ConocoPhillips

May 8, 2015

Armand Southall
Regulatory Specialist
Office of Natural Resources Revenue
P.O. Box 25165, MS 61030A
Denver, CO 80225

RE: Comments on Proposed Rule to Amend Federal Oil & Gas Valuation Regulations (1012-AA13)

Dear Mr. Southall:

ConocoPhillips appreciates the opportunity to comment on the proposed rule regarding oil and gas valuation (Proposed Rule). We support the Office of Natural Resources Revenue's (ONRR) stated objectives for the Proposed Rule – simplicity, certainty, clarity and consistency in production valuation – however, these objectives should not be achieved at the expense of valuation fairness and accuracy. The Proposed Rule would significantly change, without proper justification, long-standing processes and valuations on which industry has relied. We are concerned many of the changes are unclear – undermining the stated objective of clarity – and will lead to less accurate valuations.

ConocoPhillips has a strong U.S. presence including both developed and exploratory Federal Lands holding approximately 2.1 million net acres in the deepwater Gulf of Mexico, .7 million net acres in Alaska and core producing operations on Federal Lands in New Mexico, Wyoming, North Dakota and Offshore. We are also the largest operator in the San Juan Basin holding approximately 1.3 million net acres of oil and gas leases by production. Many of these leases contain Federal royalty interest. In 2014, ConocoPhillips paid more than $285 million and reported almost one million lines related to Federal oil and gas royalties.

ConocoPhillips strongly endorses comments submitted jointly by the American Petroleum Institute (API) and Independent Petroleum Association of America (IPAA), as well as those submitted by the Council of Petroleum Accountants Society (COPAS). We specifically express the following concerns:

1. Agency discretion – The new default provision, proposed at Sections 1206.105 for Oil and 1206.144 for Gas and mentioned throughout the Proposed Rule, does not set forth specific criteria for ONRR to use in determining what is "reasonable." The lack of criteria can result in inconsistent application of the default standard, a direct contradiction of ONRR's stated

objective for the Proposed Rule, "offer greater simplicity, certainty, clarity and consistency in product valuation," as well as the objective to "provide early certainty to industry and ONRR that companies have paid every dollar due." The Proposed default provision could result in ConocoPhillips not being allowed to value royalties based upon arms-length sales contracts, or to deduct all the actual, reasonable transportation and processing costs. ConocoPhillips desires to work with ONRR to adopt regulations providing more certainty in valuation leading to less risk, efficiencies in reporting and audits, and improved planning for both industry and ONRR. Without this certainty, more variables enter into investment decisions in areas where Federal royalties exist.

2. Processed Gas vs. Unprocessed Gas - ConocoPhillips does not agree with ONRR's proposal to eliminate the separately defined requirements for processed gas vs. unprocessed gas, especially as it relates to the marketable condition rule. By ONRR's own proposed definitions, Gas, Gas Plant Products and Residue Gas are different. Gas Plant Products and Residue Gas do not exist until after processing. Processing is defined by ONRR as "any process designed to remove elements or compounds (hydrocarbon and non-hydrocarbon) from gas". Marketable condition "means lease products which are sufficiently free from impurities and otherwise in a condition they will be accepted by a purchaser under a sales contract"; Gas Plant Products and Residue Gas do not exist, and would not be "accepted by a purchaser under a sales contract" until after processing; therefore Gas Plant Products and Residue Gas cannot be placed in marketable condition until they exist. The Proposed Rule provides no clear distinction between how the marketable condition rule is applied to processed gas vs. unprocessed gas (Section 1206.146), and is therefore confusing and inconsistent with the royalty obligation for Gas, Gas Plant Products and Residue Gas under proposed Sections 1206.141, 1206.142 and 1206.150. It is unreasonable and inappropriate to assume a lessee would be required to place processed gas in marketable condition twice; once as "Gas" and again as "Residue Gas" and "Gas Plant Products".

3. Transportation allowance - The Proposed Rule removes the ability to request approval to exceed the 50% limit on transportation allowances for Oil 1206.110(d)(1)&(2) and Gas 1206.152(e)(1)&(2). Currently, all exceptions must be requested and the transportation costs must be actual, reasonable and necessary. By removing the ability to exceed the 50% limit, ONRR would be denying the ability of the lessee to deduct all of their actual, reasonable and necessary transportation costs, which we believe is unfair and inappropriate. In ONRR's own admission, "the current 50-percent limit on transportation-related costs is adequate in the vast majority of transportation situations,"; thus invalidating ONRR's claim of administrative cost for its removal.

4. Processing allowance - The Proposed Rule also eliminates the ability to request approval to exceed the 66.67% processing cap in Section 1206.158(c)(2)&(3). ONRR provides no documentation or data justifying this proposed change. By eliminating the ability to exceed the 66.67% processing cap, ONRR would be disallowing the lessee the ability to deduct all the actual, reasonable and necessary processing costs which we believe is unfair and inappropriate.

5. Loss of extraordinary allowances – The Proposed Rule not only eliminates the ability to request an extraordinary processing allowance; it does away with previously approved allowances. ONRR does not provide sufficient justification for this change; quoting the "age of the plants" and the "improvements in technology" as justification is generic rationale and disregards the

reasons two very specific approvals for extraordinary allowances were agreed to by ONRR/MMS in the past. The ONRR/MMS approved these extraordinary processing allowances out of an acknowledgement that fields can and do have unique gas composition, complex plant designs and extremely high unit costs justifying an extraordinary allowance. Since those approvals, investment decisions have been based upon economics with these ONRR/MMS approved allowances in place. ConocoPhillips strongly disagrees with the termination of prior ONRR/MMS approval for extraordinary allowances.

6. Transportation Factors – These factors are not defined in the Proposed Rule and ConocoPhillips is confused by what is intended in regard to Transportation Allowances vs. Transportation Factors. Factors, currently netted with the price, are not incurred by the lessee; therefore detail is not always available in order to apply separate reporting. If such a requirement were adopted, similar to the field fuel reporting change, it would result in numerous complications due to insufficient guidance. It would also require a large scale contract review and major changes to accounting systems and processes. This would significantly increase administrative burden adding to industry's cost of compliance.

7. Transportation Allowances for OCS Leases – As an offshore producer and developer, ConocoPhillips is disturbed about the ONRR's proposal to remove the allowance for transportation costs as a deduction from the well to the first platform as referenced in proposed Sections 1206.110-1206.112 for Oil and 1206.152-1206.154 for Gas. Circumstances for offshore production can vary significantly from circumstances for onshore production; sometimes requiring many miles of movement for the product to travel from the well to the first platform. This movement can be very expensive, and is not the same as gathering for onshore leases. This was thoroughly researched and previously identified as a valid transportation deduction in 2000 by the MMS/ONRR.

8. No Written Contracts – ONRR's proposed requirements for written and signed contracts (1206.111(d); 1206.141(d); 1206.143(g); 1206.153(d); 1206.160(c)) are inconsistent with industry procedures and the Proposed Rule's own recognition of other forms of contracts in its proposed definitions in 1206.20. The proposed regulations need to be revised to recognize unwritten, unsigned, arms-length, legally binding contracts for sales, transportation and/or processing, and they should be acceptable in establishing value. For example, a FERC tariff should be accepted to establish arms-length transportation costs on a FERC regulated pipeline.

9. Index pricing – Proposed Sections 1206.141 and 1206.142 mention an index option as a valuation alternative when non-arm's length transactions are involved. However, the basis for the index pricing and deductions is unreasonable when compared to market. For example, a price established using the "highest reported monthly bid week price" is not justified and would result in a price that is often higher than average-and can be substantially higher. As written, the proposed price results in a price higher than the Indian Gas Valuation price containing a major portion pricing provision. The deductions for transportation and processing have similar issues, often referencing historical data in determining the amounts and reflecting costs substantially lower than current costs. ConocoPhillips believes index pricing has value, but only when the pricing and deductions compare in a reasonable manner to market values. Additionally, because arms-length sales have the same tracing and unbundling issues as those companies with non-arms-length sales, the index pricing option should also be available to companies that sell their products off-lease whether at arms-length or non-arms-length.

Federal properties are a core part of ConocoPhillips' portfolio. It is critical to our business for federal oil and gas valuation regulations to be fair, clear, and certain, and not administratively burdensome. We request ONRR seriously consider comments submitted by ConocoPhillips, and those submitted by API/IPAA and COPAS, to make the appropriate changes to the Proposed Rule. We would welcome the opportunity to discuss this Proposed Rule with you further as the review process continues.

If you have any questions regarding these comments, please contact me at the number below.

Sincerely,

Nancy J. Wyant

Nancy J. Wyant
ConocoPhillips
Director, Leveraged Services
Production, Revenue and Joint Venture Accounting
(918) 661-0034