FREEPORT-McMoRAN
OIL & GAS

Freeport-McMoRan Oil & Gas LLC
1615 Poydras Street
New Orleans, LA 70112

Telephone: 504-582-4000

May 6, 2015

Mr. Armand Southall
Regulatory Specialist
Office of Natural Resources Revenue
Building 85, Room A-614
Denver Federal Center
West 6th Ave. and Kipling St.
Denver, Colorado 80225

Attn: Regulation Identifier Number (RIN) 1012-AA13

Re: Freeport-Oil & Gas LLC Comments on Office of Natural Resources Revenue's Proposed Rule to Amend Federal Oil & Gas Valuation Regulations, 80 Fed. Reg. 608 (Jan. 6, 2015) (the "Proposed Rule")

Submitted via: OVERNIGHT COURIER

Dear Mr. Southall:

Freeport McMoRan Oil & Gas LLC (FM O&G) appreciates the opportunity to comment on the Proposed Rule. FM O&G is an exploration and production company with oil and natural gas assets in the Deepwater Gulf of Mexico ("GOM"), onshore and offshore California, the Haynesville shale play in Louisiana, the Madden area in central Wyoming, and in the emerging Inboard Lower Tertiary/Cretaceous natural gas trend located in the shallow waters of the GOM and onshore in South Louisiana. FM O&G and its subsidiaries have over 900,000 federal net acres under lease in the GOM, offshore California and onshore. Based on the recent data released under the Office of Natural Resources Revenue ("ONRR") unilateral disclosure of revenue for 2013 on natural resources extracted from Federal lands, FM O&G is the tenth highest payor of royalties and revenues to the ONRR.

I. Council of Petroleum Accountants Societies ("COPAS") Comments

FM O&G is a member of COPAS and hereby adopts and endorses the comments of COPAS submitted to ONRR in response to the Proposed Rule.

II. American Petroleum Institute ("API") and Independent Petroleum Association of America ("IPAA") Comments

FM O&G is a member of both API and IPAA and hereby adopts and endorses the combined comments of API and IPAA submitted to ONRR in response to the Proposed Rule.

III. FM O&G General Comments

FM O&G appreciates ONRR's efforts to improve the regulatory process for federal oil and gas royalty valuation and agrees with ONRR that gross proceeds from arm's-length contracts are the best indication of market value. Valuation based on the negotiations between competing economic interests should be sufficient as the basis for royalty payments to the ONRR. The Proposed Rule, however, provides opportunities for ONRR to more broadly question the use of prices received and the cost incurred by lessees as correct for royalty settlement. FM O&G supports ONRR's commitment to ensure collection of proper royalties due on production of oil and gas from federal leases. FM O&G does not support, however, duplication of effort and burdensome reporting requirements, valuation changes that do not allow for the use of gross proceeds from arms-length contracts or that result in ONRR collecting more royalties than what the proceeds collected by the lessee justify, and we do not support changes in valuation or reporting resulting from the Proposed Rule being applied on a retroactive basis.

Deepwater Transportation

FM O&G objects to the reclassification of deepwater transportation as gathering. FM O&G believes the prior efforts undertaken by the Minerals Management Service ("MMS") and industry which resulted in the May 20, 1999, Guidance for Determining Transportation Allowances for Production from Leases in Water Depths Greater than 200 Meters appropriately addressed this issue. The Proposed Rule would now supersede that guidance and unfairly deem "any" movement of production from the wellhead to a platform as gathering with no substantive justification for so doing and at a significant cost and detriment to FM O&G and industry.

The historical concept of gathering from onshore or shallow water development where field processes take place on or near the wellhead do not translate to the deepwater Outer Continental Shelf ("OCS"). Movement on a lease block or within a field does not equate to "any" movement of production from the wellhead to a platform in deepwater. There are physical, environmental, and economic barriers which necessarily preclude platform facilities from being constructed on each and every deepwater lease block. To deny transportation allowances for subsea pipelines necessary to bring production across greater distances and multiple leases to shared platforms would be arbitrary and capricious.

FM O&G has proceeded to significantly expand its activities into deepwater, spending many millions of dollars on lease bonus bids, exploration, planning and development. In planning and constructing our facilities, we are relying on tie-backs of subsea completions to our existing platforms. We have reasonably relied on the agency's historical allowance of transportation costs for subsea movement in our development planning and economics. The proposed definition should be modified to exclude the deepwater and the May 1999 Guidance should be appropriately codified.

Definition of Misconduct

The proposed regulations would define "misconduct" as any failure to perform a duty owed to the United States under a statute, regulation, or lease, or unlawful or improper behavior, "regardless of the mental state of the lessee or any individual employed by or associated with the lessee."

This definition is overbroad. The common understanding of "misconduct" involves an element of intentional wrongdoing. Under the new definition even a good faith error is "misconduct." FM O&G believes the proposed definition is overly broad and the focus of the definition should be narrowed accordingly.

Default Provision

The proposed "Default Provision" (1206.144) and the associated triggers for its application provide too much discretion resulting in additional uncertainty. While we support a default valuation when no other contractual or index pricing data is available, FM O&G believes the Proposed Rule should be amended or clarified.

The "Default Provision" should not be used for simple reporting errors.

The concept of allowing ONRR to use the "Default Provision" because the value is ten percent below the lowest reasonable measure of value in arms-length situations or because the transportation or processing allowance is ten percent above the highest reasonable measure of transportation or processing is excessive. Current regulations already require the value to be reasonable and the deductions to be actual, reasonable and necessary.

Transportation Allowance Cap: §§ 1206.152 (gas), 1206.110 (oil)

The current Proposed Rule (Subsection (e) (1)) fixes the limit so that a transportation allowance may not exceed fifty percent of the value of the oil, gas, or gas plant products. The existing federal oil and gas regulations have the same limitation, but existing §§ 1206.109(c) (2) and 1206.156(c)(3) authorize ONRR to approve a request to exceed the limit if the lessee demonstrates the costs are "reasonable, actual and necessary."

The ability to request approval to exceed the fifty percent limit on transportation allowances needs to be reinstated. Operational, environmental and pricing circumstances may justify/require the incurrence of costs which could exceed the fifty percent limit. The requirement of current regulations for the lessee on a case by case basis to request and receive an approval over the current limit for these deductions provides the ONRR the ability to confirm that the deductions are actual, reasonable and necessary. ONRR acknowledges that the vast majority of transportation allowances do not involve exceptions so administrative burden should be no justification. If ONRR wants to reduce the administrative burden, it simply needs to approve the exception for two or three year periods rather than the current annual approval process. The change appears to be arbitrary resulting in the potential overpayment of royalty as compared to gross proceeds realized and should be eliminated.

Under Subsection (e) (2) ONRR would terminate any existing approvals that exceed the 50 percent limit. This is unreasonable retroactive termination of a previously agreed to transportation allowance which by the ONRR's own standards are granted on an annual basis. In any case, termination should only apply at the end of the current approved period.

<u>Process Allowance Cap: §§ 1206.159; 1206.160; 1206.161</u>

The Proposed Rule eliminates the ability to request approval to exceed the 66.67 percent processing cap (1206.159(c) (2)&(3). As with the Transportation Allowance Cap there could be extenuating circumstances where there are unique production profiles with little or no natural gas liquids to offset all the processing costs or other operational, environmental or pricing circumstances that result in costs exceeding the 66.67 percent processing proceeds. The requirement of current regulations for the lessee on a case by case basis to request and receive an approval over the current limit for these deductions provides the ONRR the ability to confirm that the deductions are actual, reasonable and necessary. The change appears to be arbitrary, resulting in the potential overpayment of royalty and should be eliminated. The Proposed Rule also eliminates the ability to request an extraordinary processing allowance (1206.159(c) (4). ONRR provided no justification for no longer allowing a lessee to request an extraordinary processing allowance. FM O&G's comments with respect to Transportation and Processing Allowances pertain similarly to this issue.

<u>Marketable condition and boosting duplication</u>

The Proposed Rule (1206.153(c)(8)) requires lessees to place the gas, residue gas, or gas plant products into marketable condition at no cost to the lessor and disallows the costs of boosting residue gas. The disallowance of the costs of boosting residue gas may result in the lessee having to pay for some marketable condition costs twice for processed gas. In those cases, the lessee is required to compress the gas at the field or platform and then again as part of the plant processing thereby placing the gas in marketable condition twice. The proposed language for marketable condition should be sufficient and the boosting prohibition should be eliminated.

AAA bond rate and line loss

ONRR would reduce the rate of return used to calculate the return on investment from 1.3 to 1.0 times the S&P BBB bond rate. This change lacks justification in the Proposed Rule and FM O&G believes the change should be supported or eliminated.

ONRR proposes to eliminate actual or theoretical line loss as a transportation cost. This is a real cost to lessees. ONRR fails to provide justification for this change in the current regulations. The proposed rule should be justified or eliminated.

The above summary provides FM O&G's more significant concerns with the Proposed Rule. Again, FM O&G supports the comments submitted by COPAS and the combined comments of API and IPAA. FM O&G welcomes and encourages ONRR to continue to engage and participate with industry in discussing and formulating those reasonable and appropriate changes to improve, strengthen and clarify its royalty valuation process.

Sincerely,

Thomas Beron

Thomas Beron
Vice President and
Assistant General Counsel