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:

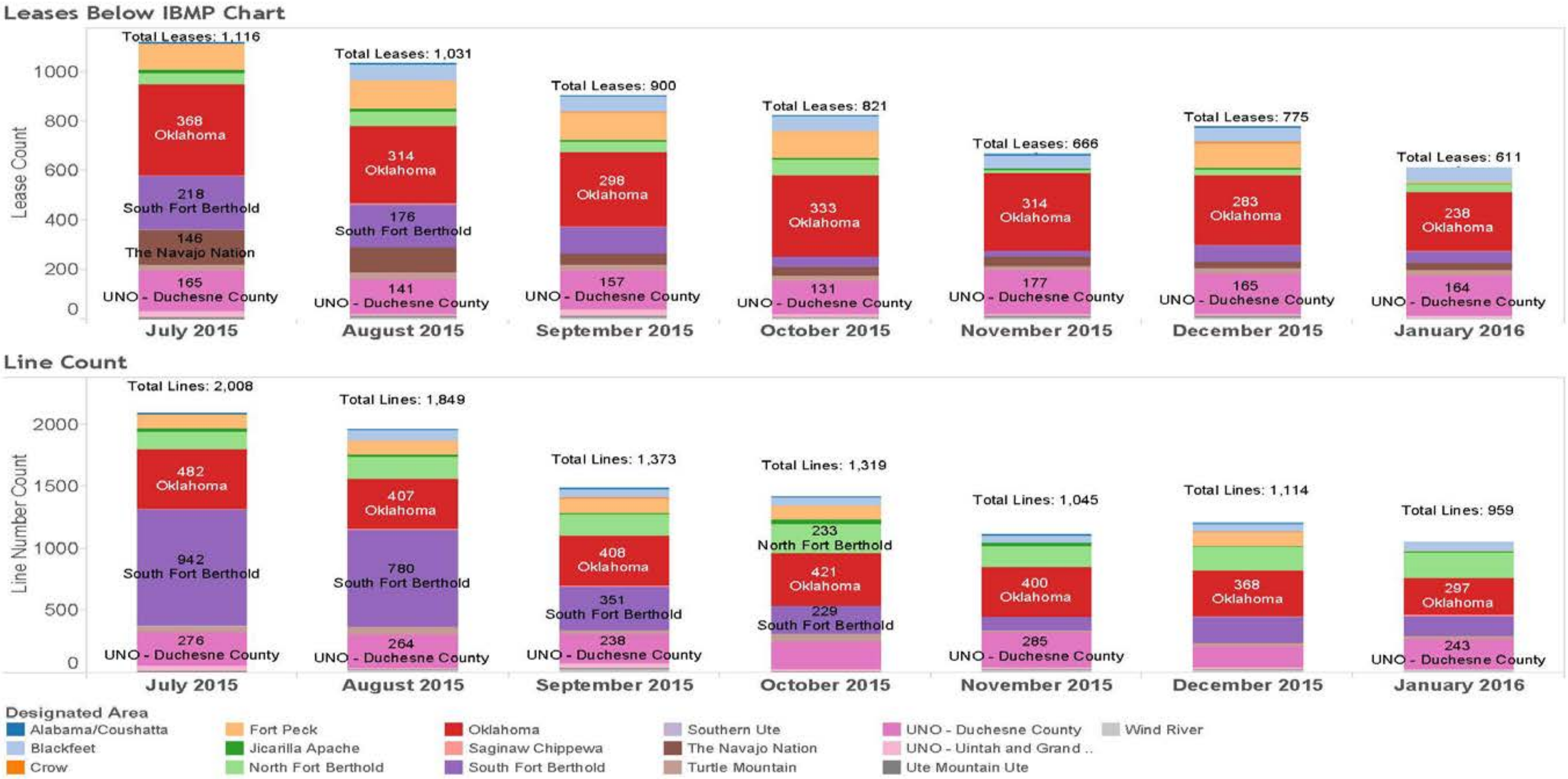
- The rule was published on May 1, 2015.
- The rule went into effect on July 1, 2015.
- Two technical conferences were held on Jan 10, 2016????? To correct the designated areas of Fort Berthold and the Uintah and Ouray Reservations.
- Consultation was held with the Ute and the three affiliated tribes.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

- 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.

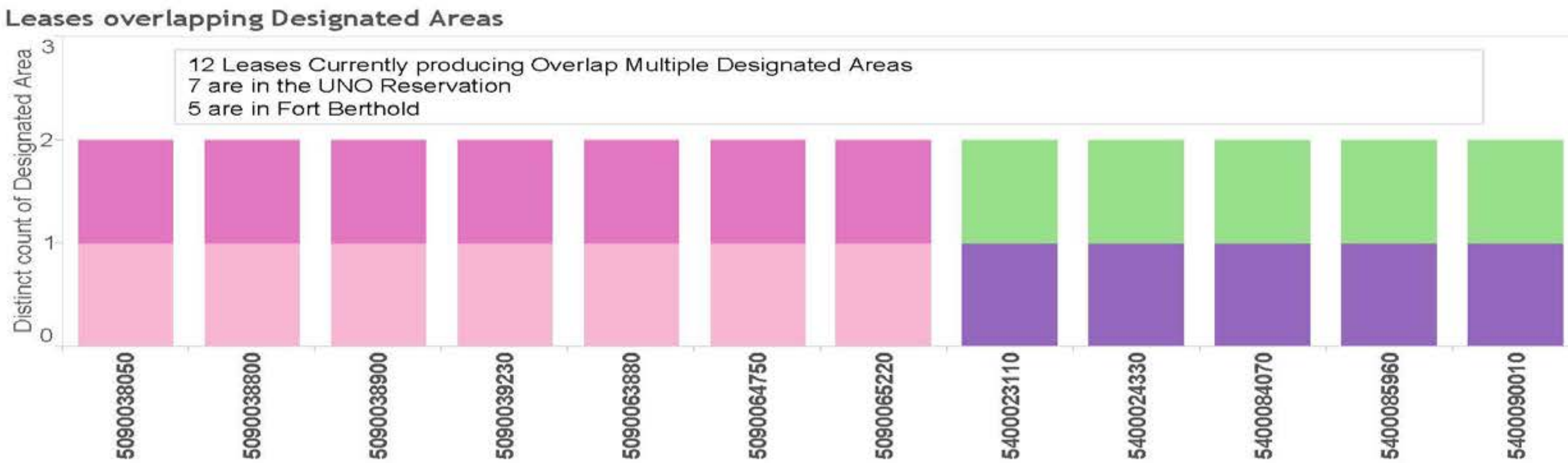
Indian Oil Valuation Rule: Is ONRR getting expected results?

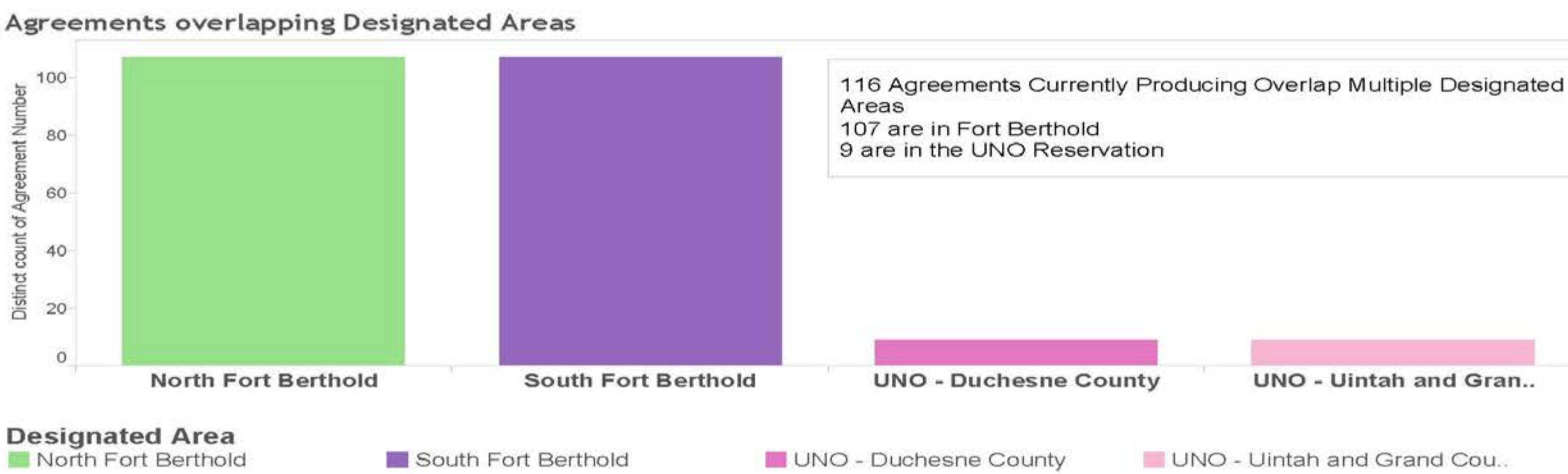
- Since the effective date of the rule through January, based on industry's reporting, there is potentially over 2 million dollars of unpaid royalties due to companies reporting below the IBMP price.
- Data Mining will be issuing Orders to Pay for these outstanding Indian royalties.

Office of Natural Resources Revenue



Office of Natural Resources Revenue





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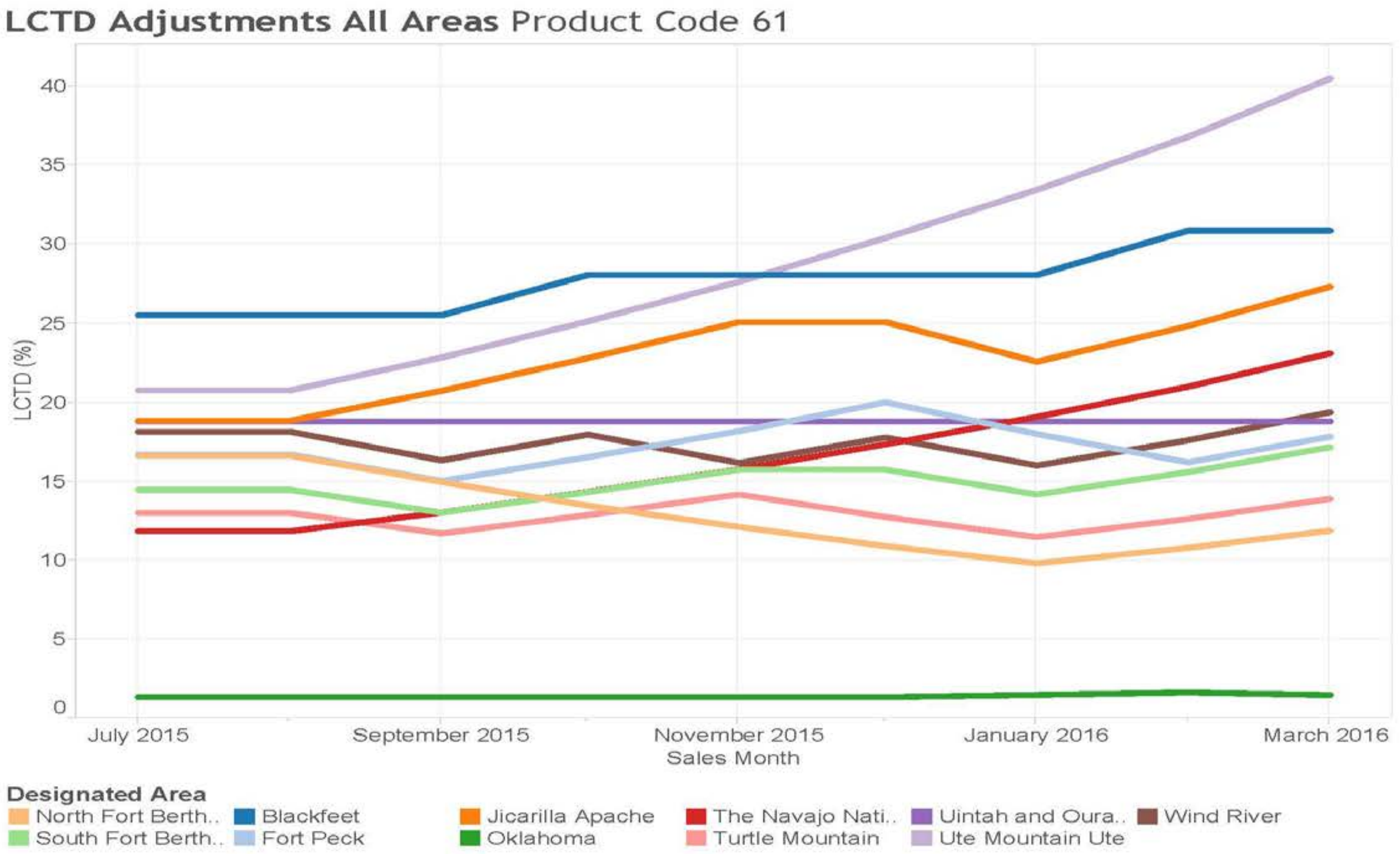


Standardized Unbundling Cost Allocation

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.

Offshore Refrigerated Lean Oil Plants	UCA Percent Allowed
Stingray	85%
Yscloskey	88%
North Terrebonne	90%
Calumet	93%

Offshore Cryogenic Plants	UCA Percent Allowed
Neptune	69%
Pascagoula	85%
Toca	84%
Eunice	43%

San Juan Basin Cryogenic Plants	UCA Percent Allowed
Chaco	25%
Ignacio	37%
Blanco	40%
Kutz	75%/57%
Lybrook	62%

Other Plants	UCA Percent Allowed
Opal	50%
Huerfano	54%
Carlsbad	90%

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.

Natural Gas Processing Tool

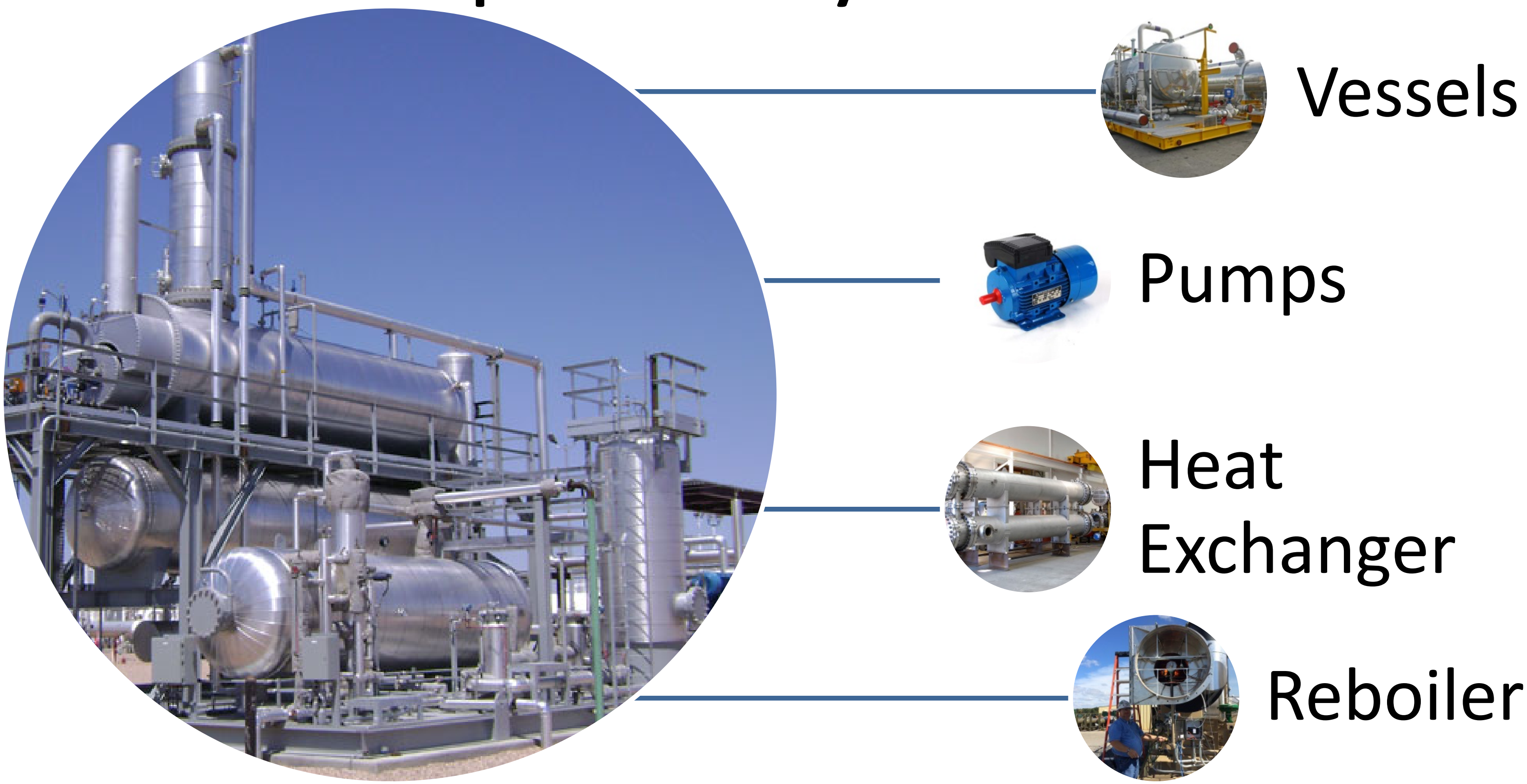
Background Information

Plant Name:	Example Gas Plant
Plant Location:	San Juan Basin
Company Name:	Example Company
Date:	3/22/2016

Processes within the plant

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

Example: Dehydration



Gas Plant Name /Type	UCA Calculated From Cost Estimation Tool $= \dfrac{\textit{Allowed Capital Cost}}{\textit{Total Capital Cost}}$	Published UCA From ASPEN Modeling $= \dfrac{\textit{Allowed Capital Cost}}{\textit{Total Capital Cost}}$
N. Terrebonne Lean Oil Plant	91%	90%
Neptune Cryogenic Plant	69%	69%

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.

Proposed Federal Oil and Gas Provisions

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.

Proposed Federal Oil and Gas Provisions

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.

Unbundling Cost Allocations

- UCAs are available online at www.ONRR.gov/unbundling

System/Plants Table

Show 10 entries

Table Search:

Name with Document Link	Type	Operator	Location	Doc Date
Eunice Gas Plant (PDF)	Plant	Enlink	LA	03/23/2016
Neptune Gas Plant (PDF)	Plant	Enterprise	LA	01/16/2016
North Terrebonne Gas Plant (PDF)	Plant	Enterprise	LA	09/30/2015
Stingray Gas Plant (PDF)	Plant	Targa	LA	09/30/2015
Yscloskey Gas Plant (PDF)	Plant	Targa	LA	09/16/2015

- 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.