to the regulations because, as is explained below, MMS is proposing that the gross proceeds under an arm's-length contract would be accepted as value. Other valuation criteria would apply to non-arm's-length contracts.

The thrust of the proposed arm's-length contract definition is to include within its coverage only those contracts between persons who have no affiliation or interrelationship of any kind that would cause the contract terms to be suspect as to their arm's-length nature. The MMS recognizes that by excluding from the definition those contracts between persons where one party to the contract has any ownership interest in the other, it is narrowing the universe of contracts which would fall within the scope of the definition.

The MMS has proposed a definition for arm's-length contract that excludes references to such matters as "adverse economic interests" or "free and open markets" because the inclusion of such sometimes subjective concepts would make a lessee's determination that its contract was arm's-length subject to uncertainty. The advantage to the proposed definition is that it would be almost purely objective, and lessees and other payors would have assurance that if they pay royalties on the basis of gross proceeds from an arm's-length contract, the royalty valuation would not later be susceptible to redetermination.

MMS would like commenters to address whether a list of items could be developed which could serve to define an arm's-length contract. Specifically, is there a list of questions which a lessee could answer which would lead to an objective determination of whether it was an arm's-length contract? Possible questions are: (1) Is there a common equity interest between the parties to the contract; (2) is there common control of the parties to the contract; (3) was there a consolidated tax filing by the parties to the contract. MMS would like commenters to address whether the development of such a list is possible and what questions should be part of the list.

The term "gross proceeds" is another term which is important to the regulations because it would be a common royalty value determinant. Gross proceeds is proposed to be defined as the total monies or other consideration paid to an oil and gas lessee, or monies or other consideration to which such lessee is entitled, for the disposition of oil. Gross proceeds would be defined to include payments to the lessee for certain services such as treating, measuring, and field gathering that the lessee is obligated to perform at no cost to the lessor. Gross proceeds also would be defined to include: payments or credits for advanced prepaid reserve payments, or advanced exploration or development costs, subject to recoupment through reduced prices in later sales; and reimbursements where the purchaser reimburses the seller, or pays any costs on behalf of the seller, for such items as severance taxes, harboring fees, or terminalling fees.

The definition is intended to be expansive to ensure that it includes all the benefits flowing from the purchaser to, or on behalf of, the seller for the disposition of the oil.

"Lessee" would be defined as any person to whom the United States, an Indian Tribe, or an Indian allottee, issued a lease, and any person who has assumed an obligation to make royalty or other payments required by the lease. The MMS is proposing to expressly include in the definition all persons who may have to make royalty payments. This would include all persons who have an interest in a lease as well as an operator or other payor, including in some instances the purchaser, who has assumed a royalty payment responsibility by contract or other agreement with the persons who have the actual lease interests. By using this broad definition for the product valuation regulations, it would not be necessary to use multiple terms such as lessee/payor/operator throughout the rules. This definition is not intended to change any contractual obligations under the lease instrument between the lessor and the current or original lease holder, except as it pertains to royalty valuation.

"Marketable condition" would be defined as lease products that are sufficiently free from inpurities and otherwise in a condition that they will be accepted by a purchaser under a typical sales contract in the field or area. Federal and Indian leases typically require the lessee to pay royalties equal to a specified percentage of the amount or value of production saved, removed, or sold from the leased area. The regulations governing operations require that the lessee place in marketable condition, to the extent economically feasible, all oil, gas, etc., produced from the leased land. See 43 CFR 3162.7-1(a) and 30 CFR 250.42. See also § 206.102(h) of the proposed rules. Court decisions have upheld the principle that the lease operator is obligated to perform necessary field gathering and treatment to develop a product that has been conditioned for market sale (*California Co. v. Udall*, 296 F.2d 384 (D.C. Cir. 1961)).

MMS would like commenters to address whether other terms used in these proposed regulations need to be defined.

Proposed § 206.102, Valuation standards, would set forth the valuation standards for all oil from Federal and Indian leases. Value would be determined differently depending upon whether or not the sales agreement is arm's-length.

Paragraph (a) would state expressly that the value, for royalty purposes, of oil production would be the value of the oil determined pursuant to § 206.102, less applicable allowances for transportation (§§ 206.104 and 206.105). However, as explained below, lessees would not be allowed to report a net number for the royalty value (i.e., value less allowances), but would be required to report the allowances separately on the Report of Sales and Royalty Remittance, Form MMS-2014. Lessees would not be entitled to deduct allowances in all situations (see discussion below).

Pursuant to proposed § 206.102(b), the value of oil sold pursuant to an arm's-length contract would be the gross proceeds accruing, or which could accrue, to the lessee. Prior MMS approval of this value would not be required, but it would be subject to monitoring, review, and audit. MMS could direct a lessee to use a different value if it determines that the lessee's reported value was determined to be improper.

Existing rules in 30 CFR 206.103 (onshore) and 30 CFR 206.150 (offshore) provide for the consideration of various criteria by MMS in establishing the value, for royalty purposes. These existing rules provide that gross proceeds is a minimum royalty value. In many instances, however, MMS has determined that the contract price is the royalty value. Therefore, in these situations, the proposed rule would not result in a change in value.

The MMS believes that there are several reasons to conclusively establish gross proceeds under an arm's-length transaction as the value of oil. In the majority of areas there will be more than one purchaser of oil. As with most commodities, each purchaser will set its own price and will seek to fulfill some finite need. A lessee will enter into a contract to sell its oil to a purchaser considering many factors. Of course, the price offered is of paramount importance, but the reliability of the purchaser to provide stability over long periods of time is also an important factor. Because the vast majority of oil is sold by referencing the price to be paid to posted price bulletins, often the lessee may seek the purchaser with the highest posted price. However, that purchaser with the highest posted price may have fulfilled its need for oil and cannot agree to purchase the lessee's oil. Posted prices change periodically, sometimes frequently. The purchaser with the highest posted price today may not maintain that position on subsequent days. Thus, there can be a range of prices that represent what the market will allow, and the prudent lessee will seek a solid and reliable purchaser to assure the most efficient operation of its lease. The lessee would no longer need to be concerned that it may have to pay royalty at a value perhaps considerably higher than the price at which it is selling the oil.

Although the consequence of adopting proposed § 206.102(b) will initially appear to reduce some royalty values, MMS believes that it ultimately will benefit the lessor.

If the disposition of oil production from a Federal or Indian lease is not pursuant to an arm's-length contract, specific criteria must be used to determine the proper royalty value. The valuation process contained in § 206.102(c) would be used when there is no arm's-length contract, including the following circumstances: there is no contract for the sale of oil; oil is used intra-company; oil is avoidably lost, or for any reason improperly disposed of without sale. In these situations, § 206.102(c) of the proposed regulations would require that the value be determined through application of criteria in a prescribed order. In other words, the second criterion would not be considered unless the first criterion could not reasonably be applied. Likewise, the third and fourth criteria would not be considered unless those preceding it were inapplicable, etc.

The first criterion is for the lessee to use its own contemporaneous posted prices used in arm's-length transactions for purchases of significant quantities of similar oil in the field or area. This method allows the lessee certainty in determining its own value for royalties without dependence upon MMS to establish the value. At the same time, it is indicative of the value in the field for similar oil. The MMS believes this method is preferable to the major portion analysis provided for in existing oil and gas regulations which has proved difficult to administer. See 30 CFR 206.103. If the first valuation criterion is inapplicable, the second criterion would apply. This second criterion would be the arithmetic average of all contemporaneous posted prices used in arm's-length transactions for purchases of significant quantities of similar oil from the same field or area.

The MMS believes that the arithmetic average of these prices is a proper indicator of the value of oil and, hence, would be acceptable as value. Also, the arithmetic average price will be less burdensome administratively than a weighted average price where volumetric sales information is difficult to obtain and varies for reasons not value related.

In both the first and second benchmarks, the proposed rule requires that there be "significant quantities of similar oil" purchased pursuant to a posting before that posting could be used to value the lessee's production. The purpose of this phrase is to prevent abuses through application of unusually low or high posting under which little or no oil actually is purchased. The term "significant quantities" also is intended to be in relation to the volumes moving under typical purchases in the field or area. Thus, for a highly productive OCS field, to meet the significant quantities test, a larger volume would be required to be purchased under a posting than in a less productive onshore field.

In the event that there are no price postings applicable to the field or area within which the oil is produced, the third criterion, other contemporaneous arm's-length contracts for purchases of significant quantities of similar oil in the area or nearby areas, would be used. The MMS believes that these prices are the next best indicator of the value of the oil. If there are no other contemporaneous arm's-length contracts which can be used, spot sales postings and any other relevant information pertaining to that oil would be considered.

If a value cannot be determined by using any of the valuation procedures previously mentioned, a net-back procedure may be used to value the oil by working backwards from the sales price to arrive at a value at the lease. This last benchmark also would authorize the use of any other reasonable method to determine value.

The MMS particulary solicits comments regarding the proposed ordering of valuation benchmarks.

It should be noted here that when a valuation method other than gross proceeds is used for oil sold pursuant to a non-arm's-length contract, such as spot prices, the lessee may not be entitled to a transportation allowance. By way of illustration, if the value of oil is established under § 206.102(c) (iv) based upon spot prices in the field where the lease is located, the value would not be reduced by a transportation allowance even if the lessee actually sold oil on a delivered basis at a point remote from the lease and incurred transportation expenses. The allowance would be inapplicable because the spot prices in this example already reflect value of oil at the lease. However, pursuant to § 206.102(g), the valuation of the lessee's oil based on the spot prices could not be less than the lessee's gross proceeds reduced by the transportation allowance which would be determined considering the costs the lessee actually incurred. Therefore, regardless of the value determined pursuant to the benchmarks, under no circumstances can the value, for royalty purposes, be less than the gross proceeds accruing, or which could accrue, to the lessee, less applicable transportation allowances. This long-standing principle is set forth at § 206.102(g), and is discussed below.

Section 206.102(d) would provide that where value is determined pursuant to the benchmarks, prior MMS approval would not be required. The lessee would be required to retain the necessary data to support its benchmark applications for future review and/or audit. MMS may direct a lessee to use a different value if it determines that the lessee's reported value was determined to be incorrect.

Proposed § 206.102(e) would permit the lessee to pay royalties at its determined valuation. The lessee then would be entitled to a credit, or would be required to pay additional royalty, plus interest, if MMS subsequently determines a different value is applicable. This could occur after MMS reviews and/or audits a value, or in situations where a lessee has requested a value determination from MMS. If the initially reported value was reasonable and in good faith, no penalties for improper reporting would be imposed for initially reporting the lower value, although penalties could be applied for other improper reporting.

Proposed § 206.102(f) would allow the lessee the option to seek value determination from MMS. The lessee would first propose to MMS what that value should be and furnish all supporting documentation for that proposal. The lessee could use its proposed value for reporting purposes until MMS issues a value determination. It would be incumbent upon MMS to expeditiously evaluate that proposal. If the determined value by MMS is different from the lessee's proposed value, the lessee would be required to adjust its reports in accordance with paragraph (e).

Proposed § 206.102(g) restates the long-standing principle that under no circumstances can the value, for royalty purposes, be less than the gross proceeds accruing, or which could accrue, to the lessee, less applicable transportation allowances. The definition of gross proceeds was discussed earlier. It is worth noting again, however, that the gross proceeds accruing to the lessee includes all costs paid by the purchaser of the oil on behalf of the seller. This principle has been upheld in several cases: *Wheless Drilling Co.*, 80 I.D. 599, 13 IBLA 21 (1973); *Amoco Production Co.*, 29 IBLA 234, 236 (1977); *Hoover & Bracken Energies, Inc.*, 52 IBLA 27, 88 ID 7 (1981), *aff'd*, 723 F.2d 1388 (10th Cir. 1983). Thus, if the purchaser reimburses the seller, or pays any costs on behalf of the seller, for such items as severance taxes, gathering, treating, or measuring, then the seller must include those reimbursed costs as part of the gross proceeds upon which the royalty value is determined.

The proposed rules in § 206.102(h) retain the existing requirement that oil operations such as gathering, treating, measuring, and storing are costs incurred to place the oil in marketable condition and are to be borne exclusively by the lessee. Proposed § 206.102(h) also would provide that, where value is based on gross proceeds, the value would be increased to the extent those gross proceeds were reduced because the purchaser, or any other person, is providing certain services the cost of which ordinarily is the responsibility of the lessee to place the oil in marketable condition. By way of illustration, treating for the removal of basic sediment and water (BS&W) is a cost of making oil marketable that must be borne by the lessee. If the lessee enters into a contract where the purchaser agrees to treat the oil and, hence, the contract price is reduced by one dollar per barrel, MMS would add the dollar per barrel back to the gross proceeds to determine the value.

Proposed § 206.102(i) would expressly impose a diligence requirement on lessees. For example, if, pursuant to an arm's-length contract, a lessee could charge its purchaser a higher price as of a certain date, and if the lessee fails to take proper and timely action to collect that additional money, the lessee would be liable for royalty on the higher value. However, if the purchaser refuses to pay and the lessee attempts to enforce its right, using reasonable, documented measures, it would not be required to pay the additional royalties until the lessee's efforts are successfully concluded. The MMS believes that this regulation reflects the lessee's obligation to operate the lease prudently for the mutual benefit of itself and the lessor.

Section 206.102(i) would not operate to excuse a lessee from paying any royalty if, for example, oil were delivered under a contract and the purchaser failed to pay. In such an event, royalty still would be due on the value of the oil. This section is intended to apply only to the lessee's obligation to pursue price increases to which it may be entitled under its contract.

Proposed § 206.103, Point of royalty settlement, would require that royalty be computed on the basis of the quantity and quality of oil in marketable condition at the location approved by MMS for offshore leases or by BLM for onshore leases. In those instances where the lessee sells oil at conditions and/or at locations other than those approved by BLM or MMS, the value of the oil, for royalty purposes, must be determined under the conditions and at the location approved by BLM and MMS. The oil actually measured at the approved point of royalty settlement will be that volume reported to MMS and that volume upon which royalty is to be paid. There would be no credit allowed against this volume or against the royalty value of this volume.

For example, a lessee is required by BLM or MMS, as appropriate, to measure its oil production, for royalty purposes, at a meter on the lease. The lessee's arm's-length contract provides for delivery to the purchaser at a point away from the lease. For whatever reason, the volume of oil measured at the point of delivery under the arm's-length contract is less than the volume of oil measured at the approved point of royalty settlement. In this situation, the gross proceeds accruing to the lessee under its arm's-length contract would be increased, for royalty purposes, to reflect the difference in the volumes measured at the two points. This increase, for royalty purposes, would be accomplished by multiplying the volumetric difference times the unit price at which the oil was actually sold. Similarly, downward adjustments to gross proceeds would be made where applicable.

As a further example, assume that the gravity of the oil delivered is higher than the gravity as determined at the approved point of royalty settlement because the lessee moved a commingled stream of oil from many leases to the same sales point. The lessee would be selling a product of higher quality and value than that measured at the point of royalty settlement. In such a case, the gross proceeds that would be received by the lessee under its arm's-length contract would be decreased, for royalty purposes, for the amount of the value of the gravity differential. This decrease, for royalty purposes, would be accomplished by adjusting the price at which the oil was sold downwards to reflect the lower gravity as determined at the approved point of royalty settlement. This would be done to assure the lessor a reasonable and correct value based upon the quality and quantity of oil at the point of royalty settlement approved by BLM or MMS, as appropriate. Upward adjustments to the gross proceeds, for royalty purposes, would be made if the gravity differential described above were to be reversed.

It is not anticipated that this provision would have a significant effect on the industry. This is because the oil sales point and the point of royalty settlement coincide in the majority of cases.

Proposed § 206.104, Transporation allowances—general, would include the general requirements for the determination of oil transportation allowances. Paragraph (a) would provide that where the value of production has been determined pursuant to § 206.102 at a point remote from the lease, MMS shall allow a deduction for reasonable, actual transportation costs. For onshore leases, this would include the transportation costs from the lease to the point remote from the lease. However, where MMS elects to take its royalty in-kind pursuant to the provisions of 30 CFR Part 208, no transportation allowance would be granted. For offshore leases, the lessee would be entitled to an allowance for the reasonable actual costs of transporting the oil from the lease to the point remote from the lease. For offshore oil taken as royalty in-kind pursuant to 30 CFR Part 208, transportation allowance would be provided for the reasonable, actual costs to transport that oil to the delivery point specified in the royalty-in-kind contract.

Proposed § 206.104(b) would impose a limit on the transportation allowance. The allowance could not exceed 50 percent of the value of the oil determined pursuant to § 206.102. This is the same limitation which exists under current MMS onshore procedures. By way of illustration, a lessee sells oil with a delivery point remote from the lease. The lessee's gross proceeds under an arm's-length sales contract is $12.00 per barrel, and the lessee pays a third party $7.00 per barrel to transport the oil. Proposed § 206.104(b) would limit the transportation allowance to $6.00 per barrel. Under the proposed rules, the MMS Director would be authorized to approve an allowance greater than 50 percent if the lessee demonstrates that a higher allowance is in the best interests of the lessor. The lessee must provide data to support its request to the Director. Under no circumstances could the Director approve an allowance that would result in a value for royalty purposes of zero.

Proposed 206.104(c) would require that transportation costs by allocated among all the products produced from a lease and transported. Specific regulations on this allocaton, and the limitations on the allowance, are discussed in more detail in proposed § 206.105. Paragraph (c) also would require that lessees compute the oil transportation allowance and express it in dollars per barrel.

Section 206.104(d) would provide that if, after an audit, MMS determines that the lessee improperly determined a transportation allowance, then the lessee would be required to pay any additional royalties, plus interest, or would be entitled to a credit without any interest.

Proposed § 206.105, Determination of transportation allowances, is the key to the transportation regulations. It would provide the procedure for determining the transportation allowance, which is substantially different depending upon whether the lessee has an arm's-length contract with another party to provide transportation services, or whether the lessee has a non-arm's-length contract or no contract, such as those situations where the lessee has an interest in the pipeline or other transportation system.

Paragraph (a) would apply to arm's-length transportation contract situations. It would provide that the transportation allowance would be the reasonable, actual costs for transportation incurred by the lessee under that contract. Prior MMS approval would not be required before the lessee could deduct the allowance in computing its royalty payments. However, the contract is subject to later review, audit, and adjustment. The lessee, before taking an allowance, would be required to submit to MMS a completed page one of Form MMS-4110 the same month the allowance first is reported on Form MMS-2014, Report of Sales and Royalty Remittance. This would be a one-time filing applicable to all months in the reporting period. The allowance would be denied for any production month for which a Form MMS-4110 is not received by the due date for the Form MMS-2014. Therefore, if a lessee begins incurring transportation costs for January oil production pursuant to an arm's-length contract, and if it did not submit a Form MMS-4110 until April 15, it would be entitled to an allowance only for March and subsequent months' production in the reporting period. No allowance would be permitted for January and February, and the lessee would be required to refund, with interest, any allowance which was taken.

Section 206.105(a)(2) would provide that a transportation allowance determined pursuant to an arm's-length contract would remain effective for a period of 12 months, or until the contract is modified or terminated, whichever is earlier. At that time, the lessee must submit a new page one of Form MMS-4110 in accordance with § 206.105(c).

As discussed earlier regarding *proposed § 206.104, the transportation* costs must be allocated among all the lease products which are transported.

An arm's-length transportation contract may include more than one liquid product but costs may not be allocated among the products. In such an instance, § 200.105(a)(3) would require the lessee to allocate the costs to each liquid product (including water) in the same proportion as the ratio of the volume of each liquid product to the volume of all liquid products.

Proposed § 206.105(a)(3) would treat water as though it were oil in determining transportation costs per barrel, but a transportation allowance for lease production which is not royalty bearing would not be allowed.

Proposed § 206.105(a)(4) would cover those situations where both gaseous and liquid products are transported in the same transportation system and the costs attributable to each cannot be determined from the arm's-length contract. Proposed § 206.105(a)(4) would require that the lessee propose an allocation procedure to MMS. MMS approval of the cost allocation would be required because a volumeric-based allocation method may not be appropriate for transporting gaseous and liquid products in the same system. The lessee would use the oil transportation allowance determined in accordance with its proposed allocation procedure until MMS issues a determination on the oil transportation allowance. Proposed § 206.105(a)(4) also would provide for the submission of the lessee's proposal within prescribed timeframes.

In some instances an arm's-length contract for transportation will not require a cash payment by the lessee. Instead, the transporter will be entitled, for example, to retain a percentage of the product. In such an event, § 206.105(a)(5) would require the lessee to determine the dollar value equivalent of those volumes to compute its allowance. Pursuant to § 206.105(a)(6), MMS could require lessees to submit copies of arm's-length transportation contracts and related documents, within the time prescribed by MMS.

If the lessee does not have an arm's-length contract for transporting lease products, but has a non-arm's-length contract or no contract because it has an interest in the pipeline or the transportation system, then the allowance would be based upon the lessee's reasonable, actual costs of transportation.

Paragraph (b)(2) proposes a procedure similar to that previously discussed for allowances for arm's-length situations. The allowance approval for non-arm's-length or no contract situations is also a two-step process, consisting of a submittal of an estimated transportation allowance for the current 12-month period and a submittal of the actual transportation allowance within 90 days after the end of the 12-month period containing the actual costs incurred during the previous 12-month period. MMS approval is not required prior to commencing transportation deductions for non-arm's-length or no contract situations. However, MMS must receive a completed Form MMS-4110 with an estimated allowance in the same month the lessee first reports its allowance on Form MMS-2014, Report of Sales and Royalty Remittance, or the allowance will be denied pending filing of the Form MMS-4110. The filing would be effective for the entire reporting period. Within 90 days following the end of the 12-month period, the lessee would submit Form MMS-4110 with its actual costs incurred during the previous 12-month period and its estimate for the succeeding reporting period. The estimate could not be greater than the actual costs for the preceding period, unless MMS approves a higher estimate upon written request from the lessee.

Proposed § 206.105(b)(3) would expressly state that a lessee may deduct its transportation allowance without MMS pre-approval, subject to review and/or audit by MMS. When necessary or appropriate, MMS could direct a lessee to modify its estimated or actual allowance deduction. This could occur, for example, if a lessee made an obviously exorbitant estimate to reduce its royalty payment obligation.

Proposed § 206.105(b)(4) provides that an estimated allowance may be used by lessees for systems that are in a start-up period.

Proposed § 206.105(b)(5) would specify the types and nature of costs which MMS considers acceptable in determining a transportation allowance for non-arm's-length or no contract situations. The categories of expenses are operating and maintenance expenses, overhead, depreciation, and a return on undepreciated capital investment or, alternatively, a return on the initial capital investment with no allowance for depreciation—see discussion below. Paragraphs (b)(5)(i) and (ii) provide a list of operating and maintenance expense categories which MMS considers typical operating or maintenance expenses. Paragraphs (b)(5)(iii) would provide for overhead to be included as a transportation cost, providing the overhead is directly attributable or allocable to the operation or maintenance of the transportation system.

MMS is proposing two alternatives regarding return on capital investment. Under alternative 1, paragraph (b)(5)(iv) would provide for two financial depreciation methods: straight-line depreciation and unit of production depreciation. Accordingly, depreciation would be based on the useful life of the equipment or the life of the reserves the transportation system services. Also, salvage value must be observed and depreciation limited to that salvage value.

The MMS is also proposing that the establishment of a transportation system depreciation schedule would not be altered because of a recapitalization or a change in ownership. A lessee would not be able to depreciate a transportation system by using a schedule based on replacement costs or any other basis other than actual costs. Similarly, a change in ownership cannot be a basis for a change in the depreciation schedule for allowance purposes. If, for example, a transportation system has a depreciation schedule of 20 years and has been depreciated for 10 years by the first owner and then sold, the new owner would be entitled to the remaining 10 years' depreciation based on the original capitalized cost. MMS specifically would like comments on whether or not this no-recapitalization provision should be adopted if alternative 1 is adopted.

As alternative 2, MMS is proposing in paragraph (b)(5)(iv) to disallow any cost deduction for depreciation. Instead, each year MMS would allow an amount equal to the initial capital investment in the transportation system multiplied by a floating rate of return, as discussed below. Alternative 2, if adopted, would be supplemental to alternative 1 and is proposed to apply prospectively only to a new transportation system or a newly acquired transportation system. MMS would like commenters to address the feasibility of alternative 2.

Paragraph (b)(5)(v) would establish the rate of return to be applied to either the undepreciated capital investment under alternative 1, discussed above, or the initial capital investment under alternative 2, also discussed above. The rate of return is proposed to be determined by the Moody Aaa corporate bond rate as published by Moody's Investors Services, Inc. in *Moody's Bond Record* the first business day of the reporting period for which the allowance becomes applicable. At the beginning of each subsequent 12-month period that follows, the rate would be redetermined.

MMS would like commenters to address whether a specific rate of return for each lessee should be used and how such a rate of return would be calculated.

Proposed § 206.105(b) would set forth the requirement that the lessee allocate the transportation costs to each product transported where more than one product is transported through the same pipeline or transportation system. In such instances, § 206.105(b)(6) would require the lessee to allocate the costs to each liquid product (including water) in the same proportion as the ratio of the volume of each liquid product to the volume of all liquid products. Water would be treated as oil in determining transportation costs per barrel, but a transportation allowance for lease production that is not royalty bearing would not be allowed.

Proposed § 206.105(b)(7) would cover those non-arm's-length and no contract situations where both gaseous and liquid products are transported in the same transportation system. Proposed § 206.105(b)(7) would require that the lessee propose an allocation procedure to MMS. The MMS approval of the cost allocation would be required because, again, a volumetric-based allocation method may not be appropriate for transporting gaseous and liquid products in the same system. The lessee would use the oil transportation allowance determined in accordance with its proposed allocation procedure until MMS issues a determination on the oil transportation allowance. Proposed § 206.105(b)(8) also would provide for the submission of the lessee's proposal within prescribed timeframes.

Section 206.105(c) sets forth the reporting requirements subsequent to the initial reporting period. Paragraph (c)(1) would require page one of Form MMS-4110 to be submitted within 90 days after the end of the previous reporting period for arm's-length contracts. For non-arm's-length or no contract situations, completed Form MMS-4110 would be required to be submitted within 90 days following the end of the reporting period. Regardless of whether or not oil transportation is conducted under arm's-length contract, non-arm's-length contract, or no contract conditions, if Form MMS-4110 is not received within the 90-day timeframe, then the new allowance for the succeeding reporting period will not be effective until the first day of the month a proper Form MMS-4110 is received by MMS and will be applicable to any Form MMS-2014 received after that date.

Section 206.105(c)(2) provides for MMS to make a change in the reporting cycle for submission of Form MMS-4110. This provision is intended to allow MMS the flexibility to equalize its workload in order to more effectively administer transportation allowances. Nothing in this subsection should be construed to alter any of the royalty reporting and payment requirements contained either in this Part or in other Parts of 30 CFR.

Section 206.105(c)(3) would require that transportation allowances under either arm's-length, non-arm's-length, or no contract situations be reported on a separate line on Form MMS-2014, Report of Sales and Royalty Remittance. Unless otherwise directed and approved by MMS, lessees are not to report values that are net of transportation allowances.

If the actual costs which the lessee computes after the close of the reporting period are different from the estimated costs used to determine the allowance for transportation, proposed § 206.105(d) would set forth the procedure for reporting the adjustments to royalty payments to the MMS. The procedure would be different for onshore than for offshore because of the refund procedures of section 10 of the OCS Lands Act (43 U.S.C. 1801 et seq.). If actual allowances differ from estimated allowances, the lessee would be required to pay additional royalty, with interest, or would be entitled to a credit, without interest.

Proposed § 206.105(e) would provide that, notwithstanding any other provision, no costs that result from payments for actual or theoretical losses would be allowed for oil transportation. Thus, if an arm's-length transportation agreement requires the lessee to pay the transporter for actual or theoretical line losses (either in value or in volume), such costs would be disallowed by MMS. Similarly, even if a transporter's tariff includes a component for actual or theoretical losses, such charges would be disallowed. The valuation regulations for oil in this Part also would disallow such actual or theoretical losses in determining royalty volumes and values. The MMS also would disallow any such costs in non-arm's-length contract or no contract situations.

Paragraph (f) is proposed to allow application of the same administrative or computation procedures contained in § 206.105 to determine other transportation costs when valuing oil under a net-back procedure or other valuation procedure contained in Subpart C of Part 206.

It is the intention of MMS to terminate all existing transportation allowances with the issuance of final rulemaking. This termination would require all lessees to follow the new reporting requirements to be eligible for the deduction of transportation costs for production months subsequent to the effective date of the final rules. Procedures for claiming actual allowances for periods prior to the effective date of the final rules will be provided at the time of final rulemaking.

Changes also are propsed for Part 207. Proposed §§ 207.2 and 207.3 recite the same language, with minor revision, regarding contracts made pursuant to new-form leases and old-form leases, respectively, currently located at 30 CFR 207.3 and 207.4.

Proposed § 207.4, Contract and sales agreement retention, requires that copies of all oil and gas sales contracts, posted price bulletins, etc., and copies of all agreements or contracts affecting gross proceeds other than oil and gas sales contracts, posted price bulletins, etc., are to be maintained by the lessee for a period of 6 years, and made available upon request, during normal working hours, to authorized officials. Any oral sales agreements must be placed in written form and retained in the lessee's files. The MMS also could request that the lessee submit requested information to MMS.

IV. Procedural Matters

Executive Order 12291

The Department of Interior (DOI) has determined that this document is not a major rule and does not require a regulatory analysis under Executive Order 12291. This proposed rulemaking is to consolidate Federal and Indian oil royalty valuation regulations; to clarify DOI oil royalty valuation policy and to clarify DOI oil transportation allowance policy; and to provide for consistent royalty valuation policy among all leasable minerals. Because the proposed rule principally consolidates and streamlines existing regulations for consistent application, there are no significant additional requirements or burdens placed upon small business entities.

Lessee reporting requirements will increase approximately $4 million. All oil posted price bulletins or sales contracts will be required to be submitted only upon request, or only in support of a lessee's valuation proposal in unique situations rather than routinely, as under the existing regulations.

Regulatory Flexibility Act

Because this rule primarily consolidates and streamlines existing regulations for consistent application, there are no significant additional requirements or burdens placed upon small business entities as a result of implementation of this proposed rule. Therefore, the DOI has determined that this rule making will not have a significant economic effect on a substantial number of small entities and does not require a regulatory flexibility analysis under the Regulatory Flexibility Act. (5 U.S.C 601, et seq.).

Paperwork Reduction Act of 1980

The information collection and recordkeeping requirements located at §§ 206.105, 207.4, and 210.55 of this rule have been submitted for approval to the Office of Management and Budget (OMB) under 44 U.S.C. 3504(h). The collection of this information will not be required until it has been approved by OMB.

National Environmental Policy Act of 1969

It is hereby determined that this rulemaking does not constitute a major Federal action significantly affecting the quality of the human environment and a detailed statement pursuant to section 102(2)(C) of the National Environmental

Policy Act of 1969 (42 U.S.C. 4332(2)(C)) is not required.

Public Comment Procedures

A. Written Comments

The public is invited to participate in this proceeding by submitting data, views, or arguments with respect to this notice. All comments should be submitted by 4:30 p.m. of the day specified in the "DATES" section to the appropriate address indicated in the "ADDRESS" section of this preamble and should be identified on the outside envelope and on documents submitted with the designation "Revision of Oil Royalty Valuation Regulations and Related Topics." All comments received by the MMS will be available for public inspection in Room E104, Building 85, Denver Federal Center, Lakewood, Colorado, between the hours of 8:00 a.m. and 4:00 p.m., Monday through Friday.

Any information or data submitted which is considered to be confidential must be so identified and submitted in writing, one copy only. MMS reserves the right to determine the confidential status of the information or data and to treat it according to its independent determination.

B. Public Hearing

1. *Procedure for requests to make oral presentations:* The time and place for the hearing are indicated in the "DATES" and "ADDRESS" sections of the preamble. If necessary to present all testimony, the hearing will resume at 9:30 a.m. on the next business day following the first day of the hearing.

You may make a written request for an opportunity to make an oral presentation. The request should contain a business telephone number and also a telephone number where you may be contacted during the day prior to the hearing. If you are selected to be heard at the hearing you will be notified. You will be required to submit 50 copies of your statement to MMS at the address indicated in the "ADDRESS" section of the preamble.

2. *Conduct of the hearing:* MMS reserves the right to select the persons to be heard at the hearing (in the event there are more requests to be heard than time allows), to schedule their respective presentations, and to establish the procedures governing the conduct of the hearing. The length of each presentation may be limited, based upon the number of persons requesting to be heard.

A Department of the Interior official will be designated to preside at the hearing. This will not be a judicial-type hearing. Questions may be asked only by those conducting the hearing. At the conclusion of all initial oral statements, each person who has made an oral statement will be given the opportunity, if he or she so desires, to make a rebuttal statement. The rebuttal statements will be given in the order in which the initial statements were made and will be subject to time limitations.

If you wish to ask a question at the hearing, you may submit the question, in writing, to the presiding officer. The presiding officer will determine whether the question is relevant, and whether time limitations permit it to be presented for answer at the hearing.

Any further procedural rules needed for the proper conduct of the hearing will be announced by the presiding officer at the opening of the hearing.

A transcript of the hearing will be made. The entire record of the hearing, including the transcript, will be retained by the MMS and made available for inspection in Room E104, Building 85, Denver Federal Center, Lakewood, Colorado, between the hours 8:00 a.m. and 4:00 p.m., Monday through Friday. You may purchase a copy of the transcript from the reporter.

List of Subjects

30 CFR Part 202

Continental shelf, Government contracts, Mineral royalties, Oil and gas exploration, Public lands-mineral resources, Reporting and recordkeeping requirements.

30 CFR Part 203

Coal, Continental shelf, Government contracts, Mineral royalties, Oil and gas exploration, Public lands-mineral resources.

30 CFR Part 206

Continental shelf, Geothermal energy, Government contracts, Mineral royalties, Oil and Gas exploration, Public lands-mineral resources.

30 CFR Part 207

Government contracts, Mineral royalties, Public lands-mineral resources, Reporting and recordkeeping requirements.

30 CFR Part 210

Continental shelf, Geothermal energy, Government contracts, Mineral royalties, Oil and gas exploration, Public lands-mineral resources, Reporting and recordkeeping requirements.

30 CFR Part 241

Administrative practice and procedures, Government contracts, Mineral royalties, Oil and gas exploration penalties, Public lands-mineral resources, Reporting and recordkeeping requirements.

Dated: December 23, 1986.

J. Steven Griles,

Assistant Secretary—Land and Minerals Management.

Subchapter A—Royalty Management

For the reasons set out in the preamble, 30 CFR Parts 202, 203, 206, 207, 210, and 241 are proposed to be amended as follows:

30 CFR Part 202 is amended as follows:

1. The Authority citation for Part 202 is revised to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1381 et seq.; and 43 U.S.C. 1801 et seq.

2. 30 CFR Part 202 is amended by revising the Part title and the titles of Subpart B, Subpart C, and Subpart D to read as follows:

PART 202—ROYALTIES

Subpart B—Oil, Gas, and OCS Sulfur, General

Subpart C—Federal and Indian Oil

Subpart D—Federal and Indian Gas [Reserved]

3. Sections 202.100, 202.101, 202.102 and 202.103 under Subpart C are removed. Sections 202.150, 202.151 and 202.152 under Subpart D are redesignated as new §§ 202.100 (Subpart C), 202.53 and 202.52 under Subpart B, respectively.

4. In Subpart B, add new §§ 202.51, 202.54, and 202.55, and revise §§ 202.52 and 202.53 (formerly §§ 202.152 and 202.151, respectively) to read as follows:

Subpart B—Oil, Gas, and OCS Sulfur, General

Subpart B—Oil, Gas, and OCS Sulfur, General

202.51 Scope and definitions.

(a) This Part is applicable to Federal and Indian (Tribal and allotted) oil and gas leases (except leases on the Osage Indian Reservation) and OCS sulfur leases.

(b) The definitions in Subparts C, D, and I of Part 206 of this Title are applicable to Subparts B, C, D, and I of this part.

202.52 Royalties.

(a) Royalties on oil, gas and OCS sulfur shall be at the rate specified in the lease, unless the Secretary, pursuant to the provisions of the applicable mineral leasing laws, reduces, or in the case of OCS leases, reduces or eliminates, the amount of royalty or net profit share set forth in the lease.

(b) For purposes of this subpart, the use of the term "royalty(ies)" includes the term "net profit share(s)".

202.53 Minimum royalty.

For leases that provide for minimum royalty payments, the lessee shall pay the minimum royalty, as specified in the lease.

202.54 General royalty management responsibilities of MMS.

It is the responsibility of MMS to:

(a) Obtain lessee reports of lease production, quantities and qualities of lease products sold, reports of rental and royalties due, and related matters;

(b) Collect and record rentals and royalties due from, and paid by, lessees;

(c) Process rental and royalty refunds;

(d) Obtain copies of lessee contracts (including contract updates and amendments), sales agreements, lease product processing agreements, lease product transportation agreements, publicly available prices and other royalty valuation records when needed by MMS to assure that royalties are properly determined;

(e) Safeguard all proprietary information and records submitted to MMS by the lessee pursuant to lease terms and regulations, and to maintain the confidentiality of any financial information and/or trade secrets which may come into its possession or about which it may gain knowledge.

(f) Promptly deposit rentals and royalties in the U.S. Treasury and/or Tribal or allottee accounts;

(g) Assure prompt disbursement to the Bureau of Indian Affairs (BIA) or Indian Tribes or royalty or rental monies belonging to Indian Tribes or allottees;

(h) Assure prompt disbursement of that portion of Federal royalty and rental monies to which the States are entitled; and

(i) Assure payment of the correct amount of rentals or royalties by maintaining current and understandable royalty and rental regulations, royalty standards and guidelines and by auditing product values and lessee documents, reports and payments.

§202.55 General Royalty obligations of the lessee.

The lessee is required among other things to:

(a) Properly handle and protect lease products;

(b) Place lease products in marketable condition at no cost to the lessor;

(c) Accurately measure production, properly maintain it in inventory, and dispose of it in a manner beneficial to the public or Indian Tribe's or allottee's interest;

(d) Maintain accurate records of production and sales;

(e) Maintain copies of all contracts, sales agreements, processing or transportation agreements, and other records that support the valuation of lease products for royalty purposes. Copies of these contracts, etc., are to be made available to MMS either in the lessee's offices during normal office hours or provided to MMS at such time and in such manner as may be requested by the Department of the Interior;

(f) Make timely rental and royalty payments;

(g) Make timely reports on production and sales quantities and qualities; and

(h) Properly value production and correctly pay royalties.

4. 30 CFR Part 202, Subpart C, is amended by revising § 202.100 (formerly § 202.150), by revising § 202.101 (formerly § 206.104), and by adding new § 202.102 to read as follows:

§202.100 Royalty on oil.

(a) The royalty on oil, including condensate separated from gas without processing, shall be at the rate established by the terms of the lease. Royalty shall be paid in value unless the MMS requires payment in-kind.

(b) All oil (except oil unavoidably lost or used on, or for the benefit of, the lease including that oil used off-lease for the benefit of the lease when such off-lease use is permitted by the appropriate agency) produced from a Federal or Indian lease to which this part applies is subject to royalty. Where the terms of any lease are inconsistent with this section, the lease terms shall govern to the extent of that inconsistency.

§202.101 Royalty rates on oil; sliding and step-scale leases (public land only).

Sliding- and step-scale royalties are based on the average daily production per well. The BLM authorized officer shall specify which wells on a leasehold are commercially productive, including in that category all wells, whether produced or not, for which the annual value of permissible production would be greater than the estimated reasonable annual lifting cost, but only wells that yield a commercial volume of production during at least part of the month shall be considered in ascertaining the average daily production per well. The average daily production per well for a lease is computed on a basis of a 28-, 29-, 30-, and 31-day month (as the case may be), the number of wells on the leasehold counted as producing, and the gross production from the leasehold. The BLM authorized officer will determine which commercially productive wells shall be considered each month as producing wells for the purpose of computing royalty in accordance with the following rules, and in the authorized officer's discretion may count as producing any commercially productive well shut in for conservation purposes.

(a) For a previously producing leasehold, count as producing for every day of the month each previously producing well that produced 15 days or more during the month, and disregard wells that produced less than 15 days during the month.

(b) Wells approved by the BLM authorized officer as input wells shall be counted as producing wells for the entire month if so used 15 days or more during the month and shall be disregarded if so used less than 15 days during the month.

(c) When the initial production of a leasehold is made during the calendar month, compute royalty on the basis of producing well days.

(d) When a new well is completed for production on a previously producing leasehold and produces for 10 days or more during the calendar month in which it is brought in, count such new wells as producing every day of the month, in arriving at the number of producing well days. Do not count any new well that produces for less than 10 days during the calendar month.

(e) Consider "head wells" that make their best production by intermittent pumping or flowing as producing every day of the month, provided they are regularly operated in this manner with approval of the BLM authorized officer.

(f) For previously producing leaseholds on which no wells produced for 15 days or more, compute royalty on a basis of actual producing well days.

(g) For previously producing leaseholds on which no wells were productive during the calendar month but from which oil was shipped, compute royalty at the same royalty percentage as that of the last preceding calendar month in which production and shipments were normal.

(h) Rules for special cases not subject to definition, such as those arising from averaging the production from two distinct sands or horizons when the production of one sand or horizon is relatively insignificant compared to that of the other, shall be made by the BLM authorized officer as need arises.

(i)(1) In the following summary of operations on a typical leasehold for the month of June, the wells considered for the purpose of computing royalty on the entire production of the property for the months are indicated.

Well No.	Record	Count (marked X)
1	Produced full time for 30 days	X
2	Produced for 26 days; down 4 days for repairs.	X
3	Produced for 28 days; down June 5, 12 hours, rods; June 14, 6 hours, engine down; June 26, 24 hours, pulling rods and tubing.	X
4	Produced for 12 days; down June 13 to 30.	X
5	Produced for 6 hours every day (well heads).	X
6	Idle producer (not operated)	
7	New well, completed June 17; produced for 14 days.	X
8	New well, completed June 22; produced for 9 days.	

(2) In this example, there are eight wells on the leasehold, but wells No. 4, 6, and 8 are not counted in computing royalties. Wells No. 1, 2, 3, 5, and 7 are counted as producing for 30 days. The average production per well per day is determined by dividing the total production of the leasehold for the month (including the oil produced by wells 4 and 8) by 5 (the number of wells counted as producing), and dividing the quotient thus obtained by the number of days in the month.

§ 202.102 Standards for reporting and paying royalties.

Oil volumes are to be reported in barrels of clean oil of 42 standard U.S. gallons (231 cubic inches each) at 60 °F. When reporting oil volumes for royalty purposes, corrections must have been made for basic sediment and water (BS&W) and other impurities. Reported American Petroleum Institute (API) oil gravities are to be those determined in accordance with standard industry procedures after correction to 60 °F.

30 CFR Part 203 is amended as follows:

PART 203—[AMENDED]

1. The Authority citation for Part 203 is revised to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. 30 CFR Part 203 is amended by revising the titles of Subpart B, Subpart C, and Subpart D to read as follows:

Subpart B—Oil, Gas and OCS Sulfur, General

Subpart C—Federal and Indian Oil—[Reserved]

Subpart D—Federal and Indian Gas—[Reserved]

§ 203.100 [Removed]

§ 203.150 [Redesignated as § 203.50]

3. Sections 203.100 under Subpart C is removed. Section 203.150 under Subpart D is redesignated as a new § 203.50 under Subpart B.

30 CFR Part 206 is amended as follows:

PART 206—[AMENDED]

1. The Authority citation for Part 206 is revised to read as follows:

Authority. 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. 30 CFR Part 206 is amended by revising the titles of Subpart B, Subpart C, and Subpart D to read as follows:

Subpart B—Oil, Gas, and OCS Sulfur, General—[Reserved]

Subpart C—Federal and Indian Oil

Subpart D—Federal and Indian Gas—[Reserved]

§ 206.103 [Removed]

§ 206.104 [Redesignated as § 202.101]

3. Section 206.103 of Subpart C is removed. Section 206.104 under Subpart C is redesignated a new § 202.101 under Subpart C of Part 202.

4. 30 CFR Part 206, Subpart C, is amended by revising § 206.100, and by adding new §§ 206.101, 206.102, 206.103, 206.104, and 206.105 to read as follows:

Subpart C—Federal and Indian Oil

§ 206.100 Purpose and scope.

(a) This subpart is applicable to all oil produced from Federal and Indian (Tribal and allotted) oil and gas leases (except leases on the Osage Indian Reservation).

(b) If the specific provisions of any statute or treaty, or any oil and gas lease subject to the requirements of this Part, are inconsistent with any regulation in this Part, then the lease, statute, or treaty provision shall govern to the extent of that inconsistency.

(c) All royalty payments made to MMS are subject to later audit and adjustment.

(d) If BLM determines that oil was avoidably lost or wasted from an onshore lease, or oil was drained from an onshore lease upon which compensatory royalty is due, or MMS determines that oil was avoidably lost or wasted from an offshore lease, then the value of the oil shall be determined in accordance with this Part.

(e) If a lessee receives compensation through insurance coverage or other arrangements for oil unavoidably lost, royalties at the rate specified in the lease are to be paid on the amount of compensation received.

§ 206.101 Definitions.

For the purposes of this Part (and Parts 202, 203, 207, 210, and 241 of this chapter:

(a) *Alaska Native Corporation* means any of the twelve Alaska Native Regional Corporations formed pursuant to the Alaska Native Claims Settlement Act (ANCSA), 43 U.S.C. 1606, and which, by virtue of the acquisition of land pursuant to ANCSA, as amended and supplemented, owns all or part of the lessor's interest in a lease or is entitled to distribution of a portion of the revenues derived from a lease.

(b) *Allowance* means an authorized or an MMS-accepted-or -approved deduction in determining value for royalty purposes. "Transportation allowance" means an allowance for the reasonable, actual costs incurred by the lessee for moving oil to a point of sale or point of delivery remote from the lease, unit area or communitized area, or an MMS-accepted or -approved deduction for costs of such transportation, determined pursuant to this subpart.

(c) *Area* means a geographic region at least as large as the defined limits of an oil and/or gas field, in which oil and/or gas lease products have similar quality and economic characteristics.

(d) *Arm's-length contract* means a contract or agreement between independent, nonaffiliated persons. For purposes of this subpart, two persons are affiliated if one person controls, is controlled by, or is under common control with another person, or if one person owns an interest (regardless of how small), either directly or indirectly, in another person.

(e) *Audit* means a review, conducted in accordance with generally accepted accounting and auditing standards, or royalty payment compliance activities of lessees or other interest holders who pay royalties, rents, or bonuses on Federal and Indian leases. The term audit includes, but is not limited to, audit activities related to Federal leases located within the boundaries of any State which has entered into a cooperative agreement with MMS under the provisions of sections 202 or 2^5 of the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1732 or 1735), audit activities related to leases located on Indian lands, and the review and resolution of exceptions processed by any accounting systems maintained by the MMS. Audits may also be conducted in response to irregularities identified by BLM, MMS, BIA or a State or Indian Tribe in the performance or production verification.

(f) *BIA* means the Bureau of Indian Affairs of the Department of the Interior.

(g) *BLM* means the Bureau of Land Management of the Department of the Interior.

(h) *Condensate* means liquid hydrocarbons (normally exceeding 40 degrees of API gravity) recovered at the surface without resorting to processing. Condensate is the mixture of liquid hydrocarbons that results from condensation of petroleum hydrocarbons existing initially in a gaseous phase in an underground reservoir.

(i) *Contract* means any oral or written agreement, including amendments or revisions thereto, between two or more persons and enforceable by law that with due consideration creates an obligation.

(j) *Field* means a geographic region situated over one or more subsurface oil reservoirs encompassing at least the outermost boundaries of all oil accumulations known to be within those reservoirs vertically projected to the land surface. Onshore fields are usually given names and their official boundaries are often designated by oil and gas regulatory agencies in the respective states in which the fields are located. Outer Continental Shelf (OCS) fields are named and their boundaries are designated by MMS.

(k) *Gross proceeds* (for royalty payment purposes) means the total monies and other consideration paid to an oil and gas lessee, or monies and other consideration to which such lessee is entitled, for the disposition of the oil. With respect to oil, gross proceeds includes, but is not limited to, payments to the lessee for certain services such as dehydration, measurement, and/or field gathering to the extent that the lessee is obligated to perform them at no cost to the Federal Government or Indian owner. Gross proceeds, as applied to oil also includes: payments or credits for advanced prepaid reserve payments subject to recoupment through reduced prices in later sales; advanced exploration or development costs that are subject to recoupment through reduced prices in later sales; and reimbursements, including, but not limited to, reimbursements for harboring or terminalling fees. Tax reimbursements are part of the gross proceeds accuring to a lessee even though the Federal or Indian royalty interest may be exempt from taxation.

(l) *Indian allottee* means any Indian for whom land or an interest in land is held in trust by the United States or who holds title subject to Federal restriction against alienation.

(m) *Indian Tribe* means any Indian Tribe, band, nation, pueblo, community, rancheria, colony, or other group of Indians for which any land or interest in land is held by the states in trust or which is subject to Federal restriction against alienation.

(n) *Lease* means any contract, profit-share arrangement, joint venture, or other agreement issued or approved by the United States under a mineral leasing law that authorizes exploration for, development or extraction of, or removal of lease products—or the land area covered by that authorization, whichever is required by the context.

(o) *Lease products* means any leased minerals attributable to, originating from, or allocated to Outer Continental Shelf, onshore Federal or Indian leases.

(p) *Lessee* means any person to whom the United States, an Indian tribe, or an Indian allottee issues a lease, and any person who has assumed an obligation to make royalty or other payments required by the lease. This includes all persons who have an interest in a lease as well as an operator or payor who has no interest in the lease but who has assumed the royalty payment responsibility.

(q) *Like-quality lease products* means lease products which have similar chemical, physical, and legal characteristics.

(r) *Load oil* means any oil which has been used with respect to the operation of oil or gas wells for stimulation, workover, chemical treatment, production or such other purposes as the operator may elect.

(s) *Marketable condition* means lease products which are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area.

(t) *Minimum royalty* means that minimum amount of annual royalty that the lessee must pay as specified in the lease or in applicable leasing regulations.

(u) *Net-back method* means a procedure for valuing lease products at the lease, unit area, or communitized area when the first sale, transfer, or use has taken place downstream from the lease, unit area, or communitized area. The procedure involves working back from the initial sales point or first alternate point which can be used for value determination, to arrive at the value at the point of settlement for royalty purposes.

(v) *Net profit share* (for applicable Federal and Indian lessees) means the specified share of the net profit from production of oil and gas as provided in the agreement.

(w) *Oil* means a mixture of hydrocarbons that existed in the liquid phase in natural underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities and is marketed or used as such. Condensate recovered in lease separators or field facilities is considered to be oil. For purposes of royalty valuation, the term tar sands is defined separately from oil.

(x) *Oil shale* means a kerogen (e.g., fossilized, insoluble, organic material) bearing rock. Oil shale kerogen separation may take place in situ or in surface retorts by various processes. The kerogen upon distillation will yield liquid and gaseous hydrocarbons.

(y) *Outer Continental Shelf (OCS)* means all submerged lands lying seaward and outside of the area of lands beneath navigable waters as defined in section 2 of the Submerged Lands Act (34 U.S.C. 1301) and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control.

(z) *Person* means any individual, firm, corporation, association, partnership, consortium, or joint venture.

(aa) *Posted price* means the price in the field, net of all deductions, as specified in a publicly available posted price bulletin, that a buyer is willing to pay for quantities of oil of marketable quality, free of contaminants not normally associated with such oil.

(bb) *Section 6 lease* means an OCS lease subject to section 6 of the Outer Continental Shelf Lands Act, as amended, 43 U.S.C. 1335.

(cc) *Selling arrangement* means a unique level of subaccounting required by MMS's Auditing and Financial System (AFS).

(dd) *Spot sales agreement* means a contract wherein a seller agrees to sell to a buyer a specified amount of oil at a specified price over a fixed period, usually of short duration, which does not require a cancellation notice to terminate, and which does not contain an obligation, nor imply an intent, to continue in subsequent periods.

(ee) *Tar sands* means any consolidated or unconsolidated rock (other than coal, oil shale, or gilsonite) that either contains a hydrocarbonaceous material with a gas-free viscosity, at original reservoir temperature, greater than 10,000 centipoise, or contains a hydrocarbonaceous material and is produced by mining or quarrying.

§ 206.102 Valuation standards.

(a) The value, for royalty purposes, of oil production from leases subject to this subpart shall be the value of oil determined pursuant to this section less applicable transportation allowances determined pursuant to this subpart.

(b) The value of oil which is sold pursuant to an arm's-length contract shall be the gross proceeds accruing, or which could accrue, to the lessee. Prior MMS approval of this value is not required, although it is subject to monitoring, review, and audit. MMS may direct a lessee to pay royalty based upon a different value if it determines that the lessee's reported value is inconsistent with the requirements of these regulations.

(c) The value of oil production from leases subject to this section which is not sold pursuant to an arm's-length contract shall be the reasonable value determined in accordance with the first applicable of the following subsections:

(1) The lessee's contemporaneous posted prices used in arm's-length transactions for purchases of significant quantities of like quality oil in the same field or area;

(2) The arithmetic average of contemporaneous posted prices used in arm's-length transactions for purchases of significant quantities of like quality oil in the same field or area;

(3) Other contemporaneous arm's-length contracts for purchases of significant quantities of like quality oil in the same area or nearby areas;

(4) Prices received for spot sales of significant quantities of like quality oil from the same field or area, and other relevant matters, including information submitted by the lessee concerning circumstances unique to a particular lease operation or the saleability of certain types of oil.

(v) If an appropriate value cannot be determined using paragraphs (c)(1) through (4) of this section, a net-back method or any other reasonable method to determine value may be used.

(d) (1) Where the value is determined pursuant to paragraph (c) of this section, that value does not require approval by MMS. However, the lessee shall retain all available data to support its determination of value. Such data shall be subject to review and audit and MMS may direct a lessee to use a different value if it determines that the reported value is inconsistent with the requirements of these regulations.

(2) A lessee shall notify MMS if it has determined value pursuant to § 206.102(c)(iv)(v). The notification shall be by letter to the Associate Director for Royalty Management or his designee. The letter shall identify which valuation method is being used and contain a brief description of the procedure being used.

(e) If MMS determines that a lessee has not properly determined value, the lessee shall be liable for the difference, if any, between royalty payments made based upon the value it has used and the royalty payments that are due based upon the value established by MMS. The lessee shall also be liable for interest computed pursuant to 30 CFR 218.54. If the lessee is entitled to a credit, MMS will provide instructions for the taking of that credit.

(f) The lessee may request a value determination from MMS. In that event, the lessee proposes to MMS what the value should be, the lessee may use that value for royalty payment purposes until MMS issues a value determination. The lessee shall submit available data to support its proposal. MMS shall expeditiously determine the value based upon the lessee's proposal and any additional information MMS deems necessary. That determination shall remain effective for the period stated therein. After MMS issues its determination, the lessee shall make the adjustments in accordance with paragraph (e) of this section.

(g) Notwithstanding any other provision of this section, under no circumstances shall the value for royalty purposes be less than the gross proceeds accruing, or which could accrue, to the lessee for production removed or sold from the lease, less applicable transportation allowances determined pursuant to this subpart.

(h) The lessee is required to place oil in marketable condition at no cost to the Federal Government or Indian lessor. Where the value established pursuant to this section is determined by a lessee's gross proceeds, that value shall be increased to the extent that the gross proceeds have been reduced because the purchaser, or any other person, is providing certain services, the cost of which ordinarily is the responsibility of the lessee to place the oil in marketable condition.

(i) Value shall be based on the highest price a prudent operator can receive under its contract. Absent contract revision or amendment, if the lessee fails to take proper or timely action to receive prices or benefits to which it is entitled it must pay royalty at a value based upon that obtainable price or benefit. Contract revisions or amendments shall be in writing and signed by all parties to an arm's-length contract, and may be retroactive. If the lessee makes timely application for a price increase allowed under its contract but the purchaser refuses, and the lessee takes reasonable measures, which are documented, to force purchaser compliance, the lessee will owe no additional royalties until monies or consideration resulting from the price increase are received. This paragraph applies to price increments only and shall not be construed to permit a lessee to avoid its royalty payment obligation in situations where a purchaser fails to pay, in whole or in part, for a quantity of oil removed or sold from a lease.

(j) Certain information submitted to MMS to support valuation proposals, including transportation and/or processing allowances, is exempted from disclosure by the Freedom of Information Act, 5 U.S.C. 522. Any data specified by the Act to be privileged, confidential, or otherwise exempt, will be maintained in a confidential manner in accordance with applicable law and regulations. All requests for information about determinations made under this Part are to be submitted in accordance with the Freedom of Information Act regulation of the Department of the Interior, Title 43 CFR Part 2.

§ 206.103 Point of royalty settlement.

(a) (1) Royalties shall be computed on the basis of the quantity and quality of oil at the point of settlement approved by BLM or MMS for onshore and offshore leases, respectively.

(2) If the value of oil determined pursuant to § 206.102 is based upon a quantity and/or quality that is different from the quantity and/or quality at the point of royalty settlement, as it has been approved by the BLM for onshore leases or MMS for offshore leases, that value shall be adjusted for the differences in quantity and/or quality.

(b) No deductions may be made from the royalty volume or royalty value for actual or theoretical losses. Any actual loss that may be sustained prior to the royalty settlement metering or measurement point will not be subject to royalty provided that such loss is determined to have been unavoidable by BLM or MMS, as appropriate.

(c) Except as provided in paragraph (b) of this section, royalties are due on 100 percent of the volume measured at the approved point of royalty settlement. There can be no reduction in that measured volume for actual losses beyond the approved point of royalty settlement or for theoretical losses that are claimed to have taken place either prior to or beyond the approved point of royalty settlement. Royalties are due on 100 percent of the value of the oil as provided in this Part. There can be no deduction from the value of the oil for royalty purposes to compensate for actual losses beyond the approved point of royalty settlement or for theoretical losses that are claimed to have taken place either prior to or beyond the approved point of royalty settlement.

§ 206.104 Transportation allowances—general.

(a) Where the value of oil has been determined pursuant to § 206.102 at a point remote from the lease, MMS shall allow a deduction for the reasonable actual costs to:

(1) Transport oil from an onshore lease to the point remote from the lease, provided, however, that for onshore leases, no transportation allowance will be granted for transporting oil taken as royalty-in-kind pursuant to Part 208 of this title; or

(2) Transport oil from an offshore lease to the point remote from the lease, provided, however, that for oil taken as royalty-in-kind pursuant to Part 209 of this Title, a transportation allowance shall be provided for the reasonable actual costs incurred to transport that oil to the delivery point specified in the royalty-in-kind sales contract.

(b)(1) Under no circumstances shall the transportation allowance exceed 50 percent of the value of the oil, as determined pursuant to § 206.102.

(2) The MMS Director may approve an allowance in excess of the limitation contained in paragraph (b)(1) of this section if the lessee demonstrates that a higher allowance is in the best interests of the lessor. An application for exception shall contain all relevant and supporting data necessary for the MMS Director to make a determination. Under no circumstances shall the Director allow the royalty payment for any selling arrangement to be reduced to zero.

(c) Transportation costs must be allocated among all products produced and transported. However, no transportation deduction shall be allowed for products which are not royalty bearing. Transportation allowances for oil shall be expressed as dollars per barrel.

(d) If, after a review and/or audit, it is determined that a lessee has improperly determined a transportation allowance authorized by this subpart, then the lessee shall be liable for any additional royalties, plus interest determined in accordance with 30 CFR 218.54, or shall be entitled to a credit, without interest.

§ 206.105 Determination of transportation allowances.

(a)(1) Arm's-length contracts. For transportation costs incurred by a lessee pursuant to an arm's-length contract, the transportation allowance shall be the reasonable, actual costs incurred by the lessee for transporting the oil under that contract, subject to review, audit, and adjustment. Such allowances shall be subject to the provisions of § 206.105(e). The MMS's approval is not required before a lessee may deduct costs incurred under an arm's-length contract. However, before any deduction may be taken, the lessee must submit a completed page one of the Form MMS-4110 the same month the transportation allowance first is reported on Form MMS-2014, Report of Sales and Royalty Remittance. This is a one-time filing effective for the entire reporting period. The allowance will be denied for any production month for which a Form MMS-4110 is not received prior to, or at the same time as, the Form MMS-2014 for that month.

(2) The transportation allowance determined pursuant to an arm's-length contract shall be effective for a reporting period beginning the month that the lessee is first authorized to deduct a transportation allowance pursuant to paragraph (a)(1) of this section and shall continue for 12 months, or until the applicable contract or rate terminates or is modified or amended, whichever is earlier. At that time, the lessee must resubmit page one of Form MMS-4110 in accordance with § 206.105(c).

(3) If an arm's-length transportation contract includes more than one liquid product and the transportation costs attributable to each cannot be determined from the contract, then the total transportation costs shall be allocated in a consistent and equitable manner to each of the liquid products transported in the same proportion as the ratio of the volume of each product (including water) to the volume of all liquid products. The MMS will not give an allowance for transporting lease production which is not royalty bearing.

(4) If an arm's-length transportation contract includes both gaseous and liquid products, and the transportation costs attributable to each cannot be determined from the contract, the lessee shall propose an allocation procedure to MMS. The lessee may use the oil transportation allowance determined in accordance with its proposed allocation procedure until MMS issues its determination on the acceptability of the cost allocation. The lessee shall submit all available data to support its proposal. The initial proposal must be submitted by [*insert date 60 days after effective date of final rule*] or within 60 days after the lessee begins the transportation, whichever is later (unless MMS approves a longer period). The MMS shall then determine the oil transportation allowance based upon the lessee's proposal and any additional information MMS deems necessary.

(5) Where the lessee's payments for transportation under an arm's-length contract are not based on a dollar per unit basis, the lessee shall convert whatever consideration is paid to a dollar value equivalent for the purposes of this section.

(6) MMS may require that a lessee submit arm's-length transportation contracts, production agreements, operating agreements, and related documents. Documents shall be submitted within a reasonable time, as determined by MMS.

(b)(1) Non-arm's-length or no contract. If a lessee has a non-arm's-length contract or has no contract, including those situations where the lessee performs transportation services itself, the transportion allowance will be based upon the lessee's reasonable, actual costs. All transportation allowances deducted under a non-arm's-length or no contract situation are subject to future review and audit. For non-arm's-length or no contract situations, MMS approval of transportation allowances is not required. The MMS will monitor the allowance deductions to ensure that deductions are reasonable and allowable. The MMS may direct a lessee to adjust its allowance when necessary or appropriate.

(2) An oil transportation allowance determined pursuant to a non-arm's-length contract or a no contract situation shall be effective for a reporting period beginning the month that the lessee first is authorized to deduct a transportation allowance and shall continue for 12 months, or until the non-arm's-length contract terminates or the no contract transportation terminates, whichever is earlier. The lessee shall submit a

completed Form MMS-4110 the same month the transportation allowance first is reported on Form MMS-2014, Report of Sales and Royalty Remittance. This filing is applicable to all months in the reporting period. The allowance will be denied for any production month for which a Form MMS-4110 is not received prior to, or at the same time as, the Form MMS-2014 for that month. As provided in § 206.105(c), at the end of the 12-month period, or after the non-arm's-length contract or no contract transportation terminates, the lessee shall submit a completed Form MMS-4110 containing the actual costs for the previous reporting period. If oil transportation is continuing, the lessee shall include on Form MMS-4110 its estimated costs for the next reporting period. The estimated oil transportation allowance shall not be greater than the reasonable, actual oil transportation costs in the previous reporting period, unless MMS approves a higher estimate upon written request from the lessee.

(3) For oil transportation allowances authorized by this paragraph, a lessee may deduct the transportation allowance that it has determined, subject to review and audit by MMS. When necessary or appropriate, MMS may direct a lessee to modify its estimated or actual transportation allowance deductions.

(4) For new transportation facilities or arrangements, the lessee's initial Form MMS-4110 shall include estimates of the allowable oil transportation costs for the applicable period. Cost estimates shall be based upon the most recently available operations data for the transportation system, or if such data is not available, the lessee shall use estimates based upon industry data for similar transportation systems.

(5) The transportation allowance for non-arm's-length or no contract situations shall be based upon the lessee's actual costs for transportation, including operating and maintenance expenses, overhead, [depreciation,] and a return on [undepreciated] capital investment. The transportation allowance shall be based upon actual costs incurred during the 12-month reporting period.

(i) Allowable operating expenses include: operations supervision and engineering; operations labor; fuel; utilities; materials; ad valorem property taxes; rent; supplies; and any other directly allocable and attributable operating expense which the lessee can document.

(ii) Allowable maintenance expenses include: maintenance of the transportation system; maintenance of equipment; maintenance labor; and other directly allocable and attributable maintenance expenses which the lessee can document.

(iii) Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, *including* royalties, are not allowable expenses.

Alternative 1

(iv) To compute depreciation, the lessee may elect to use either a straight-line depreciation method or a unit of production method based on the life of equipment or the life of the reserves which the transportation system services. After an election is made, the lessee may not althernate methods without MMS approval. A change in ownership of a transportation system shall not alter the depreciation schedule established by the original transporter/lessee for purposes of the allowance calculation. With or without a change in ownership a transportation system shall be depreciated only once. Equipment shall not be depreciated below a reasonable salvage value.

Alternative 2

(iv) MMS shall allow as a cost an amount equal to the initial capital investment in the transportation system multiplied by a rate of return determined pursuant to paragraph (v). No allowance shall be provided for depreciation.

(v) The rate of return on [undepreciated] capital investment shall be the Moody Aaa corporate bond rate as published by Moody's Investors Service, Inc. in *Moody's Bond Record* on the first business day of the reporting period for which the allowance is applicable. This rate will be effective during the reporting period. The rate shall be redetermined at the beginning of each subsequent reporting period.

(6) The deduction for transportation costs shall be determined based on the lessee's cost of transporting each lease product through each individual transportation system. Where more than one liquid product is transported, allocation of costs to each of the liquid products transported shall be in the same proportion as the ratio of the volume of each liquid product (including water) to the volume of all liquid products and such allocation shall be made in a consistent and equitable manner. The MMS will not give an allowance for transporting lease production which is not royalty-bearing.

(7) Where both gaseous and liquid products are transported through the same transportation system, the lessee shall propose a cost allocation procedure to MMS. The lessee may use the oil transportation allowance determined in accordance with its proposed allocation procedure until MMS issues its determination on the acceptability of the cost allocation. The lessee shall submit all available data to support its proposal. The initial proposal must be submitted within [*insert date 60 days after effective date of final rule*] or within 60 days after the lessee begins the transportation, whichever is later (unless MMS approves a longer period). The MMS shall then determine the oil transportation allowance based upon the lessee's proposal and any additional information MMS deems necessary.

(8) Upon request by MMS, the lessee shall submit all data used by the lessee to prepare its Form MMS-4110, including estimates and actuals. The data shall be provided within a reasonable period of time, as determined by MMS.

(c) (1) Reporting requirements. After the initial reporting period, for succeeding reporting periods, lessees shall submit Form MMS-4110 (or page one of Form MMS-4110 for arm's-length contracts) on an annual basis. Form MMS-4110 must be received by MMS within 90 days, after the end of the previous reporting period, unless MMS approves a longer period. If the Form MMS-4110 is not received timely, then the allowance requested will not be effective until the first day of the month in which the Form MMS-4110 is received, and will be applicable only to Form MMS-2014's, Report of Sales and Royalty Remittance, received after that date. The lessee will be required to refund, with interest, any unauthorized allowance which it has taken.

(2) The MMS may establish reporting dates for individual leases different than those specified in this subpart in order to provide more effective administration. Lessees will be notified as to any change in their reporting period.

(3) Transportation allowances must be reported as a separate line on the Report of Sales and Royalty Remittance, Form MMS-2014.

(d) (1) Adjustments. If the actual transportation allowance is less than the amount the lessee has estimated and taken during the reporting period, the lessee shall be required to pay additional royalties due plus interest computed pursuant to 30 CFR 218.54, retroactive to the first month the lessee is authorized to deduct a transportation allowance. If the actual transportation allowance is greater than the amount the lessee has estimated and taken during the reporting period, the lessee shall be entitled to a credit without interest.

(2) For lessees transporting production from onshore Federal and Indian leases, the lessee must submit a corrected form MMS-2014, together with any payment, in accordance with instructions provided by MMS to reflect actual costs.

(3) For lessees transporting production from leases on the OCS, if the lessee's estimated costs were more than the actual costs, the lessee must submit a corrected Form MMS-2014, together with its payment, in accordance with instructions provided by MMS to reflect actual costs. If the lessee's estimated costs were less than its actual costs, the lessee must submit a written request for refund in accordance with section 10 of the Outer Continental Shelf Lands Act, as amended, 43 U.S.C. 1339(a).

(e) Notwithstanding any other provisions of this subpart, no cost shall be allowed for oil transportation which results from payments (either volumetric or for value) for actual or theoretical losses.

(f) Other transportation cost determinations. The provisions of this section shall apply to determine transportation costs when establishing value using a net back valuation procedure or any other procedure that requires deduction of transportation costs.

30 CFR Part 207 is amended as follows:

PART 207—[AMENDED]

1. The authority citation for Part 207 is revised to read as follows:

Authority: 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; and 30 U.S.C. 1701 et seq.;

2. 30 CFR Part 207 is amended by revising the part title to read "SALES AGREEMENTS OR CONTRACTS GOVERNING THE DISPOSAL OF LEASE PRODUCTS."

§§ 207.1, 207.2, 207.5, 207.6, 207.7 [Removed]

§§ 207.3 and 207.4 [Redesignated as §§ 207.2 and 207.3 Respectively]

3. Sections 207.1, 207.2, 207.5, 207.6, and 207.7 are removed. Sections 207.3 and 207.4 are redesignated as § 207.2 and 207.3, respectively.

4. The following subparts are added to Part 207.

Subpart A—General Provisions

Subpart B—Oil, Gas and OCS Sulfur, General [Reserved]

Subpart C—Federal and Indian Oil [Reserved]

Subpart D—Federal and Indian Gas [Reserved]

Subpart E—Solid Minerals, General [Reserved]

Subpart F—Coal [Reserved]

Subpart G—Other Solid Minerals [Reserved]

Subpart H—Geothermal Resources [Reserved]

Subpart I—OSC Sulfur [Reserved]

5. 30 CFR Part 207 Subpart A, is amended by adding new §§ 207.1 and 207.4 and by revising newly redesignated §§ 207.2 and 207.3 (formerly §§ 207.3 and 207.4) to read as follows:

Subpart A—General Provisions

§ 207.1 Definitions.
§ 207.2 Contracts made pursuant to new form leases.
§ 207.3 Contracts made pursuant to old form leases.
§ 207.4 Contract and sales agreement retention.

Subpart A—General Provisions

§ 207.1 Definitions.

The definitions in all subparts of Part 206 of this Title are applicable to this Part.

§ 207.2 Contracts made pursuant to new form leases.

On November 29, 1950, a new form of lease was adopted (Form 4-1158, 15 FR 8585), containing provisions whereby the lessee agrees that nothing in any contract or other arrangement made for the sale or disposal of oil, gas, natural gasoline, and other products of the leased land, shall be construed as modifying any of the provisions of the lease, including, but not limited to, provisions relating to gas waste, taking royalty in kind, and the method of computing royalties due as based on a minimum valuation and in accordance with the oil and gas valuation regulations. A contract or agreement pursuant to a lease containing such provisions may be made without obtaining approval of the United States as lessor, but must be retained as provided in § 207.4.

§ 207.3 Contracts made pursuant to old form leases.

(a) Old form leases are those containing provisions prohibiting sales or disposal of oil, gas, natural gasoline, and other products of the lease except in accordance with a contract or other arrangement approved by the Secretary of the Interior, or by the Director of the Minerals Management Service or his representative. A contract or agreement made pursuant to an old form lease may be made without obtaining approval if the contracts or agreement either contains the substance of or is accompanied by the stipulation set forth in paragraph (b) of this section, signed by the seller (lessee or operator).

(b) The stipulation, the substance of which must be included in the contract, or be made the subject matter of a separate instrument properly identifying the leases affected thereby, is as follows:

It is hereby understood and agreed that nothing in the written contract or in any approval thereof shall be construed as affecting any of the relations between the United States and its lessee, particularly in matters of gas waste, taking royalty in kind and the method of computing royalties due as based on a minimum valuation and in accordance with the terms and provisions of the oil and gas regulations applicable to the lands covered by said contract.

§ 207.4 Contract and sales agreement retention.

Copies of all oil and gas sales contracts, posted price bulletins, etc., and copies of all agreements, contracts, or other documents which affect the gross proceeds, as well as any other information regarding any consideration for the sale or disposition of the product which is not included in such contracts, are to be maintained by the lessee, and made available upon request during normal working hours to authorized Department of the Interior audit teams, other MMS or BLM officials, or auditors of the General Accounting Office, or other persons authorized to receive such documents, or shall be submitted to MMS within a reasonable period of time, as determined by MMS. Any oral sales arrangement negotiated by the lessee must be placed in written form and retained by the lessee. Records shall be retained in accordance with 30 CFR Part 212.

30 CFR Part 210 is amended as follows:

PART 210—[AMENDED]

1. The Authority citation for Part 210 is revised to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. 30 CFR Part 210 is amended by revising the titles of Subpart B., Subpart C, D, F, and G to read as follows:

Subpart B—Oil, Gas, and OCS Sulfur—General

Subpart C—Federal and Indian Oil—[Reserved]

Subpart D—Federal and Indian Gas—[Reserved]

Subpart F—Coal [Reserved]

Subpart G—Other Solid Minerals [Reserved]

3. The following Subparts are added to Part 210:

Subpart H—Geothermal Resources [Reserved]

Subpart I—OCS Sulfur—[Reserved]

§§ 210.100, 210.101, 210.102, 210.103, 210.104, 210.105, 210.150 and 210.151 [Removed]

§§ 210.300 and 210.301 [Redesignated as §§ 210.350 and 210.351]

4. Sections 210.100, 210.101, 210.102, 210.103, 210.104 and 210.105 under Subpart C and Sections 210.150 and 210.151 under Subpart D are removed. Sections 210.300 and 210.301 under Subpart F are redesignated as new Sections 210.350 and 210.351 under new redesignated Subpart H, respectively.

5. 30 CFR Part 210, Subpart B, is amended by the addition of § 210.55 to read as follows:

§ 210.55 Special forms or reports.

When special forms or reports other than those referred to in the regulations in this Part may be necessary, instructions for the filing of such forms or reports will be given by the MMS.

PART 241—[AMENDED]

30 CFR Part 241 is amended as follows:

The authority citation for Part 241 is revised to read as follows:

Authority: 25 U.S.C. 396 et seq.; 25 U.S.C. 396a et seq.; 25 U.S.C. 2101 et seq.; 30 U.S.C. 181 et seq.; 30 U.S.C. 351 et seq.; 30 U.S.C. 1001 et seq.; 30 U.S.C. 1701 et seq.; 43 U.S.C. 1301 et seq.; 43 U.S.C. 1331 et seq.; and 43 U.S.C. 1801 et seq.

2. 30 CFR Part 241 is amended by revising the titles of Subpart B. Subpart C, and Subpart D to read as follows:

Subpart B—Oil, Gas, and OCS Sulfur, General

Subpart C—Federal and Indian Oil—[Reserved]

Subpart D—Federal and Indian Gas—[Reserved]

Subpart H [Removed]

3. "Subpart H—Indian Lands" is removed.

4. Subparts E, F, and G are redesignated as Subparts F, G, and H, respectively.

5. A new Subpart I is added to read:

Subpart I—OCS Sulfur [Reserved]

6. A new Subpart E is added to read:

Subpart E—Solid Minerals, General [Reserved]

§ 241.10 [Removed and Reserved]

7. Section 241.10 is removed and reserved.

§ 241.50 [Amended]

8. Section 241.50 is amended by removing the phrase "this subpart" and replacing it with the phrase "subparts B, C and D of this part."

§ 241.100 [Redesignated]

9. Section 241.100 under Subpart C is redesignated as a new § 241.60 under Subpart B and retitled "Assessments for Nonperformance".

§ 241.60 [Amended]

10. Paragraph (c) from newly redesignated § 241.60 is removed.

[FR Doc. 87-807 Filed 1-14-87; 8:45 am]

BILLING CODE 4310-MR-M