Council of Petroleum Accountants Society

National Meeting

Norman, Oklahoma

April 20, 2016
Agenda

• New Indian Oil Valuation Rule
• Update on unbundling
  – New UCAs
  – Standardized UCAs
  – Compliance review strategy
• New Major Portion Demands (2008-June 2015)
Update on the new Indian Oil Rule:

- The rule was published on May 1, 2015.
- The rule went into effect on July 1, 2015.
- Two technical conferences were held on Jan 10, 2016?????? To correct the designated areas of Fort Berthold and the Uintah and Ouray Reservations.
- Consultation was held with the Ute and the three affiliated tribes.
- Federal Register Notice drafted to make changes to the above designated areas.
Office of Natural Resources Revenue

• ONRR developed and implemented an upfront edit for the Index Based Major Portion Price, (IBMP) established under the new Indian Oil Valuation Rule.

• Currently, the upfront edit gives a warning error if industry price reported is below the IBMP price.

• This upfront edit will become a fatal error if industry tries to report a price below an IBMP price starting May 1, 2016.
Indian Oil Valuation Rule: Is ONRR getting expected results?

• Since the effective date of the rule through January, based on industry’s reporting, there is potentially over 2 million dollars of unpaid royalties due to companies reporting below the IBMP price.

• Data Mining will be issuing Orders to Pay for these outstanding Indian royalties.
Office of Natural Resources Revenue

Leases overlapping Designated Areas

12 Leases Currently producing Overlap Multiple Designated Areas
7 are in the UNO Reservation
5 are in Fort Berthold

Agreements overlapping Designated Areas

116 Agreements Currently Producing Overlap Multiple Designated Areas
107 are in Fort Berthold
9 are in the UNO Reservation

Designated Area
- North Fort Berthold
- South Fort Berthold
- UNO - Duchesne County
- UNO - Uintah and Grand Cou..
Standardized Unbundling Cost Allocation

and

Natural Gas Processing Cost Estimation Tool
Why Unbundle?

• Marketable Condition: lease products which are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area.” 30 C.F.R. § 1206.151 (federal gas), § 1206.171 (Indian gas).
  – The lessee must place production in marketable condition at no cost to the Federal Government.
• Unbundling: Itemizing the equipment and associated costs for transportation and processing (e.g., dehydration, compression, acid gas removal, etc.).
Industry’s Options for Claiming Allowances:

• Unbundle the transportation and/or processing costs.

• Use Unbundling Cost Allocations (UCAs) provided by ONRR.

• Take zero allowance.
<table>
<thead>
<tr>
<th>Offshore Refrigerated Lean Oil Plants</th>
<th>UCA Percent Allowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stingray</td>
<td>85%</td>
</tr>
<tr>
<td>Yscloskey</td>
<td>88%</td>
</tr>
<tr>
<td>North Terrebonne</td>
<td>90%</td>
</tr>
<tr>
<td>Calumet</td>
<td>93%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Offshore Cryogenic Plants</th>
<th>UCA Percent Allowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neptune</td>
<td>69%</td>
</tr>
<tr>
<td>Pascagoula</td>
<td>85%</td>
</tr>
<tr>
<td>Toca</td>
<td>84%</td>
</tr>
<tr>
<td>Eunice</td>
<td>43%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>San Juan Basin Cryogenic Plants</th>
<th>UCA Percent Allowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chaco</td>
<td>25%</td>
</tr>
<tr>
<td>Ignacio</td>
<td>37%</td>
</tr>
<tr>
<td>Blanco</td>
<td>40%</td>
</tr>
<tr>
<td>Kutz</td>
<td>75%/57%</td>
</tr>
<tr>
<td>Lybrook</td>
<td>62%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other Plants</th>
<th>UCA Percent Allowed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opal</td>
<td>50%</td>
</tr>
<tr>
<td>Huerfano</td>
<td>54%</td>
</tr>
<tr>
<td>Carlsbad</td>
<td>90%</td>
</tr>
</tbody>
</table>
Standardized UCA Development:

• ONRR is currently developing Standardized UCAs based on:
  – Gas Plant Location
  – Gas Processing Technology
  – Size of the plant (design throughput)

• Arms-length producers may elect to use a Standardized UCA in lieu of unbundling a plant when a UCA does not exist.
Benefits of Standardized UCAs

• Reduced data request burden for industry.

• Provide an alternative to the expense of unbundling for producers.

• All arms-length processing payors have a UCA available.

• Reduce time and money spent by producers and ONRR on audits and compliance reviews.
**Natural Gas Processing Cost Estimation Tool**

- More plants unbundled → better Standardized UCAs.
- Tool will allow us to increase number of UCAs accurately and efficiently.
- Current UCA process requires approximately 3 months to complete.
- Estimation tool will shorten UCA calculation process to approximately one week.
### Background Information

<table>
<thead>
<tr>
<th>Plant Name:</th>
<th>Example Gas Plant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant Location:</td>
<td>San Juan Basin</td>
</tr>
<tr>
<td>Company Name:</td>
<td>Example Company</td>
</tr>
<tr>
<td>Date:</td>
<td>3/22/2016</td>
</tr>
</tbody>
</table>

### Processes within the plant

<table>
<thead>
<tr>
<th>Processes</th>
<th>Does the plant of interest contain these processes</th>
<th>Number of trains/identical units</th>
<th>Capacity</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inlet Separation</td>
<td>Yes</td>
<td>1</td>
<td>7773</td>
<td></td>
</tr>
<tr>
<td>Inlet Compression</td>
<td>Yes</td>
<td>2</td>
<td>7700</td>
<td></td>
</tr>
<tr>
<td>Inlet Glycol Dehydration</td>
<td>Yes</td>
<td>1</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td>Cryogenic Process</td>
<td>Yes</td>
<td>1</td>
<td>300</td>
<td></td>
</tr>
<tr>
<td>Cryogenic Process</td>
<td>Yes</td>
<td>1</td>
<td>350</td>
<td></td>
</tr>
<tr>
<td>Lean oil absorption process</td>
<td>No</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Propane Refrigeration</td>
<td>Yes</td>
<td>1</td>
<td>360</td>
<td></td>
</tr>
<tr>
<td>Amine Treating Processes (DEA)</td>
<td>No</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Molecular Sieve</td>
<td>Yes</td>
<td>2</td>
<td>325</td>
<td></td>
</tr>
<tr>
<td>Residue Compression</td>
<td>Yes</td>
<td>2</td>
<td>14772</td>
<td></td>
</tr>
<tr>
<td>Unique Processes</td>
<td>No</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>
Example: Dehydration

- Vessels
- Pumps
- Heat Exchanger
- Reboiler
<table>
<thead>
<tr>
<th>Gas Plant Name /Type</th>
<th>UCA Calculated From Cost Estimation Tool</th>
<th>Published UCA From ASPEN Modeling</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Allowed Capital Cost</td>
<td>Allowed Capital Cost</td>
</tr>
<tr>
<td></td>
<td>Total Capital Cost</td>
<td>Total Capital Cost</td>
</tr>
<tr>
<td>N. Terrebonne Lean Oil Plant</td>
<td>91%</td>
<td>90%</td>
</tr>
<tr>
<td>Neptune Cryogenic Plant</td>
<td>69%</td>
<td>69%</td>
</tr>
</tbody>
</table>
Proposed Valuation Regulations

• The Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Proposed Rule was published on January 6, 2015.
  – The proposed rule offers greater simplicity, certainty, clarity, and consistency in product valuation for mineral lessees and mineral revenue recipients.
  – The proposed rule does not alter the underlying principles of the current royalty valuation regulations.

• ONRR received comments from over 300 commenters along with about 190,000 form letters and/or petition signatories.
  – The comments and positions on oil and gas valuation were polarized.
  – The oil and gas industry generally agreed that gross proceeds from arm’s-length contracts are the best indication of market value.
Valuing Arm’s Length Sales:
• The best indicator of value, for royalty purposes of oil & gas produced from Federal leases is the gross proceeds from arm’s-length contracts.

Valuing Non-Arm’s Length Sales:
• **Federal Oil:** valuation methodology for non-arm’s-length sales is working; ONRR did not propose major changes to oil valuation methodologies.
• **Federal Gas:** the proposed rule eliminates the existing three (3) prioritized benchmarks and provides valuation options consistent with current market practices:
  – Gross proceeds under the affiliate’s first arm’s-length sale with applicable allowances; or
  – Election to use an index price.
Transportation Allowances:
• Disallows transportation allowances greater than 50% of the value of oil or gas and terminates existing approvals for exceeding the 50% limit.
• Arm’s-length transportation allowances must be reported on Form ONRR-2014 as costs rather than a single factor.

“Default” Provision:
• Addresses valuation situations where circumstances result in the Secretary’s inability to reasonably determine the correct value of production.
• Codifies the Secretary’s authority to determine the value of production for royalty purposes and specifically enumerates the when, where, and how the Secretary will use that discretion.

Cost of Capital
• The current rate will be reduced from 1.3 to 1.0 times the S&P BBB bond rate.
Proposed Federal Oil and Gas Provisions

- The May 20, 1999, MMS Associate Director Memo “Guidance For Determining Transportation Allowances for Production from Leases in Water Depths Greater Than 200 Meters”:
  - Allowed deduction of costs to move bulk production from the subsea manifold to the platform where the oil and gas first surface; and
  - Is inconsistent with the regulatory definition of “gathering” and legal decisions interpreting that term.
- The proposed regulatory changes:
  - Rescind the 1999 Memo;
  - Clarify the meaning of gathering;
  - Provide a more consistent application of the regulations; and
  - Still allow offshore lessees to deduct considerable transportation costs to move oil and gas from the offshore platform to onshore markets.
Next Steps

• The Department of the Interior sent the final version of its proposed Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule to the White House Office of Information and Regulatory Affairs (OIRA) for review and consideration.

• The Department remains committed to updating and modernizing its regulatory framework for valuation of these products by publishing the final rule in the *Federal Register* this year.
Unbundling

- The process of taking gas transportation and/or processing fees and determining the allowed and disallowed costs for royalty reporting and payment.

- The lessee must place production in marketable condition at no cost to the federal government (30 C.F.R. § 1206.151).

- Lessees have three options for claiming allowances:
  1. Unbundle the transportation and processing systems;
  2. Use Unbundling Cost Allocations (UCAs) provided by ONRR; or
  3. Take zero allowance.
UCAs are available online at www.ONRR.gov/unbundling

- This fiscal year, ONRR is working to calculate UCAs for the following gas processing plants:
  - Toca (just posted to our web site)
  - Larose
  - Venice
  - Mobile Bay (Williams)
  - Sea Robin
Standardized UCAs

• ONRR plans to begin development in FY 2017:
  – Based on gas plant location and gas processing technology
  – Arms-length producers may elect to use a standardized UCA in lieu of unbundling a plant when a UCA does not exist.

• Benefits:
  – Reduces the data request burden for industry;
  – Provides an alternative to the expense of unbundling;
  – All arms-length processing payors would have a UCA available; and
  – Reduces the time and money spent by producers and ONRR on audits and compliance reviews.