owner must indicate in writing either concurrence with this determination or disagreement reserving all rights to claim vacancy payments for the unleased unit(s) pursuant to the contract, without prejudice by reason of the owner's signing the contract.

§ 886.335 HUD review of agreement and contract compliance.

HUD will review project operations at such intervals as it deems necessary to ensure that the owner is in full compliance with the terms and conditions of the contract, Regulatory Agreement, and Agreement to Enter into a Housing Assistance Contract, if any. The equal opportunity review may be conducted with the scheduled HUD review or at any time deemed appropriate by HUD.

Issued at Washington, D.C., October 30, 1979.

Morton A. Baruch,

Deputy Assistant Secretary for Housing—Federal Housing Commissioner.

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Part IV

Consumer Product Safety Commission

Safety Standard for Walk-Behind Power Lawn Mowers; Certification Rule

CONSUMER PRODUCT SAFETY COMMISSION

16 CFR Part 1205

Safety Standard for Walk-Behind Power Lawn Mowers; Certification Rule

AGENCY: Consumer Product Safety Commission.

ACTION: Final rule.

SUMMARY: The Commission requires that manufacturers and importers certify that their walk-behind rotary power lawn mowers comply with the Commission's Safety Standard for Walk-Behind Power Lawn Mowers. The requirements provide for certifying rotary power mowers with a permanent label and for recordkeeping. The labeling and recordkeeping requirements are needed to help the Commission monitor compliance with the lawn mower safety standard. The labeling requirement will also enable consumers to distinguish complying from noncomplying mowers.

DATES: The rule is applicable to all walk-behind rotary power lawn mowers manufactured after December 31, 1981.

In order that all interested persons may have an equal opportunity to examine this certification rule as published in the **Federal Register** and then determine in an orderly manner whether to seek judicial review of the rule, this rule shall be considered promulgated at 12:00 noon, Eastern Standard Time, on December 17, 1979.

FOR FURTHER INFORMATION CONTACT: Allen Brauninger, Directorate for Compliance and Enforcement, Consumer Product Safety Commission, Washington, D.C. 20207, (301) 492–6629.

SUPPLEMENTARY INFORMATION:

Background

On February 15, 1979, the Commission published a final consumer product safety standard for power operated walk-behind rotary and reel-type lawn mowers (16 CFR Part 1205 Subpart A, 44 FR 9990). The standard contains performance and labeling requirements intended to reduce the risk of injury to consumers caused by contact, primarily of the foot and hand, with the rotating blade of a mower. The performance requirements of the standard apply only to rotary mowers. The labeling requirements apply to both rotary and reel-type mowers. The standard contains two main performance requirements applicable to rotary power lawn mowers. The first protects against foot contact injuries that occur while the operator is in the normal mowing position. This requirement states that the rear and discharge chute areas of the mower shall be capable of being probed with a specified foot probe that simulates the action of a human foot, without the probe contacting the blade. The second main requirement protects against hand or foot injuries that occur after the operator has left the normal mowing position by requiring the blade to stop within 3 seconds of the time the operator lets go of the mower. A more detailed explanation of the standard's requirements, rationale, and background is given in the preamble to the final power lawn mower safety standard.

Certification Rule

1. Certification Testing

Section 14(a)(1) of the Consumer Product Safety Act (CPSA), 15 U.S.C. 2063(a)(1), requires manufacturers (defined in the act to include importers) and private labelers of a product subject to a consumer product safety standard to issue a certificate which states that the product conforms to all applicable consumer product safety standards, specifies the applicable standard, states the name of the manufacturer or private labeler issuing the certificate, and includes the date and place of manufacture. The certificate must accompany the product or be furnished to any distributor or retailer to whom the product is delivered. Section 14(a) also requires that the certificate be based on a test of each product or upon a reasonable testing program.

The failure to issue a certificate of compliance or the issuance of a certificate which is false or misleading in any material respect violates section 19(a)(6) of the CPSA.

The Commission is issuing this certification and recordkeeping regulation to inform manufacturers and importers of the procedures to use in certifying that their products comply with the safety standard once the standard becomes effective and to exempt private labelers from the requirement to certify. The certification rule applies to walk-behind rotary power lawn mowers and not to reel-type mowers, since the latter are subject only to the labeling requirements of the standard. Under the certification rule, manufacturers and importers are responsible for 1) issuing a certificate of compliance in the form of a permanent label attached to each mower which states that the mower complies with the standard and supplies other specified information, and 2) keeping, or assuring the availability of, records showing that the certificates are based on a test of each mower or on a reasonable testing program. These requirements are discussed in detail below.

The certification rule issued below provides that manufacturers (defined at § 1205.32(a) to include importers and assemblers) must either test individual rotary walk-behind power lawn mowers or devise "reasonable testing programs." A "reasonable testing program" is defined in the rule as one which provides reasonable assurance that the certified mowers comply with the standard. The rule allows manufacturers and importers to define their own reasonable testing programs. The Commission has exempted private labelers from the requirement to certify.

The Commission has concluded that it is unnecessary to specify the testing program for the manufacturers. A power lawn mower's ability to meet the performance requirements (except for blade stopping time) is controlled by the mower's design, materials, and method of production. Initial tests made on mowers of a specific design should be sufficient to determine that the product manufactured at a later date to essentially the same design complies with the standard. However, because blade stopping time may vary from one mower to another of essentially the same design, the Commission believes that a prudent manufacturer should test production mowers of essentially the same design periodically for the blade stopping time requirement.

The certification rule states at § 1205.33(b)(2) that the Commission will test for compliance with the standard by using the test procedures in Subpart A of Part 1205. However, *manufacturers* are not bound by these procedures and are free to use any *reasonable* test procedures.

Section § 1205.33(b)(1) of this rule explains how a reasonable testing program is conducted. For certification testing, the mowers should be grouped into "production lots," defined at § 1205.32(b) to be a quantity of mowers from which certain mowers are selected for testing prior to certifying the lot. All mowers in a production lot are required to be essentially identical in those design, construction, and material features which relate to the ability of a mower to comply with the standard. Sample mowers are then selected from the production lot for testing in accordance with the reasonable testing program.

If the production lot has been properly limited as to number and design of mowers, it should be possible for a manufacturer to test samples from a lot for certification and not to test again as long as the mowers in the production lot are essentially identical to the mowers tested for certification in all respects relating to the ability of the mower to meet the requirements of the standard. After a lot has been established, if there are any changes in the mower specifications which could affect mower performance in relation to the requirements of the standard, the manufacturer should establish a new production lot for testing. Similarly, if there are changes in parts, suppliers of parts, or production methods which could affect the ability of the mower to comply with the standard, the manufacturer should establish a new production lot for testing. Furthermore, if the testing program shows that a mower does not comply with a requirement of the standard, no mower in the production lot can be certified as complying until the noncomplying mowers have been identified and destroyed or altered by repair, redesign, or use of different materials or components to the extent necessary to make the mowers conform to the standard.

The Commission notes that the obligation to issue a certificate of compliance based on a reasonable testing program is in addition to, and not in place of, the obligation to manufacture, import, distribute, or private label only mowers which meet the requirements of the standard.

Consequently, if the Commission tests mowers in accordance with the standard and obtains failing results, the Commission may begin enforcement action for violation of section 19(a)(1) of the CPSA, even though the manufacturer or importer of the mower may have issued a certificate of compliance and may have based that certificate on a reasonable testing program which meets the requirements of the regulation issued below.

Section 22 of the CPSA authorizes the Commission to enjoin any person from violating section 19, and to seize any product which does not comply with an applicable standard. In addition, sections 20 and 21 of the CPSA authorize the Commission to seek civil or criminal penalties for violation of the CPSA in appropriate cases.

2. Recordkeeping

Section 1205.34 of the rule requires that manufacturers and importers of walk-behind rotary power lawn mowers subject to the standard maintain written records demonstrating that compliance certificates are based on tests of each mower or a reasonable testing program.

No specific format is prescribed for the records, but the records are required to contain sufficient information to show the nature of a firm's testing procedures, including the basis for and identity of the production lot, and to show whether the mowers which are being marketed and certified to comply with the standard are essentially identical in every respect that relates to compliance with the standard to the mowers that were tested for conformance with the standard. The records are also required to indicate exactly which mowers or production lots of mowers are being certified as a result of a specified test or series of tests. The records are required to be maintained for a minimum of 3 years from the date of certification of each mower or each production lot. This is because the Commission staff estimates that some mowers can reasonably be expected to remain in inventory and not reach consumers for a period of three years, and the Commission is particularly interested in being able to check the records concerning any mowers held in inventory.

These records, besides aiding Commission enforcement of the standard and the certification rule, could be helpful to a manufacturer in limiting the scope of a possible recall order under section 15 of the CPSA. (The Commission is authorized under section 15 to order a manufacturer of a product which is found, after opportunity for a hearing, to present a "substantial product hazard" to elect one of the following remedies: repair the defective product, replace the product with a non-defective product, or refund the purchase price of the product. "Substantial product hazard" is defined in section 15 to mean a failure to comply with an applicable consumer product safety rule, or a product defect, which creates a substantial risk of injury to the public.) Records of date and location of manufacture; dates of changes in specifications, parts, suppliers, or manufacturing procedures; and the dates and results of quality control or recertification testing are examples of the types of information which could serve to identify the period of time during which non-complying or defective mowers were manufactured. In the absence of such information, the entire production of a particular type of mower could be subject to a recall order.

The recordkeeping requirements of § 1205.34 are issued under the authority of section 16(b) of the CPSA, which authorizes requirements for the establishment and maintenance of records that are necessary to implement the act or to determine compliance with regulations issued under the act. The Commission believes the records required by § 1205.34 of the rule are necessary to monitor compliance with the power lawn mower standard.

Section 16(b) further provides that these records must be made available for inspection by duly designated agents of the Commission upon request.

3. Product Certification and Labeling

Section 1205.35 of the rule requires manufacturers of walk-behind rotary power lawn mowers manufactured after December 31, 1981, to affix to the mowers permanent labels which shall be considered a "certificate" of compliance, as that term is used in section 14(a) of the CPSA. (Section 14(c) of the CPSA authorizes the Commission to issue rules requiring a product to bear a label containing information similar to that required by section 14(a) for certificates.)

The certification label is required to include the following information:

1. The statement "Meets CPSC blade safety requirements."
2. An identification of the production lot.
3. The name of the manufacturer or importer issuing the certification label.
4. The location where the product was principally assembled.
5. The month and year the product was manufactured.

All of this information, except for the statement and the name of the person issuing the certificate, may be in code if an interpretation of the coding system is available to consumers, persons in the chain of distribution, and the Commission. If a mower is to be sold to a private labeler, and if the brand or trademark of the private labeler is on the certification label, the name of the manufacturer or importer may also be in such a code.

The certification label is required to be visible and legible to the ultimate consumer. However, where the permanent label is not immediately visible to the consumer at the time of sale because of packaging or other marketing practices, a second temporary label stating "Meets CPSC blade safety requirements" is required on the container, or if the container is not so visible, on the promotional material used with the sale of the mowers. The requirement for the temporary label for containers and promotional materials expires December 31, 1984.

In deciding that certification for lawn mowers should be in the form of a permanent label rather than a separate certificate supplied to persons in the distribution chain, the Commission points out that the label will be visible to all in the distribution chain, and the certification will be immediately available if any questions concerning compliance with the standard arise about a particular mower. The Commission believes that a permanent label will benefit consumers and industry, as well as the Commission, in the following ways:

1. For a period of time after the mower standard goes into effect, both complying and noncomplying mowers will be available on the retail market. A label affixed to the individual mower, in contrast to a certificate covering a group of mowers supplied to the retailer, will help consumers purchasing mowers to make an informed choice between complying and noncomplying mowers.

2. A permanent label will make it easier to determine whether a particular mower was certified to comply with the standard. In the event a power mower is involved in an injury, for example, a CPSC investigator or the victim of the injury can tell immediately if the mower was certified.

3. The Commission may amend the walk-behind power mower standard in the future to add new requirements or to modify the existing requirements. A label stating the date of manufacture will make it immediately apparent which requirements apply to a particular mower, thereby aiding a Commission investigation of particular mower-related accidents.

4. A permanent label will enable CPSC investigators screening mowers for compliance to distinguish between mowers manufactured before and those manufactured after the standard without examining retailers' or distributors' shipping records. An examination of shipping records can be time-consuming and difficult. The label will also permit the Commission investigators to identify the firm responsible for the certification and the place of manufacture, thereby expediting any further Commission actions that may be appropriate.

5. A permanent label with an identification of the production lot and the date and location of manufacture will be advantageous to manufacturers, distributors, retailers, private labelers, and consumers in the event of a recall order under section 15 of the CPSA. If the recall is limited to a certain production period or manufacturing location, the label will help in identifying and limiting those mowers which are subject to the recall.

The last section of the rule (§ 1205.36) deals with certification labeling by importers. Importers of mowers are required to issue the certification labels, but may rely on the foreign manufacturer's tests to support the certification if the records of the tests are maintained in the United States and the importer is a resident of the U.S. or has a resident agent in the U.S. The requirements that the records must be maintained in the U.S. and the importer must reside, or maintain a resident agent, in this country are necessary to enable the Commission investigators to inspect the records and monitor compliance with the standard. Importers who certify are responsible for inspecting the test records to determine that all testing has been performed properly, that the records of the tests are accurate and complete, and that the tests provide reasonable assurance that all mowers imported comply with the standard.

Comments on the Proposal

In response to the proposal of the certification rule, the Commission received 11 comments. In addition, several comments received in response to the proposal of the power lawn mower safety standard concerned certification issues. The substance of these comments and the Commission's responses to them are explained below.

1. *Third party testing.* One commenter recommended that the rule specifically mention that the certification testing could be performed by an independent third party as authorized by section 14(b) of the CPSA. The Commission agrees that inclusion of a specific reference to the acceptability of third party testing is desirable. Section 1205.33 of the rule has been changed accordingly.

Another commenter believes that *only* third parties should be allowed to certify. However, section 14 of the act specifically states that the person required to issue the certificate (manufactures, importers, and private labelers) has the option to perform the testing or to have it performed by an independent third party qualified to perform the tests. Similarly, there is no express authority for requiring witnesses to such tests, as suggested by one commenter. Therefore, the final rule allows the certifying party to perform the testing program.

2. *Certification by importers or private labelers.* The proposal required certification by manufacturers, importers, and private labelers. (However, where more than one party would otherwise have been required to certify, only the party closest to the consumer in the distribution chain would have been required to issue the certificate.) The proposal provided that importers and private labelers would be allowed to rely on the tests of manufacturers to support the certificate of compliance if the importer or private labeler assured that all testing had been performed properly with acceptable results and that all records of such tests were accurate and complete.

One commenter, who markets under its own label mowers manufactured by others, stated that the proposal unreasonably required private labelers to become the insurers of the manufacturing practices and records of others over whom the private labeler may have no control. Therefore, the commenter suggests that private labelers should be allowed to issue certificates of compliance based on certification from the manufacturer that the testing had been performed properly with acceptable results and that all records of such tests comply with the requirements of the rule, unless the private labeler, in the exercise of due care, had reason to believe otherwise. This commenter also suggested that the manufacturers be *required* to issue such a certificate to the private labeler.

The Commission agrees that the manufacturer is in a much better position than a private labeler to efficiently designate production lots and to make the other judgments involved in the certification process. The Commission also believes that it would be an unnecessary duplication for private labelers to be required to independently determine the adequacy of the manufacturer's tests and records, as would have been required by the proposal. However, the Commission believes that the simplest way to address these concerns is to eliminate the requirement of the proposal that private labelers certify their products. Thus, such products would be certified only by the manufacturer, which is defined in section 3(a)(4) of the CPSA as any person who manufactures *or imports* a consumer product. Therefore, private labelers who are also importers would still have to certify. The provision of the proposal that would allow importers to rely on the tests conducted by foreign manufacturers under certain conditions is retained, but the wording of the requirement has been changed to state that the importer's duty is to determine that the test records appear to comply with the rule and that reliance on the tests must be in good faith.

3. *Component suppliers.* One commenter stated that component manufacturers should be allowed to certify their components, and another commenter stated that component manufacturers should not be involved in certification since the complete machine is certified rather than the components. The Commission believes that since the standard applies to the complete lawn

mower and not to its component parts, it is not appropriate to rely on tests by component manufacturers for purposes of the certification required by section 14 of the CPSA. Accordingly, manufacturers who manufacture or import only component parts of a mower are exempted from the requirement to certify. However, the mower manufacturer could contractually require its component suppliers to warrant that the components will meet certain criteria relating to the standard.

4. *Defective mowers.* Section 1205.33(b)(3) of the proposal stated that if the "reasonable testing program shows that a mower does not comply with one or more requirements of the standard, no mower in the production lot can be certified as complying until mowers in the lot have been altered by repair, redesign, or use of a different material or components to the extent necessary to bring them into conformance with the standard." One commenter states that this section assumes that a single failure is attributable to assembly, design, or material and that it is a problem affecting the whole lot. The commenter believes that the "practical effect [of the section] is to impose needless and costly delays in manufacturing by forcing producers to act as if isolated test deficiencies require basic rework throughout the production run."

The Commission does not agree that this section as proposed would require all mowers in the lot to be altered. The proposal states that mowers in the lot are to be altered *"to the extent necessary* to bring them into conformance." This does not necessarily require wholesale changes in assembly, design, or materials as stated by the commenter. Instead, the section requires the manufacturer to identify all noncomplying mowers within that lot and correct deficiencies before certifying them and offering them for sale.

However, the wording of the proposal has been changed in the final rule to more clearly point out that these corrective actions are required only for noncomplying mowers and to expressly authorize destruction of the noncomplying mowers. (Disassembly of the mowers and discarding of the defective parts would be considered a destruction of the mower for this purpose.)

5. *Records.* Proposed § 1205.34(b) also required the keeping of records of "which mowers or production lots of mowers are covered by particular certificates of compliance." One commenter stated that the use of the plural in this regard was confusing and suggested that the requirement be changed to read that the "records shall indicate which specific mower or production lot of mowers is covered by any particular certificate of compliance." Since each mower has an individual certification, the Commission does not agree that this change would more precisely describe the purpose of the recordkeeping requirement. However, the final rule has amended the language of this section to require that records be kept of the mower or production lot to which each test applies.

Proposed § 1205.34(b) also required the records to "describe" the tests to which the mowers were subjected. One commenter stated that this requirement could be interpreted as requiring the record of *each* test record to fully describe the test. The commenter believes the word "reference" would be more apt in this regard than would "describe." The Commission appreciates the commenter's concern, but does not believe that the suggested change would be an improvement. The Commission does not intend to require that the record of each individual test fully describe the manner in which the test is performed. The certifier must maintain a record containing a full description of the tests used for this purpose, however, even though the record for a particular test may only refer to the test by the designation assigned to it by the certifier. (A reference to a test required by the standard would be sufficient if the reference made it clear that was the test that was performed.) Accordingly, no change has been made in the wording of this requirement.

6. *Type of label.* Proposed § 1205.35(a) required the certificates of compliance to be in the form of a label which can reasonably be expected to remain affixed for the life of the mower. Two commenters believed that this language implied that the label could not be an integral part of the mower as would be the case if the label were stamped or cast into the housing. The Commission did not mean to imply in the proposal that integral labels would not be acceptable. In order to make this more clear in the final rule, the words "affixed to" have been deleted and "on" substituted.

7. *Combinations of labels.* In the proposal, the Commission asked for comment on whether it would be appropriate for certifiers to append the information needed for the certification label to the warning label required by the standard. Two commenters were in favor of allowing this. However, neither of these commenters suggested how such information could be presented so as not to detract from the safety message of the warning label. Accordingly, there has been no change in the final rule in this regard. However, the Commission notes that the rule does not prevent combining the information presented on the mower providing it does not detract from the conspicuousness of the warning label.

8. *Wording of label.* The proposal would have required that each mower bear a label stating "Meets CPSC blade safety requirements for walk-behind rotary power mowers." The words "for walk-behind rotary power mowers" were included so that consumers would not be inclined to think that mowers outside the scope of the performance standard (i.e., reel-type and riding mowers) did not comply with a standard by virtue of the fact that they did not bear a label. However, the industry trade association and a manufacturer commented that this language is self-evident and unnecessary and should be deleted from the label. Accordingly, these words are not required for the label required by the final rule.

The manufacturers's trade association also commented that the inclusion of the words "blade safety" before "requirements" in the label implied that other requirements exist and are not met by that mower and that "blade safety" should be deleted. The Commission disagrees with this comment. Without the indication that the mower complies only with requirements addressing the hazard of contact with the blade, consumers could be mislead into thinking that the requirements protect against other hazards, such as thrown objects, when in fact they do not.

The commenter also stated that if requirements addressing other hazards are issued in the future, the label would have to be changed, thus increasing the cost to manufacturers. The Commission, however, believes that such a cost would be minimal and would not outweigh the reasons explained above for retaining the words "blade safety" in the label.

Accordingly, the label required by the final rule will read "Meets CPSC blade safety requirements."

9. *Labeling of reel-type mowers.* One commenter suggested that reel-type mowers, which are not subject to the performance requirements of the standard but which must bear the warning label required by the standard, should be allowed to bear the label stating that the mower complies with CPSC blade safety requirements. The Commission, however, believes that consumers could be misleading if reel-type mowers were so labeled.

The exclusion of reel-type mowers from the performance requirements of the standard was not based on a finding that these mowers are less dangerous than rotary mowers but rather because the standard was primarily developed for rotary mowers and there were different considerations concerning the effectiveness and economic impact of the standard's requirements for reel-type mowers than for rotary mowers. For example, the blade of a rotary mower is required to stop within 3 seconds of when the operator releases a blade control mechanism. This is not required for reel-type mowers. To allow reel-type mowers to bear a label stating that the mowers meet the CPSC blade safety requirements could mislead consumers into relying on the protections afforded by the performance requirements of the standard, which in fact apply only to rotary mowers. Accordingly, only rotary mowers may bear the label.

10. *Labeling of promotional material.* One purpose of the label stating that a mower complies with the CPSC blade safety requirements is to assist consumers who wish to purchase a safer mower in determining which mowers available for sale comply with the standard. However, there are types of marketing situations where the consumer has no opportunity to view the mower before making the purchase. This could be the case, for example, where the purchase is made through a catalog or by telephone solicitation. In order to assist consumers who purchase mowers under conditions where they would not see a label on the mower prior to purchase, the proposal required that, under these conditions, a temporary label must appear on the container, or, if the container is not visible prior to purchase, the promotional material used in connection with the sale of the mowers.

One commenter stated that the requirement for the label on promotional material was unnecessary in that a notice on the mower container was sufficient to bring the information to the consumer's attention. However, as explained above, this is not the case for the situations where the consumer does not see the carton before purchasing the mower.

The commenter also stated that the requirement was vague and could be construed as applying to general advertising practices and policies beyond the scope of the safety standard or the Commission's jurisdiction. The Commission does not agree with this contention. The requirement would not apply to general advertising practices unless the advertising solicited sales by methods such as mail or telephone. Section 14 of the CPSA specifically authorizes the Commission to require the use and prescribe the form of labels.

Therefore, the requirement for labeling of containers and promotional material in situations where consumers will not be able to inspect the mower prior to purchase is retained in the final rule.

The commenter also suggested that the temporary label for containers and promotional material would be of value only during the period shortly after the standard goes into effect. They state that at some point these labels will be unnecessary since there will be no existing stocks of prestandard mowers on the market. They recommend that a cut-off date for this requirement be established and incorporated into the certification rule.

The Commission agrees that a cut-off date for requiring an affirmative label of compliance on cartons and promotional material is appropriate. From the information available to the Commission, it appears that retailers may have mowers in stock that are two model years old. Therefore, the Commission has decided to keep the requirement of § 1205.35(d) for affirmative labeling of containers and promotional material in effect for a period of 3 years from the effective date of the performance requirements of the standard (i.e., for mowers manufactured before January 1, 1985) after that date, the labels for containers and promotional material may be discontinued.

11. *Reasonable testing program.* The proposal did not specify any particular testing program that would be required as the basis for the certification by manufacturers that their mowers complied with the standard. The Commission believes that in view of the possible range of manufacturing practices and degrees of quality control it is more appropriate to allow each manufacturer to fashion its own reasonable testing program. However, several commenters stated that the Commission should establish criteria for a testing program specifying a percentage confidence level that not more than a certain percentage of noncomplying mowers will be present in the production lot. These comments assume that a test program will be "reasonable" only if the statistical parameters of the testing program are sufficient to provide a statistical assurance that it is unlikely that there are noncomplying mowers in the production lot. However, some manufacturers may achieve satisfactory assurance of compliance through extensive programs of sub-component inspection and testing, thereby requiring much lower levels of testing of assemblies than would be needed otherwise. Therefore, the Commission does not believe that it can justify the imposition of equal requirements for testing of assembled mowers on all manufacturers. Accordingly, the Commission is not establishing statistical parameters for a reasonable testing program.

The proposal, in § in 1205.33(b)(1), stated that production lots shall be limited as to the number and design of mowers "to insure that if the mowers selected for testing meet the standard, all mowers in the lot will meet the standard." Several commenters noted that, without testing each mower, it was not possible to completely assure that all mowers would pass the test of the standard. One commenter suggested that this section be amended to state that there should be a "reasonable assurance" that the mowers in the lot shall meet the standard. The Commission agrees that this language would more accurately express the intent of the section, and the final rule incorporates such language.

One commenter stated that § 1205.33(b)(2) could be clarified by inserting the word "manufacturer's" before "reasonable testing program" in order to point out that while manufacturers may, at their discretion, choose to adopt more rigorous test procedures than those mandated by the safety standard, the Commission will test only in strict accordance with the terms of the standard. The Commission agrees, and the change has been made in the final rule.

12. *Test manual.* Several commenters contended that certification regulation should be stayed until a reasonable interval after the Commission's test manual has been published. They argue that the requirements of the safety standard are ambiguous and incomplete and that manufacturers cannot make design decisions until they know what tests will be used by the Commission to determine compliance with the standard.

The Commission disagrees with the allegations that the standard's requirements are ambiguous or incomplete. The performance requirements of the standard clearly and definitely give the criteria which mowers must meet after the effective date of the standard. The purpose of the compliance test manual is to instruct the Commission's staff in how to test a mower. For example, one of the major performance requirements of the standard is the requirement that the blade stop within 3 seconds of the time the operator releases a required blade control. The particular apparatus used to measure the time required for the blade to stop is immaterial to the understanding of the requirement. However, the compliance test manual will tell the Commission staff how to use the particular apparatus that will be used by the Commission.

Therefore, there is no need for the Commission to stay the certification rule pending publication of the compliance test manual. However, if manuacturers have any questions concerning the requirements of the standard, they should contact the Commission's Directorate for Compliance and Enforcement for clarification.

13. *Definitions.*

a. *Manufactured.* One commenter stated that the Commission should define what constitutes "manufactured" within the meaning of the certification rule, since different manufacturers might interpret the term differently. The Commission agrees that this clarification is desirable, and the term is defined in § 1205.32(b) as the earliest point at which the mower is in the form in which it will be sold or offered for sale to the consumer or is in the form in which it will be shipped to a distributor or retailer. In these forms, a "manufactured" mower may still require partial assembly by the consumer or the lawn mower dealer.

b. *Production lot.* One commenter stated that the definition of "production lot" at § 1205.32(c) of the proposal (now § 1205.32(d)) failed to specify how manufacturers using multiple suppliers for the same component parts are to define the lot. The proposal specified that all mowers in a lot must be "essentially identical" in those design, construction, and material features *which relate to the ability of a mower to comply with the standard.* The commenter believes that the term "essentially identical" suggests that a lot must be terminated whenever interchangeable parts of different suppliers are used on the assembly line. They suggest the use of the term "essentially equivalent" instead. The Commission believes that this commenter has not fully comprehended the meaning of the qualification that "essentially identical" relates only to the features *which relate to the ability of a mower to comply with the standard.* There is no requirement that a production lot be automatically established when interchangeable parts from another supplier are substituted. The manufacturer would have to make the judgment in an individual case concerning whether the possible differences in parts between suppliers "relate to the ability of a mower to comply with the standard." Accordingly, with the qualification explained above, the term "essentially identical" would appear to mean the same as the term "essentially equivalent," and no change from the proposal in this regard is required.

This commenter also states that the relationship between the definition of "production lot" and the one month labeling requirement of § 1205.35(b)(5) is not clear. The certification rule does not establish, or limit manufacturers to, any specific time limit for production lots. The one month labeling requirement merely requires identification of the production period and has no inherent relation to the beginning or ending of the production lot. Thus, if a production lot covered more than one month, the mowers produced in different months would be labeled with the same lot number but different month dates. Similarly, if more than one production lot is produced in a month, they would have the same month date but would otherwise be separately identified.

14. *Other comments.* A number of comments were received that related to the effectiveness and cost of the standard itself. Since these issues are not relevant to the issue of a certification rule, they are not discussed in this notice. However, these issues were extensively discussed in the **Federal Register** notice that issued the power lawn mower safety standard.

Other Changes to the Proposal

The proposal required that the compliance label state the month and year of production or, if the production lot is based on a period of less than one month, then a more specific date which relates to the production lot was required. However, the label is also required to contain an identification of the production lot. In view of this latter requirement, there is no need for a more specific date on the label, and the requirement for a more specific date than the month of production has been deleted from the final rule. Manufacturers are free to use a more specific date in order to identify the production lot, however, if they desire.

Anticipated Impact of the Certification Rule

The Commission believes that the retail price impact of the labeling and recordkeeping requirements of the certification rule will be approximately a $0.50 increase for each mower subject to the rule. The Commission notes that the rule mandates a label and recordkeeping but allows manufacturers a great deal of flexibility as to testing and recordkeeping.

The Commission points out that while the labeling specified in the rule will require more information on lawn mowers than is currently provided on lawn mower housings, most manufacturers already have the voluntary standard seal, the model number, and a serial number on the mower housing. Considering the amount of time until the certification rule becomes effective, it should be relatively easy and inexpensive for manufacturers, or importers to incorporate complying labels on mowers.

Furthermore, certification recordkeeping expenses should not be significant, especially for firms with relatively large production runs. Substantial recordkeeping is already done in connection with the voluntary standard and manufacturers' normal quality control procedures. Since the certification rule allows manufacturers a great deal of latitude in the format of their recordkeeping, manufacturers should be able to incorporate certification recordkeeping into their present systems with little difficulty. There may be one-time-only costs associated with changing labels and forms, and possibly computer programs for those firms with such programs, to accommodate certification information, but these costs should make only a miniscule contribution to increases in the price of mowers.

As explained above, even in the absence of a certification rule, the CPSA would require manufacturers (including importers) and private labelers to issue certificates of compliance based on a test of each mower or on a reasonable testing program. Since the rule being issued at this time does not specify what should constitute a reasonable testing program, the rule does not impose any additional testing burden on manufacturers than was already imposed by statute and the existence of the mower safety standard. With the possible exception of periodic tests of the time required for the blade to stop after release of the blade control, a reasonable testing program should not impose more of a burden to manufacturers than will be involved in initially implementing the standard and in conducting normal quality control reviews. Therefore, the additional costs imposed by the requirement to certify should not result in any significant increase in the price of mowers.

In fact, since the rule exempts private labelers from the requirement to certify, the rule lessens somewhat the burden associated with certification that would otherwise be imposed by statute.

Environmental Considerations

The Commission's interim rules for carrying out its responsibilities under the National Environmental Policy Act (see 16 CFR Part 1021; 42 FR 25494) provide that product certification or labeling rules normally have no potential for affecting the environment and environmental review of such rules is, therefore, generally not required (§ 1021.5(b)(2)).

The Commission finds that lawn mower certification rule will have no significant effect on the human environment and that no environmental review is necessary.

Effective Date

The certification rule is applicable to walk-behind rotary power lawn mowers manufactured after December 31, 1981 (§ 1205.31). This date corresponds to the effective date for the performance requirements of the lawn mower standard (see Part 1205, Subpart A).

In the time since the performance requirements of the standard were issued and the certification rule was proposed, the Outdoor Power Equipment Institute has submitted 2 petitions to the Commission for changes in the standard.

On August 17, 1979, OPEI asked for an eighteen month extension in the effective date of the standard. On November 29, 1979, the Commission denied this request. On September 12, 1979, OPEI also petitioned for an amendment to the standard that would allow, as a substitute for the blade stop requirement of the standard, the use of mowers with blades that are inaccessible as determined by a probe intended to simulate the actions of a human hand. The Commission expects that it will be several months before this petition is fully evaluated. If this petition is granted, or if other changes are made to the standard, the Commission will consider at that time whether any change in the effective date of this certification rule is appropriate.

Conclusion

Having considered the comments and other information relevant to the certification requirements set forth below, the Commission concludes that the requirements are needed, reasonable, and not unduly burdensome. Therefore, pursuant to sections 14, 16, and 27(e) of the CPSA (15 U.S.C. 2063, 2065, 2076), the Commission amends Title 16, Chapter II, Subchapter B, of the Code of Federal Regulations by adding a new Subpart B to Part 1205, reading as follows:

PART 1205—SAFETY STANDARD FOR WALK-BEHIND LAWN MOWERS

* * * * *

Subpart B—Certification

Sec.

Authority: Secs. 14, 16, 27(e); 86 Stat. 1220, 1222, 1228; 15 U.S.C. 2063, 2065, 2076)

Subpart B—Certification

§ 1205.30 Purpose, scope, and application.

(a) *Purpose.* Section 14(a) of the Consumer Product Safety Act, 15 U.S.C. 2063(a), requires every manufacturer (including importer) and private labeler of a product which is subject to a consumer product safety standard to issue a certificate that the product conforms to the applicable standard, and to base that certificate either on a test of each product or on a "reasonable testing program." The purpose of this Subpart B of Part 1205 is to establish requirements that manufacturers and importers of walk-behind rotary power lawn mowers subject to the Safety Standard for Walk-Behind Power Lawn Mowers (16 CFR Part 1205, Subpart A), shall issue certificates of compliance in the form of specified labeling and shall keep records of the testing program on which the certificates are based.

(b) *Scope and application.* (1) The provisions of this rule apply to all rotary walk-behind power lawn mowers which are subject to the requirements of the Safety Standard for Walk-Behind Power Lawn Mowers. This rule does not apply to reel-type mowers, which are subject only to the labeling requirements of the standard.

(2) As authorized by section 14(a)(2) of the act, the Commission exempts manufacturers who manufacture or import only component parts, and private labelers, from the requirement to issue certificates. (Private labelers who are also importers must still certify.)

§ 1205.31 Effective date.

Any walk-behind rotary power mower manufactured after December 31, 1981, must meet the standard and must be certified as complying with the standard in accordance with this rule.

§ 1205.32 Definitions.

In addition to the definitions set forth in section 3 of the act (15 U.S.C. 2052) and in § 1205.3 of the standard, the following definitions shall apply to this Subpart B of Part 1205:

(a) "Manufacturer" means any person or firm that manufactures or imports power lawn mowers subject to this standard, and includes those that assemble power lawn mowers from parts manufactured by other firms.

(b) "Manufactured" means the earliest point at which the mower is in the form in which it will be sold or offered for sale to the consumer or is in the form in which it will be shipped to a distributor or retailer. In these forms, a "manufactured" mower may still require partial assembly by the consumer or the lawn mower dealer.

(c) "Private labeler" means an owner of a brand or trademark which is used on a power lawn mower subject to the standard and which is not the brand or trademark of the manufacturer of the mower, provided the owner of the brand or trademark has caused or authorized the mower to be so labeled and the brand or trademark of the manufacturer of such mower does not appear on the label.

(d) "Production lot" means a quantity of mowers from which certain mowers are selected for testing prior to certifying the lot. All mowers in a lot must be essentially identical in those design, construction, and material features which relate to the ability of a mower to comply with the standard.

(e) "Reasonable testing program" means any test or serlles of tests which are identical or equivalent to, or more stringent than, the tests defined in the standard and which are performed on one or more mowers of the production lot for the purpose of determining whether there is reasonable assurance that the mowers in that lot comply with the requirements of the standard.

§ 1205.33 Certification testing.

(a) *General.* Manufacturers and importers shall either test each individual rotary walk-behind power lawn mower (or have it tested) or shall rely upon a reasonable testing program to demonstrate compliance with the requirements of the standard.

(b) *Reasonable testing program.* (1) a reasonable testing program for rotary walk-behind power mowers is one that provides reasonable assurance that the mowers comply with the standard. Manufacturers and importers may define their own reasonable testing programs. Such reasonable testing programs may, at the option of manufacturers and importers, be conducted by an independent third party qualified to perform such testing programs.

(2) To conduct a reasonable testing program, the mowers shall be divided into production lots. Sample mowers from each production lot shall be tested in accordance with the reasonable testing program so that there is a reasonable assurance that if the mowers selected for testing meet the standard, all mowers in the lot will meet the standard. Where there is a change in parts, suppliers of parts, or production methods that could affect the ability of the mower to comply with the requirements of the standard, the manufacturer should establish a new production lot for testing.

(3) The Commission will test for compliance with the standard by using the test procedures contained in the standard. However, a manufacturer's reasonable testing program may include either tests prescribed in the standard or any other reasonable test procedures. (For example, in the shield strength test (§ 1205.4), the manufacturer might choose to use a force higher than the 50 lb force specified in the standard.)

(4) If the reasonable testing program shows that a mower does not comply with one or more requirements of the standard, no mower in the production lot can be certified as complying until the noncomplying mowers in the lot have been identified and destroyed or altered by repair, redesign, or use of a different material or components to the extent necessary to make them conform to the standard. The sale or offering for sale of mowers that do not comply with the standard is a prohibited act and a violation of section 19(a)(1) of the CPSA, regardless of whether the mower has been validly certified.

§ 1205.34 Recordkeeping requirements.

(a) *General.* Every person issuing certificates of compliance for walk-behind rotary power lawn mowers subject to the standard shall maintain written records which show that the certificates are based on a test of each mower or on a reasonable testing program. The records shall be maintained for a period of at least 3 years from the date of certification of each mower or each production lot. These records shall be available to any designated officer or employee of the Commission upon request in accordance with section 16(b) of the act (15 U.S.C. 2065(b)).

(b) *Content of records.* Records shall identify the mower tested and the production lot and describe the tests the mowers have been subjected to and the results of the tests.

(c) *Format for records.* The records required to be maintained by this section may be in any appropriate form or format that clearly provides the required information

§ 1205.35 Product certification and labeling by manufacturers.

(a) *Form of permanent label of certification.* Manufacturers (including importers) shall issue certificates of compliance for walk-behind rotary power lawn mowers manufactured after the effective date of the mower standard in the form of a label which can reasonably be expected to remain on the mower during the period the mower is capable of being used. Such labeling shall be deemed to be a "certificate" of compliance as that term is used in section 14 of the act. (15 U.S.C. 2063.)

(b) *Contents of certification label.* The certification labels required by this section shall clearly and legibly contain the following information:

(1) The statement "Meets CPSC blade safety requirements."

(2) An identification of the production lot.

(3) The name of the person or firm issuing the certificate.

(4) The location where the product was principally assembled.

(5) The month and year the product was manufactured.

(c) *Coding.* Except for the requirements of paragraphs (b)(1) and (b)(3) of this section, all of the information required by § 1205.35 may be in code, provided the person or firm issuing the certificate maintains a written record of the meaning of each symbol used in the code that will be made available to the distributor, retailer, consumer, and the Commission upon request. If a mower is manufactured for sale by a private labeler, and if the name of the private labeler is also on the certification label, the name of the manufacturer or importer issuing the certificate may also be in such a code.

(d) *Placement of label.* The label required by this section must be visible and legible to the ultimate purchaser of the lawn mower prior to purchase. For mowers manufactured before January 1, 1984, where the label is not visible to the consumer at the time of sale because of packaging or marketing practices, an additional label or notice, which may be temporary, stating "Meets CPSC blade safety requriements" shall also appear on the container, or, if the container is not so visible, the promotional material, used in connection with the sale of the mowers.

§ 1205.36 Product certification and labeling by importers.

(a) *General.* The importer of any rotary walk-behind power lawn mower subject to the standard must issue the certificate of compliance requried by section 14(a) of the Act and § 1205.35 of this regulation. If testing of each mower, or a reasonable testing program, meeting the requirements of this Subpart B of Part 1205 has been performed by or for the foreign manufacturer of the product, the importer may rely in good faith on such tests to support the certificate of compliance provided the importer is a resident of the United States or has a resident agent in the United States and the records of such tests required by § 1205.34 of this Part are maintained in the United States.

(b) *Responsibility of importer.* If the importer relies on tests by the foreign manufacturer to support the certificate of compliance, the importer bears the responsibility for examining the records supplied by the manufacturer to determine that the records of such tests appear to comply with § 1205.34 of this Part.

Dated: December 3, 1979.

Sadye E. Dunn, Secretary,

Consumer Product Safety Commission.

[FR. Doc. 79-37541 Filed 12-5-79; 8:45 am]

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Thursday
December 6, 1979

Part V

Department of Energy

Leasing; Proposed Rulemaking and Public Hearing Regarding a Fixed Net Profit Share Bidding System for Outer Continental Shelf Oil and Gas Leases and Accounting Procedures for Determining Net Profit Share Payments

DEPARTMENT OF ENERGY

10 CFR Parts 376, and 390

Leasing; Proposed Rulemaking and Public Hearing Regarding a Fixed Net Profit Share Bidding System for Outer Continental Shelf Oil and Gas Leases and Accounting Procedures for Determining Net Profit Share Payments

AGENCY: Department of Energy.

ACTION: Proposed Rule.

SUMMARY: These proposed regulations establish a "fixed net profit share" bidding system for use in lease sales of Outer Continental Shelf oil and gas tracts. The proposed bidding system uses cash bonus as the bid variable and requires net profit share payments at a rate that is constant for the duration of the lease. There is also a fixed annual acreage rental payment. These regulations also establish accounting procedures that oil and gas firms are required to use in order to calculate net profit share payments due the United States for the right to produce oil and gas from Outer Continental Shelf leases issued under this bidding system. This proposal implements rulemaking responsibilities under section 8(a) of the Outer Continental Shelf Lands Act, as amended by Pub. L. 95-372, that were transferred to the Department of Energy under sections 302(b) and 303(c) of the Department of Energy Organization Act.

DATES: Written comments are due by March 7, 1980. Hearings will be held in Houston on February 26, 1980; in San Francisco on February 28, 1980; and in Washington, D.C. on February 20, 1980. All hearings will begin at 9:30 a.m. local time. Requests to speak at any hearing must be received by February 8, 1980.

ADDRESSES:

A. Hearing Locations

1. Houston: [To be published in **Federal Register** at a later date].

2. San Francisco: [To be published in **Federal Register** at a later date].

3. Washington, D.C.: Room 2105, 2000 "M" Street, N.W., Washington, D.C.

B. Requests To Speak

Requests to speak should be addressed to the appropriate office:

1. Houston Hearing: U.S. Department of Energy, 2626 Mocking Drive, Dallas, Texas 75235, Attn: Mac L. Lacefield, (214) 729-7745.

2. San Francisco Hearing: U.S. Department of Energy, 111 Pine, San Francisco, California 94111, Attn: Terry Osborne, (415) 556-4953.

3. Washington Hearing (One hundred copies of statement for this hearing are due by February 13, 1979, at the following address): Office of Hearings Management, Economic Regulatory Administration, Room 2313, Docket No. LPD-79-06, 2000 "M" Street, N.W., Washington, D.C. 20461.

4. One copy of each request to speak for each hearing should also be forwarded to: Leasing Policy Development Office, U.S. Department of Energy, 1200 Pennsylvania Avenue, N.W., Room 2313, Washington, D.C. 20461, Attn: Net Profit Share Hearing (Location of Hearing).

In the event that it becomes necessary for us to cancel a hearing, we will make every effort to publish advance notice in the **Federal Register** of such cancellation. Moreover, we will give actual notice to all persons scheduled to testify at the hearings. However, it is not possible to give actual notice of cancellations or changes to persons not identified to us as participants. Accordingly, persons desiring to attend a hearing are advised to contact the appropriate DOE office on the last working day preceding the date of the hearing to confirm that it will be held as scheduled.

C. Written Comments

All written comments (identify the outside envelope and the document with the designation "OCS Net Profit Share Leasing, Docket LPD-79-06") should be addressed to: Office of Hearings Management, Economic Regulatory Administration, Room 2313, Docket LPD-79-06, 2000 "M" Street, N.W., Washington, D.C. 20461.

FOR FURTHER INFORMATION CONTACT:

Robert C. Gillette (Office of Public Hearings Management), Economic Regulatory Administration, 2000 "M" Street, N.W., Room 2214C, Washington, D.C. 20461, (202) 254-5201.

Stuart W. Edwards (Leasing Policy Development Office), U.S. Department of Energy, 1200 Pennsylvania Avenue, N.W., Room 2313, Washington, D.C. 20461, (202) 633-9035.

Michael T. Skinker (Office of General Counsel), U.S. Department of Energy, 1000 Independence Avenue, SW., Room 5E064, Forrestal Building, Washington, D.C. 20585, (202) 252-2904.

Fred Appel, Public Affairs, Resource Applications, U.S. Department of Energy, 1200 Pennsylvania Avenue, NW., Room 3307, Washington, D.C. 20461, (202) 633-9418.

SUPPLEMENTARY INFORMATION:

I. Introduction

Sections 302 and 303 of the Department of Energy Organization Act (DOE Act, Pub. L. 95-91, 91 Stat. 578-580 (42 U.S.C. 7152, 7153)) transferred to the Secretary of Energy certain authorities previously held by the Secretary of the Interior under the Outer Continental Shelf Lands Act (OCSIA), the Mineral Lands Leasing Act, the Mineral Leasing Act for Acquired Lands, the Geothermal Steam Act of 1970, and the Energy Policy and Conservation Act. Specifically, with respect to Federal leases issued under these statues, § 302(b) of the DOE Act authorizes the

Secretary of Energy to promulgate regulations which relate to the: (1) Fostering of competition for Federal leases (including, but not limited to, prohibition on bidding for development rights by certain types of joint ventures); (2) implementation of alternative bidding systems authorized for the award of Federal leases; (3) establishment of diligence requirements for operations conducted on Federal leases (including, but not limited to, procedures relating to the granting or ordering by the Secretary of the Interior of suspension of operations or production as they relate to such requirements); (4) setting rates of production for Federal leases; and (5) specifying the procedures, terms, and conditions for the acquistion and disposition of Federal royalty interests taken in kind.

In addition, section 320(c) of the DOE Act grants the Secretary of Energy the authority to establish rates of production for Federal leases, and section 303(c)(1) permits the Secretary to disapprove any term of condition of a Federal lease that relates to the Department of Energy's (DOE) authority to promulgate regulations under section 302(b).

As required by section 303(b) of the DOE Act, the Secretary of Interior was consulted during the preparation of these proposed regulations and offered not less than thirty (30) days to comment formally on them. The Secretary of the Interior provided comments which were considered in drafing these regulations prior to today's publication.

II. Outer Continental Shelf Leasing—General

According to a predetermined schedule, the Department of Interior (DOI) periodically offers for sale oil and gas leases for tracts on the Outer Continental Shelf (OCS). This event is the culmination of a series of DOI actions, including nominations for the inclusion of OCS tracts in a sale, geological/geophysical analysis, preparation and publication of an environmental impact statement (EIS), public hearings, coordination with State officials and members of the public, coordination with Federal agencies, and the publication of a notice of OCS lease sale in the **Federal Register**. The bidding system or systems to be utilized by DOI in each OCS lease sale will be chosen from those authorized by the Outer Continental Shelf Lands Act, (OCSLA, Act of August 7, 1953, Ch. 345, 67 Stat. 462 (43 U.S.C. 1331 *et. seq.*), as amended by Pub. L. 95-372), and prescribed by regulation.

Bidders submit bids on the basis of the bidding system that is applicable to a particular tract as specified in the sale notice. The bidding system also states the method by which the successful bidder pays the United States for the lease. For example, under the proposed bidding system employing a fixed net profit share with a variable cash bonus bid and a fixed annual acreage rental, the successful bidder pays the United States a one-time cash bonus, a yearly cash rental and a fixed percentage (not less than 30 percent) of net profits, based on the revenue received from the production and sale of oil and gas minus the costs of production. After the bids submitted at the publicly held OCS lease sale are opened and evaluated, leases are awarded to successful bidders on a tract-by-tract basis.

III. The Proposed Regulation

A. *Authority.* The Secretary of Energy is specifically authorized to promulgate regulations under the OCSLA as they relate to the implementation of alternative bidding systems authorized for the award of Federal leases (section 302(b)(2) of the DOE Act) and to disapprove any term or condition of a Federal OCS lease which relates to DOE's authority to promulgate regulations under section 302(b) (section 303(c)(1) of the DOE Act).

B. *Purpose and Scope.* The purpose of this proposed regulation is to establish the fixed net profit share bidding system [1] for the award of Federal OCS leases and to prescribe accounting procedures required for the calculation of net profit share (NPS) payments due the United States for the production of oil and gas from leases issued under this bidding system.

Today's proposal amends the proposed regulations in 10 CFR Part 376 regarding bidding systems for OCS oil and gas leasing (44 FR 46236, August 6, 1979) by establishing the additional fixed net profit share bidding system and adds a new Part 390 containing the necessary accounting procedures to implement this new bidding system.

Section 205 of the Outer Continental Shelf Lands Act Amendments of 1978 (amendments, Pub. L. 95-372, 92 Stat. 629) authorizes the establishment of the fixed net profit share bidding system for the award of OCS oil and gas leases and requires the Secretary of Energy to establish rules to govern the calculation of net profits. The proposed regulation, therefore, includes accounting procedures designed to permit lessees to calculate net profits in a uniform manner. In addition, the proposed regulation establishes procedures for auditing by the Federal Government of lessees' accounting practices and net profit calculations and prescribes the process whereby a lessee may challenge any adjustment to its calculations resulting from such auditing.

The fixed net profit share bidding system satisfies a primary intention of Congress by reducing reliance on large front-end cash bonuses as the means for obtaining a fair price for the public's property. Congress' perception was that large cash bonus payments may inhibit competition for OCS leases by preventing smaller, independent firms from participating in OCS development. The fixed net profit share bidding system is designed to shift government return away from initial cash bonuses into deferred payments, which, in the case of this bidding system, are based on net profits from the actual production of oil and gas. The proposed bidding system should make it possible for smaller firms to compete more effectively for OCS leases and to free funds for exploration that previously have been tied up in cash bonuses.

C. *Impact of Proposal.* The primary impact of the fixed net profit share bidding system proposed by this regulation should be a reduction of cash bonus bids. The regulation is also expected to maximize production of oil and gas from the OCS, foster the development of marginal oil and gas fields, and increase the total revenue to the public for its property. The summary of the Regulatory Analysis supporting this regulation (section VIII of this preamble) explains how the proposed fixed net profit share bidding system promotes these objectives.

Since the administration of this regulation is the responsibility of the U.S. Geological Survey (USGS) within DOI, utilization of this bidding system will result in greater administrative responsibilities for the USGS, related to determinations on the allowability of certain costs, concern for inventory, and performance of periodic audits. USGS regulations are not superseded by this action but must be followed in conjunction with this regulation, as appropriate.

D. *Basis for Proposed Fixed Net Profit Share Bidding System.* Royalty based bidding systems require, in addition to the royalty rate, only the value or amount of lease production to determine royalty payments due the United States. However, a net profit share bidding system requires accounting procedures for the identification and measurement

[1] For purposes of this preamble the term "fixed net profit share bidding system" means any bidding system with a cash bonus bid, a fixed share of the net profit, and a fixed annual acreage rental, as proposed in section 376.110(a)(4).

of costs, and a system for charging costs against production revenue to determine net profits. This requirement makes the fixed net profit share bidding system considerably more complex than the bidding systems previously used for OCS lease sales.

Several systems for accumulating and charging costs against revenues were analyzed for their economic impacts by simulation with a resource policy evaluation model. The description of the model, assumptions made, systems studied, and discussion of the results is contained in the summary of the Regulatory Analysis (section VIII of this preamble). The results of these simulations led DOE to propose a fixed net profit share bidding system which utilizes the "fixed capital recovery system."

The fixed capital recovery system is a simple approach for (a) accumulating costs (both capital and non-capital) incurred during the exploration and development phase of lease operations, and then (b) recovering these costs from production revenues in a manner that provides a reasonable return on the lessee's investment. With the fixed capital recovery system, which forms the basis for calculating net profits as proposed by these regulations, costs are not segregated as to whether they constitute capital or non-capital expenses. Rather, costs are accumulated in a preproduction or a production account depending on whether they are incurred prior to, or after, the initiation of production, respectively.

The key feature of the fixed capital recovery system is the mechanism for capital recovery, including a return on investment. The balance in the preproduction account (expenses incurred during the preproduction period less any credits received) is multiplied by a number known as the "recovery factor." The product of this calculation becomes an amount designated as the "allowance for capital recovery." This allowance operates to defer net profit share payments until the amount of the allowance has been charged against production revenues.

The recovery factor is a number equal to or greater than 1.0. The recovery factor and the profit share rate are unique to each profit share lease and will be determined prior to each lease sale. They are selected to provide an adequate return on investment for overall lease operations, given the cost and resource expectations for a particular tract. The recovery factor and the profit share rate will be specified in the Notice of Lease Sale published in the **Federal Register** prior to an OCS lease sale.

The fixed capital recovery procedure is itself only part of the overall net profit share bidding system. It dictates the basic scheme for aggregating costs and manipulating aggregate costs and production revenues to determine net profits. The other part of the system is the set of accounting procedures for identifying, measuring, and allocating individual costs to the net profit share accounts.

The search for the other component of the system independently led DOE to the accounting procedure for joint offshore operations developed by the Council of Petroleum Accountants Societies of North America (COPAS). Unless otherwise noted the COPAS procedure used is Bulletin 15, "Accounting Procedure—Offshore Joint Operation," October 1977.

The COPAS procedure is an appropriate basis for the cost identification portion of the accounting procedures because: (1) The net profit share lease relationship is analogous to a joint working interest agreement between private parties (*i.e.*, an agreement that shares at a fixed rate all costs and revenue), (2) COPAS is only a procedure for identifying, measuring, and allocating costs for direct billing of joint interest partners; hence, it is not complicated by rules for capitalization or other guidelines for disposition of costs that would be contained in a complete financial accounting procedure, and (3) the COPAS procedure, or minor variations thereof, are in widespread use, thus use in a Government regulation would minimize accounting burden and interpretation problems for the industry.

The modifications to the COPAS procedure that were necessary to adapt it to the purpose of this regulation are discussed in section IV. B of this preamble.

E. *Description of Proposed Accounting Procedures—Part 390.* 1. *Definitions.* Most of the definitions appearing in § 390.002 are taken from two sources: The COPAS Procedure, and the Cost Accounting Standards Board Regulations (4 CFR Part 400), with necessary modifications to adapt them to this regulation. The terms "allowance for capital recovery", "net profit share base", "net profit share payment", "net profit share rate", "NPSL", "NPSL project area", "NPSL property", "NPSL operations", "NPSL tract", "outside party", "preproduction period", and "production period" are new definitions.

Definition of other terms used in Part 390 may be found in proposed Part 375 of Title 10, Code of Federal Regulations (10 CFR 375.004), which contains some general provisions that will be applicable to all of DOE's mineral leasing regulations (44 FR 45900, August 3, 1979).

2. *Accounts.* Proposed § 390.010 establishes five controlling accounts for net profit share lease (NPSL) operations: Preproduction account, production account, production revenue account, net profit share payment account, and lessee's net profit share account. The preproduction and production accounts are expense accounts. The production revenue account is, as its name implies, the account in which oil and gas production revenue entries are made. The net profit share payment account and the lessee's net profit share account are accounts for recording net profit share payments to the United States and net profits retained by the lessee, respectively.

All costs permitted by §§ 390.011 (schedule of allowable direct and joint costs and credits) and 390.012 (overhead allowance will be allocated to either the preproduction or production accounts, depending on whether they are incurred during the preproduction or the production period. Direct costs (costs that are traceable to and incurred exclusively for the benefit of NPSL operations) and joint costs (costs that are traceable to and benefit NPSL and non-NPSL operations) are allocated between the preproduction and production periods on the basis of whether they were incurred before or after the beginning of the production of oil and gas from the lease. Allowable direct and joint costs are limited by § 390.011 to the following 14 categories, which are based on the COPAS procedures: Lease rental to the United States for the tract; labor expenses, including fringe benefits and certain personal expenses; the costs of material, transportation, contracted services, insurance, communications, audit, damage and losses to NPSL property; certain legal expenses; use charges for equipment and facilities furnished by the lessee; taxes (except income taxes); the cost of complying with environmental regulations; and miscellaneous costs approved by the USGS Supervisor.

Credits are allocated to either the preproduction or production accounts in the same manner as direct and joint costs. That is, they are allocated on the basis of when they are incurred (before or after the start of production). Revenue is credited to the production account as explained in section III E.3 of this preamble.

Generally, overhead is a residual category for costs that are difficult to associate or attribute to a particular aspect of lease operations. Examples of overhead costs are general and administrative expenses, office services, and research and development. Rather than allow charges for overhead expenses, these proposed regulations provide a charge equal to 4 percent of allowable direct and joint costs (exclusive of specific costs identified in § 390.012(c)) as an allowance for overhead costs occurring in the preproduction period. Similarly, an allowance equal to 10 percent of allowable direct and joint costs is proposed for the production period. The capital recovery factor is not applied to the overhead allowance.

3. *Determination of net profit share payments.* This section briefly describes the proposed net profit share accounting process and the determination of net profit share payments.

Direct and joint costs and credits incurred during the preproduction period are accumulated in the preproduction account. At the end of the preproduction period, the allowance for capital recovery is calculated and entered in the production period account. The preproduction period overhead allowance is also calculated and entered in the production period account.

During the production period, direct and joint costs and credits incurred or received are entered individually in the production period account. Examples of credits that may be entered into the production account include salvage credits, income from equipment rental, income from the sale of geological information, rebates, and refunds. Credits reflecting the value of production are entered in the production revenue account.

At the end of each month during the production period, the allowance for production period overhead is calculated and entered in the production account. Then, the balance in the production revenue account is cleared and credited to the production account.

The balance of the production account, that is, the difference between the costs and credits (including production revenue), is computed monthly. If the end of the month balance is positive (*i.e.*, a credit balance indicating that revenues exceed accumulated costs and allowance for capital recovery), the balance is the net profit share base which is distributed between the lessee and the United States according to the profit share rate. If the production account balance is negative (*i.e.*, a debit balance indicating that accumulated costs and allowance for capital recovery exceed revenues), the balance is carried forward to the next month.

The profit share payment is the United States' share of the profit share base and is calculated by multiplying the profit share base times the profit share rate.

4. *Administration.* Sections 390.030 through 390.034 propose the following procedural requirements necessary for the administration of fixed net profit share leases by the USGS: The keeping of records of production revenue, materiel inventory, costs, and credits; filing monthly reports of production revenue and costs; submitting monthly payments; taking an annual inventory of controllable materiel; provisions for an audit of records and accounts at least every two years; a provision for the USGS Supervisor to recalculate the profit share payment based on a determination that an expense was improperly claimed or classified or that another type of error was made; and a provision for the lessee to appeal any such determination made by the USGS Supervisor.

IV. Major Issues

A. *Selection of the Fixed Capital Recovery System.* Three different types of systems were considered in the course of developing the fixed net profit share bidding system regulations proposed in Part 390. The three systems differ in the mechanism each provides for the recovery of capital invested to develop a lease. An evaluation of the relative performance of these systems (fixed capital recovery, annuity capital recovery, and investment account systems) was made by DOE with a computer-based resource policy evaluation model. Based on the results of this analysis, the fixed capital recovery system is being proposed. Important conclusions of this analysis are summarized in section VIII of this preamble and specific comments are requested in section VI.A of this preamble.

B. *Adjustments to COPAS Accounting Procedures.* 1. *Allowable direct and joint costs.* The cost categories established by COPAS for direct charges to joint operations are generally adopted within the framework of the proposed regulations. However, various changes have been made to the COPAS approach. These changes are discussed below:

a. *Royalties.* The proposed fixed net profit share bidding system does not require royalty payments to the United States. Therefore, the proposed regulation deletes royalties from the schedule of allowable costs.

b. *Labor.* The guidelines in § 390.011(b) of the proposed regulation for charging labor are patterned after COPAS Bulletin No. 14, "Accounting Procedure—Arctic Operations," rather than COPAS Bulletin No. 15, "Accounting Procedure—Offshore Joint Operations." The Arctic Operations procedures are more liberal than the procedures for offshore operations in that they permit direct charging of field employees within the project area rather than on just the tract. They also permit the direct charging of technical personnel at headquarters or district offices. The Arctic Operation procedures were chosen because their more liberal provisions are better suited to the OCS with its attendant logistics problems than the offshore guidelines, which appear to be designed primarily for near-shore operations.

i. *Salaries and wages.* The proposed regulations adopt the COPAS definition and interpretation of "field employees," "first level supervisors," and "technical employees." Salaries and wages of field employees, first level supervisors, and technical employees are allowable costs, provided these personnel are employed in the NPSL project area and are engaged in NPSL operations. The NPSL project area includes the NPSL tract and shore based support and production facilities that directly support NPSL operations. When personnel work in the NPSL project area and are engaged in activities that benefit several tracts or separate activities in addition to the NPSL tract (e.g., a support facility that services several tracts), the charge to NPSL accounts must be made on the basis of time spent on activities that directly benefit NPSL operations.

The proposed regulations establish, by design, the criterion that a charge for salaries and wages is allowed for qualified personnel only if they are employed and "engaged in activities within the NPSL project area." There is only one exception to the requirement that personnel must physically work at a location within the NPSL project area. A charge is allowed for salaries and wages of technical employees assigned to a technical branch of the lessee's organization and who are engaged full time in activities that directly support NPSL operations or specific problems related to the NPSL tract. However, no charge is allowed for salaries and wages of technical employees who, while working on some aspect of NPSL operations not within the NPSL project area, are also assigned or perform collateral duties unrelated to NPSL operations.

This exception regarding technical workers is intended to relax somewhat the requirement that personnel must work within the project area. However, the farther an individual is removed from the NPSL project area, the more difficult it is to establish the extent to which he is involved with NPSL operations. The requirements in the proposed regulations are dictated by the need to establish criteria that can be easily documented and verified at audit. To take advantage of this exception, it is expected that lessees will segregate within the technical branches of their organizations those technical employees working on NPSL operations or related technical problems, and that lessees will not assign these personnel duties unrelated to NPSL operations or problems.

No charge is permitted for salaries and wages of personnel not falling within the definitions of field employees, first level supervisors, or technical employees. The overhead allowances are intended to provide compensation for personnel involved in NPSL operations or support but who do not fall within these categories.

ii. *Personal expenses.* Limitations on employee relocation costs have been proposed in § 390.013(g) that are not contained in COPAS. Relocation costs that may not be claimed are: loss on the sale of a home, costs of acquiring a home in the new location, payments of employee income taxes incident to reimbursed relocation costs, and any relocation cost in connection with an employee move that is for the primary benefit of the lessee's other operations. Closing costs on the employee's former residence and continuing costs of ownership of the former residence are permitted, except that the amount claimed as an expense may not exceed 8 percent of the sales price of the property. These limitations are in place of negotiated terms and conditions recommended by COPAS.

c. *Materiel.* Through reference to § 390.015, DOE has required in § 390.011(c) that single items of equipment with an original cost of $100,000 or more that are acquired or disposed of by the lessee for NPSL operations be priced on a current market basis with approval by the Supervisor.

d. *Transportation.* The proposed regulation in § 390.011(d) would be more restrictive than COPAS with respect to allowable charges for materiel movements to and from the NPSL project area. COPAS limits such costs only with respect to movements between the NPSL project area and storage facilities owned by or under the control of the lessee. This regulation would extend the COPAS limitation to cover all materiel movements between the NPSL project area and any storage facility, regardless of its location or connection with the lessee. The ceiling on allowable materiel transportation costs would be the same ones that COPAS applies to materiel movements between the joint property and the operator's storage facilities. NPSL operations would not be charged for transportation costs greater than the distance between the NPSL project area and the nearest supply source where like materiel is normally available.

e. *Contract services.* As with salaries and wages, the COPAS requirement that contract services must be performed within the NPSL project area is relaxed. A charge is permitted for contract services performed away from the NPSL project area, provided that there is compliance with specific requirements in the regulations. These requirements are designed to isolate and verify that charges for services performed under contract to the lessee exclusively benefit NPSL operations.

f. *Equipment and facilities furnished by lessee.* Both COPAS and the proposed regulation in § 390.011(g) contain detailed provisions regarding the charging of lessee-owned equipment and facilities, and both require such items to be rented to the jointed operations. As an element of the rental rate, COPAS allows the estimate cost of platform dismantlement. The proposed regulation, however, would not include this element of the rental rate as an allowable cost. DOE believes that this charge is difficult to estimate accurately, and therefore, may result in interim debits that do not reflect the actual costs of removal. It is anticipated that potential bidders will estimate their expected cost of platform dismantlement and incorporate this estimate in calculations that determine cash bonus bids.

Unlike COPAS, the proposed regulation explicitly permits the charging of lease-to-shore pipelines and shore-base production facilities to NPSL operations on a rental or use charge basis.

g. *Taxes.* COPAS permits the operator to charge the joint account for all taxes paid by him for the benefit of the joint operations. The proposed regulations in § 390.011(i), however, expressly exclude income taxes and all other taxes based upon income from being charged to NPSL operations. This approach is required because the Government allows net profit share payments to be deducted from gross income for Federal income tax purposes. To permit income and related taxes to be allocated to NPSL operations would confer a double-benefit on lessees and result in the reduction of the public's return for its property.

h. *Audit.* In the event that the Government exercises its option under § 390.011(m) of the proposed regulation and requires the lessee to commission an independent audit, the cost of that audit may be charged to NPSL operations. The costs of audits of joint operations conducted under COPAS are borne by the partners since each partner contributes one or more staff auditors to the audit team.

i. *Other expenditures.* COPAS authorizes the operator to charge any expenditure, not listed as an allowable cost, that is incurred in the necessary and proper conduct of the joint operations. The proposed reulation in § 390.11(n), however, requires the prior approval of the USGS Supervisor before like charges to NPSL operations may be made.

2. *Unallowable costs.* Section 390.013 of the proposed regulation notifies lessees that certain costs are expressly disallowed as direct or joint costs and would not be approved by the USGS Supervisor. These include the cash bonus; interest on any loans obtained to finance NPSL operations, equipment, construction, etc.; the cost of taking inventory; research and development costs; certain employee relocation costs; the cost of adminstering employee benefit plans; certain expenses; the cost of construction and equipping shore-base facilities; and lease abandonment costs.

The cash bonus is not an allowable cost. Excluding the cash bonus as a charge tends to reduce the magnitude of initial cash bonuses—a desired effect—without distorting production economics.

Interest is not an allowable cost because the fixed capital recovery system proposed by these regulations is designed to provide a return on total capital investment, regardless of whether the capital is borrowed or equity.

Other costs (listed below) are not allowed because they are either inappropriate, not customarily charged, or because it is extremely difficult to determine the proportion that directly benefits NPSL operations: Construction of shore-based facilities and real property (note that shore-based facilities are, in effect, rented to NPSL operations); certain employee relocation costs (loss on the sale of a home; acquisition costs for a home in a new location such as brokerage fees, appraisal fees, etc.); payments for employee income taxes incident to reimbursed relocation costs; relocation costs for moving an employee when the move primarily benefits non-NPSL operations; and fines or penalties levied by a Federal agency.

The cost of taking inventory, research and development costs, the cost of a legal staff, and administration costs for employer benefit plans are covered as overhead. Abandonment costs are not allowed for previously stated reasons.

3. *Overhead.* COPAS recognizes three categories of overhead costs: (1) Drilling and producing operations; (2) major construction; and (3) catastrophe. Traditional (i.e., general and administrative) overhead charges appear to be accommodated in category (1). Major construction overhead (2) is designed to compensate the operator for overhead costs associated with the installation or expansion of fixed assets required to develop the joint property or with dismantling for abandonment. The catastrophe category (3) compensates an operator for costs incurred for dealing with single-event natural or environmental disasters, and is calculated using a method similar to that which applies to major construction overhead. Under the COPAS procedures, the parties negotiate the fixed rate that will apply to each category, and these rates are specified in the joint operating agreement.

However, for the Government to undertake a similar procedure (i.e., negotiate overhead rates for each net profit share lease) would be both administratively burdensome and excessively time-consuming. Thus, in keeping with the proposed regulatory scheme of differentiating between preproduction and production costs, these regulations provide a preproduction period overhead allowance of 4 percent of allowable direct and joint costs (which compensates for overhead incurred during the capital intensive development phase of offshore operations) and a production period overhead allowance of 10 percent.

C. *Other Issues.* 1. Should the proposed regulations permit the cost of cleanup of oil spills to be charged to NPSL accounts?

Concern regarding this issue appeared to center on the propriety of the U.S. sharing in the cost of ameliorating environmental damage to U.S. property caused by operation of the lessee, and on the effect this cost sharing would have on the resolve of the operator to prevent oil spills. Nevertheless, DOE believes that to some extent, even with the exercise of all reasonable precautions, seepage and spillage may occur, and thus, their amelioration represents a normal cost of doing business which should be chargeable to NPSL operations. DOE does not believe that the sharing of these costs by the U.S. will weaken the incentive to prevent accidental contamination. Furthermore, DOE believes that consideration of the risks of accidental contamination will result in potential bidders discounting their bids as a means of offsetting these potential costs if they are not allowed to be charged to NPSL operations.

2. The proposed regulation should provide specific criteria for "proper materiel control, inventory, and purchasing" (§ 390.032(a)).

DOE believes that further guidance can not be provided by regulation, since individual situations such as distance from the supply base or store will determine what is reasonable. Thus, the USGS area supervisor will be called upon to interpret and implement these guidelines on an area or case-by-case basis.

3. The proposed regulations permit new materiel required or consumed by NPSL operations to be charged at current market value rather than charged at original cost or the lesser of original cost or current market value (§ 390.015). This is consistent with the requirement, in § 390.032, that the lessee can only maintain an inventory (the cost of which has been charged to NPSL operations) that is essential to support efficient and economical operations.

Taken together, these actions establish the condition that the cost of materiel is charged to NPSL accounts only when used to support NPSL operations, allowing some inventory flexibility to facilitate efficient operations. Thus, a charge is not necessarily made when the materiel is originally purchased. The regulations do not allow warehousing costs to be charged to NPSL operations except as is required to maintain the inventory that supports efficient and economical operations.

The intent of these provisions in the regulations is to avoid, to the extent possible, the problems of inventory control and audit. Clearly, the level of inventory required for efficient and economical operations depends on conditions encountered in each OCS region. Higher levels of inventory will be required to support operations in frontier Alaskan areas than are needed in the Gulf of Mexico. DOE expects that the supervisor will issue specific guidelines regarding the levels of inventory for each OCS region.

V. Example of Net Profit Share Payment Calculation

The following is a detailed example of how to calculate the NPS payment. These calculations illustrate how the NPS formula and the proposed NPS accounts are to work.

1. *During the Preproduction Period.* During the preproduction period, direct and allocable joint costs and credits are accumulated in the preproduction account.

Specifically, at the end of each month during the preproduction period, the preproduction account is charged for direct and allocable joint costs and credits for the month in each of the following 15 categories: rent, labor, materiel, transportation, services, legal expenses, equipment and facilities furnished by lessee, damages and losses to NPSL property, taxes, insurance, communications, ecological and environmental, audit and other costs and credits. Exhibit I illustrates these transactions:

Exhibit I

	Preproduction account	
	Dr.	Cr.
January		
Rent	5	
Labor	10	
Materiel	10	2
Transportation	2	
Services	1	
Legal	1	
Other	1	
Total	30	2
February 1980		
Rent	6	
Labor	12	
Materiel	12	4
Transportation	4	
Services	1	
Legal	1	
Other	3	
Total	39	4

2. *End of the Preproduction Period.* At the end of the preproduction period, the cumulative total of all direct and allocable costs and credits is determined by calculating the balance in the preproduction account. Exhibit II illustrates this transaction:

Exhibit II

	Preproduction account	
	Dr.	Cr.
January 1980	30	2
February 1980	39	4
March 1980	45	6
December 1985	60	10
	5,500	500
	5,000	

Next, the allowance for capital recovery and the preproduction overhead allowance are calculated as follows:

The total allowance for capital recovery (TACR) is calculated by multiplying the balance in the preproduction account at the end of the preproduction period by the recovery factor. The recovery factor is a number between 1.0 and 2.0 that is published in the notice of NPSL sale and is fixed as a term of the NPSL; in this example, the recovery factor is 1.4.

Total allowance for capital recovery

(TACR)=\$5,000×1.4=\$7,000

The preproduction overhead allowance is calculated by multiplying the balance in the preproduction account (less any charges for the value of injected substances, rent, and legal expenses; in this example, \$200) by 0.04.

Preproduction overhead allowance

(PPOA)=(\$5,000 \$200) × 0.04=\$192

3. *Beginning of the Production Period.* At the beginning of the production period, the production account is debited by the allowance for capital recovery and by the preproduction overhead allowance calculated above. Exhibit III illustrates these transactions:

Exhibit III

	Production account	
	Dr.	Cr.
ACR	7,000	
PPOA	192	
Total	7,192	

4. *During the Production Period.* During the production period, direct and allocable joint costs and credits are accumulated in the production account; production revenue is accumulated in the production revenue account. Specifically:

The production revenue account is credited with production revenue.

The production account is debited with allowable costs and credited with allowable credits. (Credits associated with the preproduction period, however, are first multipled by the recovery factor before crediting the production account).

Exhibit IV illustrates these transactions for the first month of the production period:

Exhibit IV

	Production account	
	Dr.	Cr.
TARC	7,000	
PPOA	192	
Total	7,192	

Exhibit IV—Continued

	Production account	
	Dr.	Cr.
January 1986		
Rent	5	
Labor	10	
Material	10	2
Transportation	2	
Services	1	
Legal	1	
Other	1	
Total	30	2

	Production revenue account	
	Dr.	Cr.
January 1980		1,000

5. *At the End of Each Month During the Production Period.* At the end of each month during the production period, the production overhead allowance is calculated by multiplying the net of the debits and credits to the production account for that month (less any charges for the value of injected substances, rent, and legal expenses; in this example, \$2) and any credits from the return of surplus material by 0.10.

Production overhead allowance

(POA) = (\$28 − \$2) × 0.10 = \$3

The production account is then debited by the production overhead allowance.

The balance in the production revenue account is then calculated and cleared to the production account by debiting the production revenue account and crediting the production account by the balance in the production revenue account. Exhibit V illustrates these transactions:

Exhibit V

	Production account	
	Dr.	Cr.
TACR	7,000	
PPOA	192	
Total	7,192	
January 1986		
Rent	5	
Labor	10	
		2
Material	10	
Transportation	2	
Services	1	
Legal	1	
Other	1	
Total	30	2

	Production revenue account	
	Dr.	Cr.
P.O.A.	3	
Revenue		1,000
	7,225	1,002
	6,223	

	Production revenue account	
	Dr.	Cr.
		1,000
	1,000	
	1,000	1,000
		0

If, as a result, there is a debit balance in the production account, this debit balance is carried forward in the production account to the next month.

If, as result, there is a credit balance in the production account, this credit balance is the net profit share base for that month.

In this example, there is a debit balance of \$6,223 in the production account. Therefore, this amount is carried forward in the production in the production account to the next month. Exhibit VI summarizes these transactions for the first 5 months of the production period:

Exhibit VI

	Production account		Production revenue account	
	Dr.	Cr.	Dr.	Cr.
	7,192	·2		1,000
	33	1,000	1,000	
Total	7,225	1,002	1,000	1,000
	6,223			0
February	6,223	5		2,000
	60	2,000	2,000	
Total	6,283	2,005	2,000	2,000
	4,278			0
March	4,278	6		1,500
	70	1,500	1,500	
Total	4,348	1,506	1,500	1,500
	2,842			0

Exhibit VI—Continued

	Production account		Production revenue account	
	Dr.	Cr.	Dr.	Cr.
April	2,842	4		2,500
	80	2,500	2,500	
Total	2,922	2,504	2,500	2,500
	418			0
May	418	7		2,990
	85	2,990	2,990	
Total	503	2,997	2,990	2,990
		2,494		

At the end of the fifth month during the production period, there is a credit balance in the production account. This credit balance is the profit share base for that month.

The net profit share payment is calculated by multiplying the net profit share base (if any) by the net profit share rate; in this example, the net profit share rate equals 0.30.

Net profit share payment = $2,494 × 1.30 = $748

The lessee's net profit share is calculated by subtracting the net profit share payment from the net profit share base.

Lessee's net profit share = $2,494 − $748 = $1,746

At the end of each month during the production period for which a profit share base is calculated, the following transactions are then made:

Debit the production account by the profit share base for the month.

Credit the net profit share payments account by the net profit share payment for the month.

Credit the lessee's net profit share account by the lessee's net profit share for the month.

These transactions are illustrated in Exhibit VII:

Exhibit VII

NPS payment account		Production account	
Dr.	Cr.	Dr.	Cr.
	748	418	7
		85	2,990
		503	2,997
		2,494	2,494

Exhibit VII—Continued

Lessee's NPS account	
Dr.	Cr.
	1,746

During the remainder of the production period, the net profit share payment account is used to accumulate each month's NPS payment due the Federal Government. The lessee's net profit share account is used to accumulate each lessee's NPS for the month.

VI. Public Comments and Public Hearing Procedures

We request comments on any aspect of this regulation as proposed. To the extent comments are submitted in response to this rulemaking either proposing or opposing amendments, they should be accompanied by as much supporting data as possible. Data submitted pursuant to this rulemaking that is deemed proprietary should be so labeled.

A. *Specific Comments Requested.* We are requesting comments on the following matters in particular:

1. *Selection of the fixed net profit share bidding system.* Many different net profit share bidding systems were originally considered in the analysis that guided the development of these regulations. Under the fixed net profit share bidding system, three systems for accumulating and charging costs against production revenue were identified—the fixed capital recovery system, the annuity capital recovery system, and the investment account system—as deserving careful evaluation. DOE performed this evaluation and decided to propose the fixed capital recovery system because it appears to be more effective in encouraging diligent and efficient development and production, and because this system minimizes administrative, compliance, and auditing costs.

Further, DOE has chosen not to propose regulations defining two alternative systems because this action will be unnecessarily confusing, will create uncertainty, and could generally undermine efforts to successfully implement profit share leasing. DOE recognizes that the fixed net profit share bidding system proposed in these regulations represents a distinct departure from bidding systems used in the past. Operating procedures and evaluation concepts must be changed and adapted to profit share leasing; an adjustment that will take place over several years. Thus, any attempt to experiment with several different systems concurrently (*i.e.*, use of fixed capital recovery system at one sale, then another system at another sale), each requiring somewhat different accounting and implementation procedures, would be confusing, create uncertainty, and generally slow the adjustment process. Ultimately, this could vitiate the effectiveness of profit share leasing.

Accordingly, DOE feels strongly that one profit share system should be adopted and used for the period of time necessary to determine accurately its effectiveness. This places a premium on proper evaluation and selection, at the outset, of that system. Because of the complexity of profit share systems and their evaluation, DOE requests comments on procedures and criteria for evaluating alternative profit share systems, including:

(a) What is the relative importance of the following evaluation criteria:

The degree to which the system reduces initial cash bonuses and the resulting increases in competition;
The present value of government receipts;
Net economic value achieved;
Production value;
Ability of the system to promote the development of smaller fields, *i.e.*, those that are uneconomic to produce under alternative leasing conditions;
Production life of fields developed.

(b) what are the likely effects of alternative profit share systems on:

Exploration and development decisions;
Timing and magnitude of investment in installed capacity;
Initiation and rate of production;
Timing and magnitude of operating costs;
Timing and magnitude of investments during production period.

(c) What is the likely effect of alternative systems as measured by the performance criteria listed in (a) of this section?

(d) What is the likely administrative impact and cost of:

Requirements to determine, for each lease sale, the parameters needed to specify the alternative profit share systems (capital recovery factors, interest rates, profit share rates, etc.);
Accounting and audit costs of the different system;
Compliance problems that result from incentives to manipulate the timing of expenses, and the degree to which the various systems mitigate these problems.

(e) Which system should be adopted in the final regulation and why that particular system should be selected?

2. *Treatment of abandonment costs and credits.* The proposed regulations provide that accounts are to be closed when production ends. Salvage credits

received by the lessee after this period are not credited to the NPSL account, but are retained 100 percent by the lessee. Similarly, abandonment expenses cannot be charged to NPSL accounts. The expected difference between the salvage credits and abandonment expenses must be anticipated by the lessee when he prepares his bid and an allowance made in his calculation of the cash bonus bid. Is this approach workable? Are there better—administratively feasible—alternatives to provide for abandonment expenses and credits?

3. *Percentage rate for overhead allowance.* The rates of 4 percent and 10 percent for preproduction period and production period overhead, respectively, were chosen as representative of overhead treatment in joint venture agreements. Are these rates appropriate, and if not, what evidence is there to suggest more appropriate rates?

4. *Accounting procedures.* Comments are requested on any of the accounting procedures proposed in Part 390, modifications to COPAS, or interpretations discussed in sections IV.B and IV.C of this preamble.

B. *Written Comments.* You are invited to participate in this rulemaking by submitting data, views or arguments with respect to the proposals set forth in today's rulemaking. Written comments should be submitted by 4:30 p.m., March 7, 1980, to the address indicated in the "ADDRESSES" section of this preamble. Comments should be identified on the outside envelope and on the document with the designation: "OCS Net Profit Share Leasing, Docket LPD-79-06". Fifteen copies should be submitted. All copies received by the above date, and all other relevant information will be considered by DOE before final action is taken on this proposed regulation. Any information or data submitted which you consider to be confidential must be so identified and submitted in writing, one copy only. We reserve the right to determine the confidential status of the information or data and to treat it according to our determination.

C. *Public Hearings.* 1. *Procedure for Request to Make Oral Presentation.* The time and place of the hearings are indicated in the "DATES" and "HEARING LOCATIONS" sections at the beginning of the preamble. The hearings will be continued, if necessary, on the next business day.

If you have an interest in today's proposal, or represent a group or class of persons that has an interest, you may make a written request for an opportunity to make an oral presentation. This request should be made by 4:30 p.m. on February 8, 1980 for all hearings, and should be sent to the appropriate addresses indicated in the "REQUEST TO SPEAK" section of this preamble. Please describe your interest and, if appropriate, state why you are a proper representative of a group or class of persons that has such an interest, and give a concise summary of the proposed oral presentation. You should also provide a phone number where you may be contacted through the day before the hearing. If you are selected to be heard, you will be so notified prior to the hearing. One hundred copies of your statement, labeled "OCS Profit Share Leasing," are due five working days prior to the date of the regional hearings and due February 13, 1979 for the Washington hearing and should be delivered to the "REQUEST TO SPEAK" addresses indicated at the beginning of this preamble. In the event any person wishing to testify cannot meet the 100 copy requirement, alternative arrangements can be made with the Office of Hearings Management in advance of the hearing by so indicating in the letter requesting an oral presentation or by calling the Office of Hearings Management at 202-254-5201.

2. *Conduct of the Hearings.* DOE reserves the right to select the persons to be heard at this hearing, 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 on the number of persons requesting to be heard.

A DOE official will be designated to preside at the hearing. This will not be a judicial or evidentiary-type hearing. Questions may be asked only by those conducting the hearing, and there will be no cross-examination of persons presenting statements. At the conclusion of all initial oral statements, each person who has made an oral statement will be given the opportunity 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.

You may submit questions to be asked of any person making a statement at the hearing to the address indicated above for "REQUEST TO SPEAK" before 4:30 p.m. the day prior to each hearing

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

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

A transcript of the hearings will be made and the entire record of the hearing, including the transcript, will be retained by DOE and made available for inspection at the DOE Freedom of Information Office, Room 2107, Federal Building, 12th and Pennsylvania Avenue, N.W., Washington, D.C., between the hours of 8:00 a.m. and 4:30 p.m., Monday through Friday. You may purchase a copy of the transcript from the reporter.

VII. Environmental and Competitive Analysis

After reviewing this proposed regulation pursuant to DOE's responsibilities under the National Environmental Policy Act of 1969 (Pub. L. 91-190, 83 Stat. 852 (42 U.S.C. 4321)) DOE has determined that the proposed action does not constitute a major Federal action significantly affecting the quality of the human environment. Therefore, DOE has determined that no environmental impact statement is required for the proposed regulation.

Environmental impacts resulting from the use of the fixed net profit share bidding system are expected to be minimal. There are two sources of potential environmental impact. First, since the fixed net profit share system is expected to improve economic incentives for expeditious exploration and development of tracts, there could be an increase of this activity on profit share tracts in the sale area. Second, the fixed net profit share bidding system will improve economic conditions and incentives for developing and producing smaller oil and gas deposits. Thus, the use of this bidding system could result in increased levels of production from the sale area.

In either case, however, the use of the bidding system is expected to result in a culmulative increase in activity or production, but no major increase on any individual tract. Absolute rates of activity or ultimate levels of production are not expected to fall outside the ranges that should be considered during an environmental impact analysis for lease sales conducted with conventional leasing systems. Environmental impacts associated with using the fixed net profit share bidding system will, of course, be examined prior to each lease sale. Moreover, potential environmental impacts resulting from the use of this system will be considered prior to the selection of a leasing system for tracts in each sale.

Thus, to summarize, DOE believes that any environmental impacts attributed directly to the use of the fixed net profit share bidding system are minimal and inconsequential. Moreover, the rates of activity and levels of production that could result from the use of the fixed net profit share bidding system are well within the ranges that must be considered by the environmental impact analysis for each specific sale.

Pursuant to § 204 of the Amendments (section 5 OCSLA, 43 U.S.C. 1334), a copy of this proposed regulation has been transmitted to the Attorney General for his views on any matters contained herein that may affect competition. The Attorney General will consult with the Federal Trade Commission in accordance with § 204 in preparing any such views. Their views will be carefully considered by DOE before the promulgation of final regulations.

VIII. Summary of Regulatory Analysis

We have determined that this is a significant regulation and will have a major impact within the meaning of DOE's procedures to implement Executive Order 12044 on "Improving Government Regulations" (DOE Order No. 2030.1, (44 FR 1032, January 3, 1979)). Therefore, a regulatory analysis is required for this proposed regulation.

A summary of the regulatory analysis prepared for this regulation is included below. Copies of the complete regulatory analysis are available for public review in the DOE Freedom of Information Reading Room, Room 2107, 12th and Pennsylvania Avenue, N.W., Washington, D.C. 20461. Interested parties are invited to submit written comments on the Regulatory Analysis to the address indicated in the "ADDRESSES" section of this preamble.

The regulatory analysis examines the impact of using a cash bonus bid with a fixed share of the net profit from production (using a method of capital recovery known as the fixed capital recovery system) by comparing the performance of this bidding system with other types of net profit share and royalty based bidding systems including the current cash bonus bid with a fixed royalty.

Research performed in support of the analysis shows that when a fixed net profit share bidding system is used, prospective bidders lower their cash bonuses in anticipation of the higher costs in the form of net profit share payments to the government which they will incur during the production phase of the lease. This lowering of the cash bonus improves competition by lowering the "ante required to get into the game" and distributes risk more evenly between government and industry by minimizing industry's losses in the event of an unproductive lease. The analysis also shows that government revenue is expected to increase as potential risks to the bidders are decreased.

This same phenomenon of reduced cash bonuses with its attendant benefits is also observed for bidding systems which employ a variable royalty. Such systems, however, lead to perverse incentives for lease development and production. Higher royalty rates necessary to effect reductions in the cash bonus tend to cause the smaller oil fields to go undeveloped because they are uneconomic. Also, higher royalty rates affect the rate of production of the leases that are developed. Earlier studies of royalty systems indicated a premature termination of production. However, more recent studies indicate that, faced with high royalty rates, producers will install smaller initial production capacity and produce the same amount of resource over a longer period of time than would occur with the current cash bonus—⅙ royalty system or the proposed fixed net profit share bidding system.

Because net profit share bidding systems incorporate a definition of cost as well as revenue, they differ markedly from royalty systems which need only be concerned with the gross value of production. Thus, net profit share bidding systems require accounting procedures that define which costs are allowable as offsets to lease revenues.

Two controlling accounts are common to all of the net profit share systems analyzed for charging costs against production revenues: The preproduction account that accumulates all of the expenses incurred from lease acquisition until the start of production, and the production account that accumulates the expenses incurred in the production period. Provisions for captial recovery are specifically provided through the capital recovery mechanism of each leasing system. The different types of systems for determining net profit share payments, fixed capital recovery system, annuity capital recovery system, and investment account system, differ in the way in which capital recovery is made.

In the fixed capital recovery system the balance in the preproduction account is multiplied by a number known as the capital recovery factor. The product of this calculation is the total allowance for capital recovery (TACR). A portion of the TACR equal to the excess of revenue over operating costs is taken in successive reporting periods until the sum of the portions (ACR) equals the TACR.

In the annuity capital recovery system, the balance in the preproduction account at the end of the preproduction period is annuitized to determine the ACR available to the lessee each reporting period. The interest rate and the number of reporting periods would be selected as term of the lease.

The third system considered, the investment account system, has some of the features of the other two systems. Like the annuity capital recovery system, an interest rate rather than a fixed factor is applied; however, the interest rate is applied to the balance of the preproduction account at established accounting periods (months) during the preproduction period, rather than merely to the final preproduction account balance. At the end of the preproduction period the sum of all expenses and interest charges becomes the TACR that is available as an ACR in any production accounting period (as with the fixed capital recovery system). Unlike the fixed capital recovery system, any unused TACR and any operating expenses in excess of revenues accrued during each accounting period are forwarded to the next accounting period with an additional interest charge that is calculated by multiplying the sum of the operating expenses in excess of revenues plus the unused TACR by the interest rate.

The net profit share base from which the net profit share payments are calculated is determined by subtracting the current operating expenses in the production account and the ACR from gross lease revenue. If operating expenses or the ACR exceed the gross revenue to offset them, they are carried forward to the next accounting period. The net profit share payment is the net profit share base times the net profit share rate.

These three systems were analyzed by simulating their performance with a resource policy evaluation model. Four measures of performance were used to compare the performance of these systems. These measures are: 1) Percentage of cash bonus reduction (relative to the current cash bonus—⅙ fixed royalty system), 2) percentage of fields developed, 3) production life of the lease, and 4) the present value of total expected government revenue generated. Comparisons were made over a wide range of reservoir sizes and development costs, net profit share rates, and interest/recovery factor rates.

The simulations showed that the fixed capital recovery system with a recovery factor of 2.0 and net profit share rate of

60 percent gave the best overall performance. No investment account system variation was found that resulted in a greater percentage of cash bonus reduction while maintaining as high a percentage of fields developed as is available under the fixed capital recovery system. Furthermore, DOE found the investment account system provides less incentive for expeditious lease development and is susceptible to the artificial acceleration, for accounting purposes, of the timing of expenses. By contrast, the fixed capital recovery system (2.0 capital recovery factor, 60 percent profit share rate) as compared to the present cash bonus bid with a fixed ⅙ royalty improves the percentage of fields to be developed, thus enhancing efficient resource recovery; reduces expected cash bonuses approximately 40 percent, thus promoting competition; increases slightly the amount of expected government revenue; and does not result in any prolongation of the production period.

The implementation of the fixed net profit share bidding system will have some minor impacts on industry costs, resulting from the administrative costs attendant with accounting and reporting requirements. These costs will result from changes to accounting systems and procedures as required to track NPS tract expenses and calculate net profit. Estimates of these costs are $50,000 to $150,000 for the one time accounting system modification and $25,000 to $30,000 for the annual cost for administration. Administrative costs to the government for audit and monitoring of net profit share leases are expected to be nominal.

Authority: (Outer Continental Shelf Lands Act, ch. 345, 67 Stat. 462 (43 U.S.C. 1331 *et seq.*, 1953), as amended by Pub. L. 95-372; Department of Energy Organization Act, Pub. L. 95-91, 91 Stat. 565 (42 U.S.C. 7101 *et. seq.*, 1977), E.O. 12009, 42 F.R. 46267.

In consideration of the foregoing it is proposed to amend Chapter II of Title 10, Code of Federal Regulations as set forth below.

Issued in Washington, D.C., November 30, 1979.

Dr. Ruth M. Davis,

Assistant Secretary, Resource Applications, Department of Energy.

1. Part 376 of Chapter II of Title 10, Code of Federal Regulations, is amended by adding paragraph (4) to § 376.110(a) to read as follows:

§ 376.110 Bidding systems.

(4) *Cash bonus bid with a fixed share of the net profits of no less than 30 per centum to be derived from the production of oil and gas from the lease area and a fixed annual acreage rental.* (i) *Net profit share payment calculation.* The amount of the net profit share payment to the United States by the person awarded the lease shall be determined for each month by multiplying the net profit share base times the net profit share rate, in accordance with § 390.022.

(A) *Net-profit share base.(1)* The net profit share base shall be calculated in accordance with § 390.021.

(2) The recovery factor needed to calculate the allowance for capital recovery, § 390.020, shall be specified in the notice of OCS lease sale published in the **Federal Register.**

In determining the recovery factor, which may vary from tract to tract, the factors stated in § 376.111 shall be considered in relation to the characteristics of each tract to which the bidding system will be applied.

(B) *Net profit share rate.* The net profit share rate, which determines the fixed share of the net profits owed to the United States, shall be a percentage that is specified in the notice of OCS lease sale published in the **Federal Register.** Such net profit share rate shall not be less than 30 percent of the net profit share base. In determining the net profit share rate, which may vary from tract to tract, the factors stated in § 376.111 shall be considered in relation to the characteristics of each tract to which the bidding system will be applied.

(ii) The amount of cash bonus to be paid is determined by the person submitting the bid. Any deferment and the schedule of payments shall be included in the notice of OCS lease sale published in the **Federal Register.**

(iii) The annual acreage rental to be paid by the person awarded the lease shall be the amount specified in the notice of OCS lease sale published in the **Federal Register.**

In determining the rental, which may vary from tract to tract, the factors stated in § 376.111 shall be considered in relation to the characteristics of each tract to which the bidding system will be applied.

2. Chapter II of Title 10, Code of Federal Regulations, is amended by adding a Part 390 to read as follows:

PART 390—ACCOUNTING PROCEDURES FOR DETERMINING NET PROFIT SHARE PAYMENT FOR OUTER CONTINENTAL SHELF OIL AND GAS LEASES

Authority: Sec. 205, Pub. L. 95-372, 92 Stat. 643 (43 U.S.C. 1337); sec. 302(b), Pub. L. 95-91, 91 Stat. 578-79 (42 U.S.C. 7152(b).

§ 390.001 Purpose and scope.

(a) This Part 390 establishes accounting procedures for determining the net profit share base and calculating net profit share payments due the United States for the production of oil and gas from Outer Continental Shelf leases.

(b) The procedures established by the Part 390 apply to any Outer Continental Shelf leases issued by the Department of the Interior under a net profit share bidding system established by § 376.110(a)(4) of this chapter.

§ 390.002 Definitions.

"Allowance for capital recovery" means the amount calculated according to procedures specified in § 390.020. This amount allows a premium for risk initially undertaken by the lessee and a return on his investment made during the preproduction period. It is provided in lieu of depreciation on equipment and materiel charged to the preproduction account.

"Compensated personal absence" means any absence from work for illness, vacation, holidays, jury duty, military training, disability benefits and other customary allowance, for which the lessee pays compensation directly to an employee under an existing plan of the lessee.

"Controllable materiel" means materiel which at the time of inventory is so classified in the Materiel Classification Manual as most recently recommended by the Council of Petroleum Accountants Societies of North America.

"Cost" means an expense incurred by a lessee in conducting NPSL operations.

"Cost pool" means a grouping of incurred costs identified with two or more operations.

"Credit" means a payment, rebate, or reimbursement to a lessee, exclusive of production revenue, in the course of NPSL operations.

"Direct cost" means any cost listed in § 390.011 that benefits only NPSL operations.

"Field employee" means an employee below a first level supervisor who is directly employed in the NPSL project area.

"First level supervisor" means an employee whose primary function in NPSL operations is the direct supervision of other employees and contract labor directly employed on the NPSL tract in a field operating capacity.

"G & G" means geological and geophysical exploration.

"Joint cost" means any cost listed in § 390.011 that benefits NPSL operations and one or more other operations of the lessee or outside party.

"Lessee" means a person authorized by an OCS lease, or an approved assignment thereof, to develop and produce oil and gas, including all parties holding such authority by or through the lessee, and the person designated to conduct NPSL operations.

"Materiel" means equipment, apparatus, and supplies.

"Net profit share base" means the end of the month credit balance in the production account. The net profit share base is the production revenue remaining after substracting all allowable costs and adding all allowable credits (including production revenue) in accordance with the procedures established by this Part 390.

"Net profit share payment" means the portion of the net profit share base payable to the United States.

"Net profit share rate" means the fixed percentage share of the net profit share base payable to the United States.

"NPSL" means a net profit share lease, which is an OCS lease that provides for payment to the United Sttes of a fixed share of the profits for production of oil and gas from the tract.

"NPSL operations" means all activities subsequent to issuance of the NPSL necessary and proper for the exploration, development, operation, and maintenance of the NPSL property.

"NPSL project area" means the NPSL tract, offshore facilities, and shore base facilities.

"NPSL property" means the NPSL tract, and materiel and offshore facilities acquired for use in NPSL operations and that are installed and/or used on the NPSL tract.

"NPSL tract" means a tract subject to a NPSL.

"OCSLA" means the Outer Continental Shelf Lands Act, as amended (43 U.S.C. 1331 *et seq.).*

"OCS lease" means a Federal lease for oil and gas issued under the OCSLA.

"OCS lease sale" means the DOI proceeding by which leases for certain OCS tracts are offered for sale and then issued to the person who is the highest qualified responsible bidder.

"Offshore facilities" means platform and support systems located offshore and that are necessary to conduct NPSL operations, *e.g.*, oil and gas handling facilities, living quarters, offices, shops, cranes, electrical supply equipment and systems, fuel and water storage and piping, heliport, marine docking installations, communication facilities, and navigation aids.

"Outside party" means any person who is not a lessee.

"Person" means person as defined in Part 376 of this chapter.

"Personal expenses" means travel and other reasonable reimbursable expenses of lessee's employees.

"Preproduction period" shall mean the period from the date of issuance of the NPSL until production begins.

"Production" means the bringing forth of oil or gas from the NPSL tract is commercial quantities, as determined by the Supervisor.

"Production period" means the time during which production occurs, for purposes of this Part 390.

"Production revenue" means the value of all oil and gas production saved, removed or sold from a tract, or, if the tract is unitized, the value of all oil and gas production saved, removed or sold and credited to the tract under a unitization formula, during a month, which value is determined in accordance with § 376.110(c) of this chapter.

"Reliable supply store" means a recognized source or common stock point for the particular materiel involved.

"Railway receiving point" or "recognized barge terminal" means the location that a vendor would use in determining the sale price to the lessee of new material to be delivered to the NPSL project area.

"Shore base facilities" means onshore facilities necessary for NPSL operations, including:

(a) Shore base support facilities, *e.g.*, a receiving and trans-shipment point for material, staging area for shuttling personnel to and from the NPSL tract, a communication, scheduling, and dispatching center; and

(b) Shore base production facilities, *e.g.*, pumps, separating facilities, gas plants, and tankage for production from the NPSL tract.

"Technical employees" means those employees having special and specific engineering, geological or other professional skills, and whose primary function in NPSL operations is the handling and resolution of specific operating conditions and problems for the benefit of NPSL operations.

"Tract" means land located on the OCS that is offered for lease through an OCS lease sale and is described and identified by an Outer Continental Shelf Official Protraction Diagram that is prepared and published by DOI in connection with an OCS lease sale.

§ 390.010 Profit share accounts.

(a) For each NPSL tract, five controlling accounts shall be established and maintained by lessee for NPSL operations, as follows:

(1) *Preproduction account.* The preproduction account shall include direct and allocable joint costs and credits that are incurred from issuance of the NPSL until the first day of the production period.

(2) *Production account.* The production account shall include (i) direct and allocable costs and credits incurred during the production period, (ii) the allowance for capital recovery, (iii) preproduction period costs not allowed in the allowance for capital recovery, and (iv) preproduction period overhead.

(3) *Production revenue account.* The production revenue account shall include credits reflecting the value of oil and gas produced during the production period.

(4) *Net profit share payment account.* The net profit share payment account shall include the amounts of net profit share payments due the United States.

(5) *Lessee's net profit share account.* The lessee's net profit share account shall include the amounts of net profit share base retained by the lessee.

(b) NPSL accounts shall be kept on an accrual basis.

§ 390.011 Schedule of allowable direct and joint costs and credits. The costs and credits specified in paragraphs (a)–(o) of this section may be charged direct, or allocated to NPSL operations, as appropriate, in accordance with § 390.014.

(a) *Lease rental.* The rent paid by the lessee for the NPSL tract.

(b) *Labor.* (1) (i) Salaries and wages of lessee's field employees, first level supervisors and technical employees employed in the NPSL project area in NPSL operations, if such costs are not charged under subparagraph (g) of this section.

(ii) Salaries and wages of technical employees within technical branches of the lessee's organization who are either temporarily or permanently assigned to, and directly employed in NPSL operations, provided that such employees work "full time" on some particular aspect of NPSL operations or some specific technical problem. Excluded from this category are employees assigned a role in NPSL operations as a duty collateral with other duties that do not directly benefit NPSL operations.

(2) Lessee's cost of compensated personal absence paid to employees whose salaries and wages are chargeable to NPSL operations under subparagraph (b)(1) of this section.

(3) Expenditures or contributions made pursuant to assessments imposed by governmental authority that are applicable to lessee's costs chargeable to NPSL operations under subparagraphs (b)(1) and (b)(2) of this section.

(4) Reasonable personal expenses, including allowable relocation costs of employees whose salaries and wages are chargeable to NPSL operations under subparagraph (b)(1) of this section and that are paid by the lessee or for which the employees are reimbursed under the lessee's normal practice.

(i) Allowable relocation costs include:

(A) Travel expenses, including transportation, lodging, subsistence, and reasonable incidental expenses of the employee and members of his immediate family and transportation of his household and personal effects to the new location.

(B) Other necessary and reasonable expenses normally incident to relocation, such as costs of cancelling an unexpired lease, disconnecting and reinstalling household appliances, and purchases of insurance against damages to or loss of personal property. Costs of cancelling an unexpired lease shall not exceed three times the monthly rental.

(C) Closing costs (*i.e.* brokerage fees, legal fees, appraisal fees, etc.) for the sale of the employees' actual residence when notified of the transfer; and

(D) Continuing costs of ownership of the vacant former actual residence being sold, such as continuing mortgage principal and interest payments, maintenance of building and grounds (exclusive of fixing-up expenses), utilities, taxes, property insurance, etc., after settlement date or lease date of new permanent residence.

(ii) The combined total of costs listed in subparagraphs (b)(4)(i)(C)-(D) shall not exceed 8 percent of the sales price of the property sold.

(iii) Section 390.013(g) specifies employee relocation expenses that are not allowable as a charge ot NPSL operations.

(5) Lessee's current costs of established plans for employee's group life insurance, hospitalization, pension, retirement, stock purchase, thrift, bonds, and other benefit plans of a like nature that are made availabe to all employees on an equitable basis, applicable to lessee's labor cost chargeable to NPSL operations under subparagraph (b)(1) and (b)(2) shall be lessee's actual cost not to exceed 20 percent of the total charges under subparagraphs (b)(1) and (b)(2).

(6) Charges for expensed incurred under subparagraphs (b)(2)-(b) (5) of this section may be made to NPSL accounts on a "wide and as paid" basis on by a percentage assessment method. If the percentage assessment method is used, it shall be based upon the lessee. Actual cost experience for the proceeding year expressed as percentage of costs chargable under suparagraphs (b)(1) and (b)(2) of this section, and adjustments shall be made at the end of each fiscal year to balance total charges made NPSL accounts during the year with the lessee's actual costs for the year. Under either method the lessee's own cost of administering the plan and paying the salaries and benefits defined in this paragraph shall be excluded. In determining actual cost experience actual cost experience of any employee benefit plan, any dividend or refunds received are applicable to insurance of annuity policies shall be used to reduce the cost of such policies.

(c) *Materiel.* (1) Materiel purchase of furnished by a lessee as NPSL property shall be charged or credited at amounts specified in § 390.015. The purchase and inventorying of materiel is subject to conditions and provisions in $390.032.

(2) Credit for salvage or returned materiel shall be made to the account originally charged except that, in the case of crediting the preproduction account when the calculation of the allowance for capital recovery in § 390.020 has been made, the credit shall be multiplied by the recovery factor and entered in the production account.

(d) *Transportation.* Transportation of employees and materiel necessary for NPSL operations, to, from and within the NPSL project area, but subject to the following limitations:

(1) If materiel is moved to the NPSL project area, no charge shall be made to NPSL operations for a distance greater than the distance from the nearest reliable supply store, recognized barge terminal, or railway receiving point where like materiel is normally available, unless agreed to by the Supervisor.

(2) If surplus materiel is moved from the NPSL project area, not charge shall be made to NPSL operations for a distance greater than the distance to the nearest reliable supply store, recognized barge terminal, or railway receiving point unless agreed to by the Supervisor. No charge shall be made to NPSL operations for moving materiel to other properties owned by or under the control of a lessee, unless agreed to by the Supervisor.

(3) In the application of subparagraph (1) and (2) of this paragraph , there shall be no equalization of actual gross trucking costs of $200 or less, excluding accessorial charge

(e) *Contract services.* Except when exclused by paragraph (f) of this section and/or $390.013(c), the cost of services and utilities provided under contract by outside parties to the lessee and which constitute proper and necessary NPSL operations or support for NPSL operations, and rental charges paid to outside parties for the rental of equipment used in the NPSL project area in support of NPSL operations, may be charged to NPSL operations subject to the following conditions and limitations:

(1) Contract services (including professional consulting services and contract services of technical personnel) that are entirely performed in the NPSL project area and benefit exclusively NPSL operations may be charged at the rates specified in the contract.

(2) Contract services (including professional consulting services and contract services of technical personnel that are entirely performed in the NPSL project area and benefit the NPSL operations and operations on other tracts must be allocated among all tracts benefited and only that portion representing services benefiting the NPSL tract charged to NPSL operations.

(3) Contract services (including professional consulting services and contract services of technical personnel) that are performed at sites outside the NPSL project area may be charged to NPSL operations only if:

(i) The contracted services benefit only the NPSL tract or support NPSL operations;

(ii) The contract under which such services are provided deals exclusively with services benefiting the NPSL tract or NPSL operations; and

(iii) Services specified in the contract relate to the resolution of specific technical problems confronting NPSL operations, or specific engineering design problems related to equipment or facilities required for NPSL operations.

(4) The cost of any contract service related to research and development is specifically excluded, as are contract services calling for feasibility studies not directly related to specific engineering design problems or alternatives for equipment and facilities required by NPSL operations.

(f) *Legal expenses.* Expense of handling, investigating and settling litigation or claime, discharging or liens, payments of judgments and amounts paid for settelement of claims incurred in or resulting from NPSL operations, or necessary to protect or recover the NPSL property, except tose costs listed in § 390.013(d) as unallowable.

(g) *Rental of equipment and facilities furnished by lessee.* (1)(i) NPSL accounts shall be charged for the use of equipment and facilities owned by a lessee that are proper and necessary for NPSL operations, including shore base and offshore facilities and pipelines from the tract to shore base production facilities, and that are not NPSL property. Charges shall be made at rates based upon actual costs of acquisition, construction, and operation. Such rates may include labor, the cost of setting up and dismantling equipment, maintenance, repair, other operating expenses, insurance, taxes, depreciation (calculated with the same method adopted for depreciating the asset for Federal income tax purposes), and a return on the remaining undepreciated basis not to exceed 8 percent per year. Any cost of acquiring real property in excess of that reasonably required to support the facilities furnished for NPSL operations shall not be included in the costs used to established these rates. Rates charged shall not exceed average commercial rates for equipment and facilities of similar nature and capability currently prevailing in the vicinity of the NPSL project area, or such other maximum rates as may be set by the Supervisor.

(ii) The term equipment and facilities is used in the broad sense to include equipment that may be mobile or semimobile and also installations that may be semipermanent or permanent is nature. Such equipment and facilities listed below shall be charged on the basis indicated:

Equipment/facilities	Basis of charge
A. Mobile equipment:	
Aircraft	Hour.
Automobiles	Mile or hour.
Trucks	Mile or hour.
Tractors	Hour.
Bulldozers	Hour
Mobile cranes	hour
Trailer-mounted test separators	Hour
Truck-mounted paraffin scraping units.	Hour
Trailer-mounted cement mixers.	Hour
Boats	Day or hour
House trailers	Day.
B. Semimobile equipment:	
Drill rigs.	Foot or day.
Workover rigs	Hour.
Pulling units	Hour.
Derricks	Day.
Drilling tender	Day.
Barges	Day.
C. Semipermanent installations:	
Skid-mounted separators	Day or volume.
Skid-mounted compressors	Day or volume.
D. Permanent installations:	
Compressor stations	Volume.
Saltwater disposal Wells	Volume or wells.
Source water wells and supply systems.	Volume.
Roads	Wells.
Production/drilling platform	Volume or wells.
Canals	Wells.
Dock	Wells.
Oil storage and loading facilities.	Volume.
Gathering systems and pipeline	Volume.
ACT systems	Volume.
Laboratory services (excluding research work).	Hour or unit.
Shore base production facilities	Volume.
Shore base support facilities	Wells.
E. Miscellaneous:	
Drill Pipe	Foot or day.
Casing Setting Tools	Day.
Well Testing Equipment	Day.

Equipment and facilities that are not listed shall be charged on a basis consistent with the nature of the use.

(2) In lieu of charges in subparagraph (g)(1) above, the lessee may elect to use average commercial rates prevailing in the vicinity of the NPSL project area less 20 percent. For automotive equipment, the lessee may elect to use rates established by the Supervisor. For other equipment for which no commercial rate exists, the lessee shall submit the basis for determining such costs to the Supervisor for approval.

(h) *Damages and losses to NPSL property.* All costs necessry for the repair or replacement of NPSL Property made necessary because of damages or loses incurred by fire, flood, storm, theft, accident, or other causes not covered by insurance, except those resulting from lessee's negligence or willful misconduct. Lessee shall inform the supervisor of all such damages and losses suffered as soon as practical following their discovery. Notice to the Supervisor shall include the time, cause, and extent of damage or loss, and the estimated charge. Any settlement received from an insurance carrier should be credited to NPSL operations when received.

(i) Taxes. All taxes, except income taxes, profit share payments, and taxes based upon income, that are assessed or levied upon or in connection with NPSL operations which have been paid by the lessee.

(j) *Insurance.* (1) Net premiums paid for insurance required to be carried for NPSL operations. For NPSL operations in which the lessee may act as self-insurer for Workmen's Compensation and Employer's Liability, the lessee may include the risk under its self-insurance program in providing coverage under State and Federal laws and charge NPSL operations at lessee's cost not to exceed manual rates.

(2) NPSL operations shall be credited for all reimbursements for costs of damage to NPSL property or personal injury. Reimbursements for damage NPSL property shall be credited as follows:

(i) If the damagè NPSL property is replaced or repaired, to the NPSL account charged for the cost of replacement or repair; or

(ii) If the damaged NPSL property is not replaced or repaired, to the NPSL account originally charged for the cost of the NPSL property except that in the case of the preproduction account, when the calculations of the allowance for capital recovery in § 390.020 has been made, the production account shall be credited in accordance with § 390.021.(a)(2).

(k) *Communications.* costs of acquiring, installing, operating, repairing and maintaining communication systems, including radio and microwave facilities, between the NPSL tract and te lessee's nearest shore base facility. If communication facililties/systems serving the NPSL tract are lessee-owned, or serve operations and/or facilities outside the NPSL project area, charges to NPSL operations shall be made as provided in subparagraph (g) of this section.

(l) *Ecological and environmental.* Costs incurred in the NPSL project area as a result of statutory regulations for archeological and geophysical surveys relative to identification and protection of cultural resources and other environmental or ecological surveys required by the Bureau of Land Management or other regulatory authority. Also, the costs to provide or have available pollution containment and removal equipment, and the costs of actural control and cleanup and resulting responsibilities of oil spills as required by applicable laws and regulations.

(m) *Audit.* The cost of an audit of NPSL operations made by an independent auditor, if such audit is not performed by an agent of the United States.

(n) *Other costs.* Any other costs not covered in Paragraphs (a)–(m) of this section and not specified by § 390.013 that are incurred by the lessee in the necessary and proper conduct of NPSL operations and are approved by the Supervisor.

(o) *Other credits.* Credit shall be given to the preproduction or production account, depending on when it is occurred, for NPSL property leased or used in non/NPSL operations, and for the sale of information derived from test wells and G & G.

§ 390.012 Overhead allowance.

(a) The preproduction period overhead allowance shall be calculated on a percentage basis at the rate of 4 percent of direct and allocable joint costs charged to the preproduction accout, exclusive of costs specified in § 390.012(c), and debited to the production period account in accordance with § 390.020.

(b) Production period overhead allowance shall be calculated on a percentage basis at the rate of 10 percent of direct and allocable joint costs.

(c) Overhead shall not be charged on the value of:

(1) Lease rental (§ 390.011 (a));

(2) Contract services (§ 390.011 (e));

(3) Legal expenses (§ 390.011(f));

(4) Rental of equipment and facilities furnished by the lessee and that are charged to NPSL accounts under (§ 390.011 (g));

(5) Taxes (§ 390.011(i));

(6) Injected substances charged under (§ 390.011 (c)); and

(7) Credits for materiel charged under (§ 390.011 (c)) that are salvaged, returned, or used for the benefit or non-NPSL operations.

§ 390.013 Unallowable costs.

The following costs shall not be charged as direct or joint costs to NPSL operations:

(a) Bonus payments to the United States;

(b) Interest (except as permitted under § 390.011(g));

(c) Depreciation, amortization, or any other charge for capital recovery, except as explicitly provided by the allowance for capital recovery calculated according to (§ 390.020, for materiel charged to a NPSL account under § 390.011 (c));

(d) The cost of taking inventory;

(e) Reserach and development costs;

(f) The following legal expenses;

(1) The costs of litigation against the Federal government;

(2) Fines or penalties levied by any Federal agency;

(3) Settlement of claims or other litigation resulting from the lessee's violation of regulatory requirements or negligence; and

(4) The cost of the lessee's legal staff or expense of outside attorneys.

(g) The following employee relocation costs (whether incurred by the employee or the lessee):

(1) Loss on the sale of a home;

(2) Purchase price of a home in the new location;

(3) Payments for employee income taxes incident to reimbursed relocation costs; and

(4) Any relocation cost in connection with an employee move that is for the primary benefit of the lessee's non-NPSL operations;

(h) The lessee's own cost of administering employee benefit plans;

(i) The cost of acquiring or constructing shore base facilities and real property improvements supporting NPSL operations but that are not on the NPSL property; and

(j) Abandonment costs.

§ 390.014 Allocation of joint costs and credits.

(a) Joint costs shall be grouped in cost pools for allocation to NPSL and non-NPSL operations in reasonable proportion to the beneficial or causal relationships which exist between a specific cost pool and the operations. That portion of a joint cost pool that may be allocated to NPSL operations is called an allocable joint cost.

(b) The following allocation principles apply in allocating joint costs:

(1) *G & G.* G & G shall be allocated on a line mile per tract basis.

(2) *Wages and salaries.* Wages and salaries that are not charged direct on the basis of time spent on a particular job shall be allocated on a well basis, i.e., on the basis of the number of wells on each property served.

(3) *Compensated personal absence, payroll taxes and personal expenses.* These items shall be allocated on the same basis as wages and salaries.

(4) *Transportation costs.* Transportation costs for employees that are not charged direct shall be allocated on the same basis as their salaries and wages.

(c) Joint credits shall be allocated in the same manner as joint costs.

§ 390.015 Pricing of materiel purchases, transfers, and disposition.

(a)(1) *Purchased materiel.* Except as provided in paragraph (a)(2)(i) of this section, materiel purchsed for use in NPSL operations shall be charged to NPSL operations at the price paid, after deduction of any discounts received. Should any purchased materiel be defective or returned to a vendor for other reasons, the credit shall be allocated to NPSL operations when received by the lessee in accordance with § 390.011(c)(2).

(2) *Transferred and disposed materiel.* An item of materiel with an original cost under $100,000, which is acquired by the lessee for use in NPSL operations by means other than purchase or disposed of by any means, shall be priced according to this subparagraph:

(i) *Condition A (New) Materiel:* (A) Tubular goods, except line pipe, shall be priced at the current market price in effect on date of movement on a minimum carload or barge load weight basis, regardless of quantity transferred, equalized to the lowest published price "free on board" (f.o.b.) railway receiving point or recognized barge terminal nearest the NPSL tract where such materiel is normally available.

(B) *Line Pipe. (1)* Movement of less than 30,000 pounds shall be priced at the current price in effect at date of movement, as listed by a reliable supply store nearest the NPSL tract where such materiel is normally available.

(2) Movement of 30,000 pounds or more shall be priced under provisions of tubular goods pricing in paragraph (a)(3)(i)(A) of this section.

(C) Other materiel shall be priced at the current price in effect at date of movement, as listed by reliable supply store or f.o.b. railway receiving point nearest the NPSL tract where such materiel is normally available.

(ii) *Condition B (Good Used) Materiel:* Materiel in sound and serviceable condition and suitable for reuse without reconditioning:

(A) Materiel transferred to the NPSL project area shall be priced at 75 percent of current Condition A price.

(B) Materiel transferred from the NPSL project area shall be priced—

(1) At 75 percent of current Condition A price, if the materiel was originally charged to NPSL operations as Condition A materiel, or

(2) At 65 percent of current Condition A price, if the materiel was originally charged to NPSL operations as Condition B materiel at 75 percent of current Condition A price.

(iii) *Conditions C and D (Other used) Materiel:* (A) *Condition C.* Materiel that is not in sound and servicable condition and not suitable for its original function until after reconditioning shall be priced at 50 percent of current Condition A price.

(B) *Condition D.* Materiel no longer suitable for its original purposes but suitable for some other purpose shall be priced on a basis commensurate with its use and comparable with that of material normally used for such other purpose. If the material has no alternative use it should be priced at prevailing prices as scrap.

(iv) *Obsolete Materiel.* Materiel that is serviceable and usable for its original function and has a value less than Condition A, B, or C materiel may be valued at a price agreed to by the Supervisor. Such price should be the equivalent of the value of the service rendered by such materiel.

(3) *Transferred and disposed materiel with a value of $100,000 or more.* An item of materiel with an optional cost of $100,000 or more or item of similar materiel with aggregate original cost exceeding $100,000 acquired by the lessee for use in NPSL operations by means other than purchase or disposed of by any means, shall be priced on a current market basis with the approval of the Supervisor.

(b) *Pricing conditions.* (1) Loading and unloading costs shall be charged at a rate of 15 cents per hundred weight, or such other rate as may be set by the Supervisor, on all tubular goods movements, in lieu of loading/unloading costs sustained, when the actual hauling costs of such tubular goods is equalized under provisions of § 390.011(d).

(2) Materiel involving erection costs shall be charged at the applicable percentage of the current knocked-down price of new material.

(c) When materiel subject to subparagraphs (a)(2)(ii)(iii) of this section is transferred, the cost of reconditioning shall be borne by the receiving property.

§ 390.020 Calculation of allowance for capital recovery and preproduction overhead allowance.

(a) The allowance for capital recovery and the preproduction overhead allowance shall be calculated at the end of the preproduction period.

(1) At the end of the preproduction period, the allowance for capital recovery shall be calculated by multiplying the balance in the preproduction account, less any charges specified in § 390.011(g) and exlusive of the preproduction period overhead allowance, by the recovery factor that is published in the notice of lease sale and is specified in the NPSL.

(2) The preproduction overhead allowance shall be calculated by multiplying the balance in the preproduction account, less any charges specified in § 390.011(g), by 0.04.

(b) At the beginning of the production period, the production account shall be debited by the allowance for capital recovery and by the preproduction overhead allowance calculated in paragraph (a) of this section, and by the sum of charges specified in § 390.011(g) that were excluded from calculations in paragraph (a)(1) of this section.

§ 390.021 Determination of net profit share base.

(a) During each month of the production period:

(1) The production revenue account shall be credited with an amount reflecting the current value of production during the month and calculated in accordance with § 376.110(c) of this chapter.

(2) The production account shall be debited with allowable costs and credited with allowable credits. Credits associated with the preproduction period, however, shall first be multiplied by the recovery factor before crediting the production account.

(b) At the end of each month during the production period:

(1) The production overhead allowance shall be calculated by multiplying the net of the debits and credits to the production account for that month (less any charges or credits specified in 390.012(c)) by 0.10.

(2) The production account shall then be debited by the production overhead allowance.

(3) The balance in the production revenue account shall be calculated.

(4) The balance in the production revenue account shall then be cleared to the production account by debiting the production revenue account and crediting the production account by the balance in the production revenue account.

(c) If, as a result of the accounting transactions described in paragraph (b) of this section, there is a credit balance in the production account, this credit balance is the *net profit share base* for that month.

§ 390.022 Calculation of net profit share payment and lessee's net profit share.

(a) The net profit share payment shall be calculated by mulitplying the net profit share base calculated in accordance with § 390.021 by the net profit share rate.

(b) The lessee's net profit share shall be calculated by subtracting the net profit share payment from the net profit share base.

(c) At the end of each month during the production period for which a profit share base is calculated, the following transactions shall be made in the NPSL accounts.

(1) Debit the production account by the profit share base for the month.

(2) Credit the net profit share payments account by the net profit share payment for the month.

(3) Credit the lessee's net profit share account by the lessee's net profit share for the month.

§ 390.030 Maintenance of records.

(a) Each lessee subject to this part shall establish and maintain such records as are necessary to determine for each NPSL:

(1) The volume and disposition of all oil and gas production saved, removed or sold for each production period;

(2) The value of all oil and gas production saved, removed or sold for each production period;

(3) The amount and description of costs and credits to all NPSL accounts.

(4) The amount and description of all costs of acquisition, construction, and operation of equipment and facilities furnished by the lessee and charged to NPSL accounts under § 390.011(g). Such records shall include worksheets or other documents that indicate the method used to calculate the amount of each charge made under § 390.011(g).

(5) The cumulative balance of costs and credits to all NPSL accounts; and

(6) The inventory of material.

(b) Records shall be maintained from the date of issuance of the NPSL to the date five years subsequent to the abandonment of the NPSL.

§ 390.031 Reporting and payment requirements.

(a) Each lessee subject to this part shall file an annual report during the preproduction period. Such report shall list the costs incurred, credits received, and the balance of the preproduction account. Not later than 45 days after the start of production, a final preproduction report, that includes the calculation of the allowance for capital recovery, shall be filed.

(b) Each lessee subject to this part shall file a report, not later than 45 days following the end of each month, together with the appropriate net profit share payment, containing the following information for each NPSL:

(1) The volume and disposition of all oil and gas production saved, removed or sold for the production period;

(2) The monthly production revenue;

(3) The amount and description of all costs and credits to the production account, and monthly balance of the production account; and

(4) The monthly net profit share payment due the United States and the monthly profit share of the lessee.

(c) Each lessee subject to this part shall file a report each year, not later than 90 days after inventory is taken, reporting the controllable materiel on hand, acquired, transferred or used, and a list of overages and shortages.

(d) Each lessee subject to this part shall file a report, not later than 45 days following the end of production, together with the appropriate net profit share payment, indicating the remaining balance and costs and credits to the NPSL accounts for the production period.

(e) Reports required by this section shall be filed with the Supervisor, either separately or as part of the reports that are currently filed.

Interest shall be charged at the annual rate of 18 percent, compounded monthly, on the amount of a net profit share payment, from the due date (45 days following the end of the production period) of a net profit share payment until such payment if received by the United States.

§ 390.032 Inventories.

(a) The lessee is responsible for NPSL materiel and shall make proper and timely cost and credit notations for all materiel movements affecting NPSL property. The lessee shall provide only such materiel as may be required for immediate use or is consistent with practical, efficient, and economical operations. The accumulation of surplus stocks shall be avoided by proper materiel control, inventory and purchasing. The lessee shall make timely disposition of idle and surplus materiel through sale.

(b) At reasonable intervals, but at least once every year, inventories of controllable materiel shall be taken by the lessee. Written notice of intention to take inventory shall be given by the lessee at least 30 days before any inventory is to be taken so that the Supervisor may be represented at the taking of inventory. Failure of the Supervisor to be represented at an inventory shall bind the Supervisor to accept the inventory taken by the lessee.

(c) Inventory shall be valued with any generally accepted accounting method used by the lessee to value the same materiel for financial or income tax reporting purposes, provided that the method is consistently applied throughout the life of the materiel.

(d) Reconciliation shall be made of a physical inventory with the NPSL by the lessee, and a list of overages and shortages shall be furnished to the Supervisor within three months following the taking of the inventory as part of the report required by § 390.031(c). Inventory adjustments of controllable materiel shall be made by the lessee to NPSL accounts for overages and shortages. Controllable materiel removed from physical inventory that has not been credited to NPSL operations under § 390.015(a)(2) or (3) shall be credited to NPSL operations at its original value.

§ 390.033 Audits.

(a) The records of financial transactions pertaining to NPSL operations shall be audited periodically, but at least once every two years, by the United States or, at its option, by an independent auditor. Such audit may include the records pertaining to NPSL operations of contractors or the lessee.

(b) An independent auditor is a certified public accountant who has no financial interest in the NPSL or any corporation or partnership which has an interest, and who is an independent contractor employed solely for the purpose of providing a periodic audit of the financial records of the NPSL.

(c) The Supervisor is authorized at any time, to inspect NPSL operations for compliance with this part.

(d) Records required to be kept under paragraph (a) shall be made available for inspection by any authorized agent of the United States at any time during normal business hours upon the request of the Supervisor or other authorized official.

§ 390.034 Redetermination and appeals.

(a) If, as a result of an inspection of records or an audit under § 390.033, the Supervisor determines that there is an error in an NPSL account or an error in calculating the net profit share payment, the Supervisor shall redetermine the net profit share base and recalculate the net profit share payment due the United States and notify the lessee of the recalculation.

(b) The lessee shall pay any additional amount of net profit share payment owed plus interest at the rate of 18 percent per year, compounded monthly, from the date that the payment was due until the date it is actually paid. If the recalculated profit share payment is less than the amount paid the United States, the lessee will reclaim a credit that will be applied to the next profit share payment.

(c) Within 30 days after receiving notice of the recalculation as provided in paragraph (a), the lessee may appeal the decision of the Supervisor in accordance with the appeals provisions of 30 CFR Part 290.

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