

Bravo Dome

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ENCLOSURE

United States Department of the Interior

MINERALS MANAGEMENT SERVICE

ROYALTY MANAGEMENT PROGRAM

P.O. BOX 25165

DENVER, COLORADO 80225

Mail Stop 653

IN REPLY
REFER TO:

MMS-RVS-OG:84-802

FEB 12 1985

ENCLOSURE CONTAINS COMPANY
PROPRIETARY INFORMATION
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Certified Mail -
Return Receipt Requested

Ms. Lonita Atkinson
Amoco Production Company
P.O. Box 591
Tulsa, OK 74102

Dear Ms. Atkinson:

By letter dated September 12, 1984, you transmitted a copy of Form MMS-2014 for the Bravo Dome Carbon Dioxide Gas Unit and asked to be advised whether your proposed payment method is acceptable for the 16 Federal leases being reported thereon. You advised that Amoco does not have a sales contract "but receives reimbursement for its royalty paid from the purchasers; therefore, the value of the product is determined by the purchaser's contract."

We understand that two companies, Amerada Hess and Sun Exploration, currently are purchasing carbon dioxide from the Bravo Dome Unit. Amerada Hess has advised that it is taking its own carbon dioxide from Bravo Dome for its own use, but that the value of the carbon dioxide is based on the price Amerada, as a purchaser, pays to other companies under arm's-length contracts. Amerada supplied us with a copy of a Bravo Dome carbon dioxide gas sales contract with a request that it be kept confidential. We understand that Amoco was previously given a copy of the Amerada contract.

The carbon dioxide gas is gathered to a central facility in the Bravo Dome Unit where it is dehydrated to a maximum water content of 12 pounds per MMcf and compressed to about 2400 psi. Custody transfer to the purchaser takes place at the sales meter at the tailgate of the central facility.

The United States has committed its royalty interest to the Bravo Dome Unit Agreement. Section 6.3., Basis of Payment to Royalty Owners, provides that royalties will be paid on the greater of (1) the net proceeds derived from sale of carbon dioxide gas at the well or (2) \$0.12/Mcf. However, the Certification-Determination page signed by the Manager, USGS, approving the unit, provided that the \$0.12/Mcf minimum does not apply to the Federal lands and the United States reserves the right to establish higher minimum values for Federal substances. In addition, Section 14.3 of the unit agreement, Royalty Owners Free of Costs, states that the agreement shall not be construed to impose upon any royalty owner any obligation to pay unit expenses unless such royalty owner is otherwise so obligated.

Correspondence between Amoco and the New Mexico Commissioner of Public Lands shows that Amoco is deducting or plans to deduct the following costs in computing royalties due the State of New Mexico:

- (a) depreciation of the gathering system and the compression-dehydration plant processing facilities;
- (b) operating costs of the gathering and processing systems;
- (c) interest on the undepreciated investment in the gathering and processing facilities.

If such costs are being deducted from value for Federal royalty purposes, a recomputation must be made.

Pertinent regulations require that the lessee place the leasehold gas production into marketable condition. According to the lease terms and regulations, the term "gas" includes carbon dioxide.

Decisions by the Director, Geological Survey, and a supporting court decision (The California Company v. Secretary of Interior, August 10, 1961), have upheld the principle that the lease operator is obligated to perform necessary field gathering, dehydration, and compression operations. The court made a distinction between "transportation" of gas and "conditioning" of gas and accepted the Secretary's definition of production as "gas conditioned for market."

The Federal lessee is responsible for all costs involved in gathering, dehydrating, and compressing the carbon dioxide at the Bravo Dome Unit. With this understanding, it is requested that you propose to this office no later than March 18, 1985, a procedure for valuing CO₂ for royalty purposes, which you consider equitable. We expect your proposed procedure to value CO₂ at a price comparable with that being paid pursuant to arm's-length contracts for a majority of like-quality CO₂ produced from the Bravo Dome Field.

Ms. Lonita Atkinson

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After your CO₂ valuation procedure is approved by MMS, you will be asked to submit amended Forms MMS-2014.

~~A copy of our Findings and Conclusions on this matter is enclosed for your information.~~

Sincerely,



William H. Feldmiller
Chief, Royalty Valuation and
Standards Division

Enclosure

ROYALTY MANAGEMENT PROGRAM
ROYALTY VALUATION AND STANDARDS DIVISION

Findings and Conclusions

on
Amoco Production Company's Request for a Determination
of
Royalty Value for Carbon Dioxide Gas Produced from
the Bravo Dome Carbon Dioxide Gas Unit, Union County, New Mexico

Background

By letter dated September 12, 1984, Amoco Production Company advised that it began to pay and report royalties in August on production from the Bravo Dome Carbon Dioxide Gas Unit. Amoco listed the 16 leases for which it was making payment. Amoco also advised that it does not have a sales contract "...but receives reimbursement for its royalty paid from the purchasers; therefore, the value of the product is determined by the purchaser's contract."

The copy of Form MMS-2014 attached to the September 12 letter shows a reported value for carbon dioxide (CO₂) of about \$0.41 per Mcf.

Findings

- ° The CO₂ is gathered to a central facility in the Bravo Dome Unit where it is dehydrated to a maximum water content of 12 pounds per MMcf and compressed to about 2400 psi. Custody transfer to the purchaser takes place at the sales meter at the tailgate of the central facility.
- ° An Amoco representative (Ms. Tammy Douglas, oral commun., October 9, 1984) advised that the two companies currently purchasing CO₂ from the Bravo Dome Unit are Amerada Hess Corporation and Sun Exploration Company.
- ° An Amerada Hess representative (Mr. Rogers, oral commun., October 11, 1984) advised that Amerada is taking its own gas from Bravo Dome for its own use, but that the value of the CO₂ is based on the price Amerada; as a purchaser, pays under arm's-length contracts with other companies. Amerada transmitted a copy of an arm's-length "carbon dioxide sale and purchase contract" with a request that it be kept confidential.

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- ° The Amerada Hess contract shows that the CO₂ is delivered for purchase at a location within the Bravo Dome field and that the price of the CO₂ exceeds the price reported by Amoco on its Form MMS-2014. The CO₂ must meet "Quality Specifications" as to purity, water content, hydrogen sulfide, sulfur content, oxygen content and temperature.
- ° A Sun Exploration Company representative (Mr. Savage, oral commn., October 9, 1984) advised that the price at which it purchases CO₂ at Bravo Dome is comparable to that specified in the Amerada Hess contract.
- ° The Bravo Dome Carbon Dioxide Gas Unit Agreement, Section 6.3, Basis of Payment to Royalty Owners, provides in pertinent part:
 - "It is recognized by the parties hereto that there is now no preeminent market for Carbon Dioxide Gas. Therefore, the parties hereto agree that, as a further consideration for entering into this agreement, royalties paid upon the Unitized Substances allocated to each tract shall be based on the greatest of the following:
 - "(a) The net proceeds derived from the sale of Carbon Dioxide Gas at the well whether such sale is to one or more of the parties to this agreement or to any other party or parties (Emphasis added.)
 - "(b) A minimum value at the well of twelve cents per thousand cubic feet (12¢/Mcf)...."
- ° Section 6.3 of the unit agreement was not acceptable to the Department of the Interior. The Certification-Determination page signed by the Conservation Manager, South Central Region, U.S. Geological Survey, on August 29, 1980, states, in part:
 - "...C. Certify and determine that the drilling, producing, rental, minimum royalty, and royalty requirements of all Federal leases committed to said agreement are hereby established, altered, changed, or revoked to conform with the terms and conditions of this agreement.
 - "2. The provisions of Article 6.3(b) shall not apply to the Federal lands and the United States reserves the right to establish higher minimum values for Federal substances.
 - "3. The provisions of Article 7.3 requiring a party to bear any extra expenditure incurred in the taking in kind or separate disposition of share of the production shall be ineffective as to any royalty which may be taken in kind by the Federal Government...."

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- ° Section 14.3, Royalty Owners Free of Costs, of the Bravo Dome Unit Agreement states, "This agreement is not intended to impose, and shall not be construed to impose, upon any Royalty Owner any obligation to pay Unit Expense unless such Royalty Owner is otherwise so obligated."
 - ° Correspondence between Amoco Production Company (USA) and the New Mexico Commissioner of Public Lands shows that Amoco is deducting, or plans to deduct, the following costs in computing royalties due the State of New Mexico.
 - (a) depreciation of the gathering system and the compression-dehydration plant processing facilities;
 - (b) operating costs of the gathering and processing systems;
 - (c) interest on undepreciated investment.
 - ° The value of about \$0.41 per Mcf of CO₂ reported by Amoco on Form MMS-2014 reflects a deduction of costs for the gathering, dehydrating and compressing the CO₂.
 - ° Production costs are the responsibility of the lessee. The Manual of Oil and Gas Terms by Williams and Meyers defines a lessee as "The person entitled under an oil and gas lease to drill and operate wells, paying the lessor a royalty and retaining the remainder, often 7/8 of the production, known as the 'working interest.' The lessee pays all production costs out of his fraction, the lessor's fraction being free and clear of all such costs...." This lessor-lessee relationship has been long recognized in Federal regulation.
 - ° 43 CFR 3162.7, "Measurement, disposition and protection of production," section (a), provides that:

"The lessee shall put into marketable conditions, if economically feasible, all oil, other hydrocarbons, gas, and sulphur produced from the leased land."
- This regulation applies to CO₂ under the term "gas." Accordingly, the lessee is obligated to place the CO₂ gas in marketable condition.
- ° NTL-1, "Procedures for Reporting and Accounting for Royalties," states under Section III, "Gas and Associated Liquids Production, Sales, and Royalty Requirements":

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~~"Under no circumstances will the royalty value be computed on less than the gross proceeds accruing to the operator from the sale of such leasehold production. Gross proceeds include, but are not limited to, tax reimbursements and payments to the operator for gathering, measuring, compressing, dehydrating, or performing other services necessary to market the production. Likewise, no deduction will be allowed for the cost which an operator incurs by reason of placing the gas in a marketable condition as an operator is obligated to do so at no cost to the lessor."~~

The preceding statement is primarily concerned with gross proceeds. However, in defining the term, it is clear that gathering, dehydrating, and compressing CO₂ gas are considered part of the activities for which the operator is responsible, at no cost to the lessor.

- ° The procedural guide manual used by the Conservation Division, U.S. Geological Survey (predecessor to the Minerals Management Service), Section 647.3A, states in part:

"The lessee is obligated to place lease production in marketable condition without deduction of costs for measuring, compressing or otherwise conditioning the gas for market. Under no circumstances will royalty be computed on less than the gross proceeds accruing to the lessee from the sale of leasehold production."

- ° Decisions by the Director, Geological Survey, and a supporting court decision, The California Company v. Secretary of the Interior, August 10, 1961, have upheld the principle that the lease operator is obligated to perform necessary field gathering, dehydration, and compression operations. The court made a distinction between "transportation" of gas and "conditioning" of gas and accepted the Secretary's definition of production as "gas conditioned for market."

Conclusions

- ° The CO₂ sales contracts provide that the gas is to be conditioned for market and delivered to the purchaser at a location within the Bravo Dome Unit. Accordingly, no transportation costs are involved.
- ° Pertinent regulations and NTL-1 clearly state that the lease operator has the responsibility and obligation to place the CO₂ gas in marketable condition. At least one court decision has upheld the principle that the lease operator is obligated to perform necessary field gathering, dehydration, and compression operations and that gas-conditioning processes are not deductible in computing Federal royalty.

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- ° The costs for gathering, dehydration and compression of CO₂ are a part of the costs involved in conditioning the CO₂ to meet the quality criteria specified in the sales contracts. The operator is responsible for all costs of conditioning the CO₂ at the Bravo Dome Unit to meet the specifications of the sales contracts.
- ° The Bravo Dome Carbon Dioxide Gas Unit Agreement, Section 6.3, permits the deduction of processing and gathering costs because it provides for payment of royalty based upon "net proceeds...at the well" or a minimum value of \$0.12/Mcf. However, this cannot be applied to Federal leases. The unit agreement cannot invalidate the requirements of the regulations as affirmed by court decision. The conditioned approval of the Unit Agreement by the Conservation Manager, South Central Region, United States Geological Survey on August 29, 1980, made this clear to all parties to the Unit Agreement. x-4
- ° Amoco Production Company should propose a procedure for valuing CO₂ for royalty purposes. Such a procedure should provide a value for royalty purposes that is comparable to the prices specified in arm's-length contracts for sale of CO₂ from the Bravo Dome Unit area.

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O&G Valuation Branch
February 1985
Proj. No.: 84-802
C. Curtis

ABSTRACT

By letter dated September 12, 1984, Amoco Production Company transmitted a copy of Form MMS-2014 for the Bravo Dome Carbon Dioxide Gas Unit, New Mexico, and asked to be advised whether its proposed payment method is acceptable for the 16 Federal leases being reported thereon. The carbon dioxide gas is gathered to a central facility in the Bravo Dome Unit where it is dehydrated and compressed to about 2400 psi. Custody transfer to the purchaser takes place at the central facility tailgate sales meter. The CO₂ value being reported on Form MMS-2014 apparently reflects deductions for gathering, dehydration, and compression of the gas. Amoco was advised that such costs are not deductible on computing Federal royalty and was requested to submit a procedure for valuing CO₂ for royalty purposes which it considers equitable.