Disclaimer

This presentation does not provide legal advice and should not be construed as stating ONRR’s legal interpretation or position. Rather, this presentation serves as guidance for determining value for royalties and is not an appealable decision or order under 30 CFR Part 1290, Subpart B. This general guidance is based on examples and not a particular situation. While this message is not appealable, ONRR may use this guidance in conducting audits and as a basis for demanding additional royalties.
Housekeeping

• All participants are automatically muted. To ask a question, raise your hand, and we’ll call on you to unmute yourself.

• We are also monitoring the chat.

• If you need assistance with the captioning, please drop that in the chat.
Test the Polling

How long have you been working with oil and gas royalties?

A. 0-2 years
B. 2-5 years
C. 5-10 years
D. More than 10 years
2016 Rule

• This training is valuation guidance on the regulations promulgated in the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule (81 FR 43338, July 1, 2016).

• Reinstated on March 29, 2019, by the US District Court for the Northern District of California (Case No. 4:17-cv-05948-SBA (Mar. 29, 2019)).

• Effective for federal oil and gas production on or after January 1, 2017.
Valuation Regulations

30 CFR Part 1206

◆ Definitions: §1206.20

◆ Federal Oil: §1206.100 - §1206.119

◆ Federal Gas: §1206.140 - §1206.165

Electronic Code of Federal Regulations:
http://www.ecfr.gov/
AGENDA

• ONRR Royalty Equation
  • Volume
  • Value
  • Allowances
• Gas Valuation
• Oil Valuation
• Reporting
ONRR Royalty Equation

Royalty due =

\[ \text{volume} \times \text{unit value} \times \text{royalty rate} \] - allowances

Oil example:
Volume sold = 100 bbl
Unit value = $90/bbl
Royalty rate = 12.5%
Allowable transportation cost = $2.00/bbl

\[100 \text{ bbl} \times $90/\text{bbl} \times 0.125\] – \[\$2.00/\text{bbl} \times 100 \text{ bbl} \times 0.125\] = \$1,100.00
Form ONRR-2014
Common Product Codes

Production
- Oil (PC 01)
- Condensate (PC 02)
- Unprocessed Gas (PC 04)
- Coalbed Methane (PC 39)

Transportation
- Pipeline Fuel (PC 15)
- Drip Condensate (PC 05)

Processing
- CO₂ (PC 17)
- Sulfur Recovery
- Sulfur (PC 19)
- Gas Treating
- Dehydration
- Condensate Stabilization
- Inlet Scrubber Condensate (PC 06)
- NGL Extraction
- NGLs (PC 07)

Residue Gas (PC 03) or Coalbed Methane (PC 39)
Volume Overview

Royalty is due on the quantity and quality of production as measured at the Bureau of Land Management (BLM) or Bureau of Safety and Environmental Enforcement (BSEE)-approved royalty settlement point.

Regs: 30 CFR Part 1202, §§1206.119, 1206.150
Volume – Oil and Gas Reporting

Oil reporting requirements

• Reported in barrels (42 gal)
• 60 degrees F
• Reported as clean barrels, adjusted for basic sediment and water (BS&W)

Gas reporting requirements

• Report using Mcf and MMBtu
• Adjust the Mcf to a pressure base of 14.73 psi
• Report using the **dry** heating value, unless the water vapor content has been measured, then use the “real” or “actual” heating value
• Report natural gas liquids (NGLs) using gallons

Regs: 30 CFR Part 1202, §§1206.119, 1206.150
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• ONRR Royalty Equation
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Arm’s Length or Non-Arm’s Length?

Are the parties...

• Affiliated?
  • Does the entity control, is it controlled by, or is it under common control with another entity?

• Negotiating with opposing economic interests?
  • Factors outlined in *Vastar Resources, Inc.* 167 IBLA 17 (2005)

• Related by blood or marriage?

Regs: 30 CFR §1206.20
Gross Proceeds

**Gross proceeds** means the total monies and other consideration accruing to an oil and gas lessee for the disposition of production. It includes certain tax reimbursements and includes costs of marketing or marketable condition-related services.

You produce 1 barrel of oil from Federal land that is adjacent to your back yard and sell it to your neighbor at arm’s length for:

- $20
- 5 chickens
- 1 goat

Regs: 30 CFR §1206.20
Polling Question

What are your gross proceeds ("total monies and other consideration")?

A. $20

B. $20 and the market value of the 5 chickens and 1 goat

C. NYMEX + roll
Marketable condition means 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.

Regs: 30 CFR §§1206.20, 1206.107, 1206.146
Marketable Condition – Key Concepts

- The lessee must place the production into marketable condition at no cost to the Federal government.
- The lessee cannot reduce royalties by transferring the costs to the purchaser for a lower sales value.
- The lessee should increase its gross proceeds to the extent they were reduced for costs associated with placing the production into marketable condition.
- If the lessee meets or exceeds the marketable condition requirements, they may be able to deduct a portion of their costs.

Regs: 30 CFR §§1206.20, 1206.107, 1206.146
AGENDA

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Allowances

Royalty due =

\[\text{volume} \times \text{unit value} \times \text{royalty rate}\] - allowances
Netting

Netting means reducing the reported sales value to account for an allowance instead of reporting the allowance as a separate entry on the Report of Sales and Royalty Remittance (Form ONRR-2014) or the Solid Minerals Production and Royalty Report (Form ONRR-4430).

Regs: 30 CFR §1206.20
Polling Question

In what situations do the regulations permit netting?

A. POP Contracts
B. Transportation factors
C. Fractionation costs
D. All of the above
E. None of the above
Transportation Allowances

Transportation allowance means a deduction in determining royalty value for the reasonable, actual costs that the lessee incurs for moving:

- Oil, gas, or gas plant products to the point of sale or delivery off the lease, unit area, or communitized area
- The transportation allowance does not include gathering costs

Regs: 30 CFR §1206.20
Transportation factors are transportation costs within a sales contract that adjust the sales price. For data-transparency purposes, lessees should report all transportation costs (whether in the sales contract or a separate transportation contract) as an allowance.
Gathering means the movement of lease production to a central accumulation or treatment point on the lease, unit, or communitized area, or to a central accumulation or treatment point off of the lease, unit, or communitized area that BLM or BSEE approves for onshore and offshore leases, respectively, including any movement of bulk production from the wellhead to a platform offshore.

Regs: 30 CFR §1206.20
Processing allowance means a deduction in determining royalty value for the reasonable, actual costs the lessee incurs for processing gas.

Processing means any process designed to remove elements or compounds (hydrocarbon and nonhydrocarbon) from gas, including absorption, adsorption, or refrigeration.

Regs: 30 CFR §1206.20
Allowances – Key Concepts

<table>
<thead>
<tr>
<th>Arm’s-Length</th>
<th>Non-Arm’s-Length</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on contract charges</td>
<td>Based on the lessee’s or their affiliate’s actual capital and operating costs</td>
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</tbody>
</table>

- Allowances should not include any costs associated with marketing or placing the production into marketable condition
- Allowable costs should be allocated across all the products being transported/processed
- May not deduct costs for moving or processing lease production that is not royalty bearing
- May not deduct costs incurred for moving or processing anything other than Federal production

Regs: 30 CFR §§1206.110 - 112, 1206.152 - 165
Polling Question

The lessee transports a rich gas stream from the lease to a gas processing plant. They pay royalties on residue gas (PC 03), NGLs (PC 07), and pipeline fuel (PC 15). Which products should be allocated a share of the transportation allowance?

A. Only PC 03
B. Only PC 07
C. PC 03 and 07 only
D. PC 03, 07, and 15
Allowance Limits

- Limits based on the royalty value of each product
- 50% transportation
- $66 \frac{2}{3}\%$ processing
- For gas plant products, the combination of transportation and processing allowances cannot exceed 99% of the value of the product

Regs: 30 CFR §§1206.110, 1206.152, 1206.159
AGENDA

• ONRR Royalty Equation
  • Volume
  • Value
  • Allowances

• Gas Valuation

• Oil Valuation

• Reporting
Gas Valuation

- **Gas**
  - **Processed**
    - **Arm’s Length**
      - Gross proceeds
      - Allowances
    - **Non-Arm’s Length**
      - GP for 1st arm’s-length sale
      - Index-based option
      - Allowances
    - Minimum 2-year election
  - **Unprocessed**
    - **Arm’s Length**
      - Gross proceeds
      - Allowances
    - **Non-Arm’s Length**
      - GP for 1st arm’s-length sales
      - Index-based option
      - Allowances
    - Minimum 2-year election
Gas Basics – Processed vs Unprocessed Gas

**Unprocessed Gas**
- Only valuing one commodity (unprocessed gas) on a $/Mcf or $/MMBtu basis and one product code:
  - Unprocessed gas (PC 04) or
  - Coalbed methane (PC 39)

**Processed Gas**
- Valuing multiple commodities and multiple product codes:
  - Pipeline condensate (PC 05)
  - Pipeline fuel (PC 15)
  - Coalbed methane (PC 39)
  - Residue gas (PC 03)
  - NGLs (PC 07)
  - Possibly others (plant inlet scrubber, CO₂, sulfur, etc.)

Regs: 30 CFR §§1206.141, 1206.142
Gas Basics – Arm’s-Length Sales

- If your first sale is arm’s-length, base your value on gross proceeds
- If your first sale is to an affiliate, you must elect one of the following options:
  - Gross proceeds under your affiliate’s arm’s-length sale or
  - Index-based valuation option

Regs: 30 CFR §§1206.141, 1206.142
Gas Basics –
No Sale Situation

If some of your gas is used, lost, unaccounted for, or retained as a fee under the terms of a sales or service agreement, that gas will be valued for royalty purposes using the same royalty valuation method for valuing the rest of the gas that you do sell.

Regs: 30 CFR §§1206.141(d), 1206.142(e)
Polling Question

Your transporter, Frank’s Pipeline and Coffee Company, retains gas that Frank uses for compressors along the pipeline and to run his espresso machine in Carlsbad. How do you value the PC 15 that Frank keeps under your contract?

A. Use the same method you’re using for the rest of your gas under that contract.

B. Use the index-based option.

C. Weren’t the indexes negative? For this month let’s say 23 cents sounds about right.
Gas Basics – Vented or Flared Gas

- If you do not have a written contract or if your gas is not sold but you are required to pay royalties (vented or flared gas), you must value it using the index-based option.
- If a valid index price point is not available, value is determined under the default provision.

Regs: 30 CFR §§1206.141(e), 1206.142(f)
Unprocessed Gas

If the value of your gas is based on unprocessed gas and you sell it before it’s processed, you must report and value it as unprocessed gas:

• Unprocessed gas (PC 04)
• Unprocessed gas volume x unit price

Regs: 30 CFR §1206.141
Percentage-of-Proceeds (and similar) Contracts

If the value of your gas is based on processed products, you must report and value it as processed gas. This includes:

- Arm’s-length POP contracts
- Gas sales based on processed products even when the sales point is before processing occurs

Regs: 30 CFR §1206.142
Polling Question

You sell unprocessed gas at arm’s length at the wellhead and your contract provides that you are paid on a percentage of the purchaser’s proceeds for your NGLs and on an index for the residue gas recovered from your volume. How do you value your production?

A. Use the OGOR volume and the residue gas price.
B. Use the index-based option.
C. Report 03, 07, 15, and 05, and value based on gross proceeds.
Processed Gas Valuation & Reporting

- Pipeline fuel
- Condensate (drip and scrubber)
- No netting of fees, including NGL T&F
- Full volumes and values
- Report all royalty-bearing products

- Allocation of transportation allowances to all products, including non-royalty-bearing ones
- Unbundle costs
- Disallowed plant fuel
- Allowance limits
Processed Gas Valuation & Reporting Example

https://www.onrr.gov/valuation/2016-rule-processed-example.htm

2016 Valuation Rule Federal Processed Gas Reporting Example
For production after January 1, 2017

Valuation of Processed Gas using Gross Proceeds

This example applies when you meet all of the following circumstances:

- You are valuing gas produced from a federal oil and gas lease on or after January 1, 2017.
- You are valuing your gas for royalty purposes based on the gross proceeds accruing to you or to your affiliate under an arm's-length contract under 30 CFR §1206.142.
- Your contract provides for payment based on the value of residue gas, NGLs, or other gas plant products (e.g., sulfur, carbon dioxide, etc.), regardless of where title transfers.

What's New in this Update?
April 2020
- Accounting for netting of TAF fees
- Calculating allowances related to TAF fees
- Splitting the value of the plant retainerage between transportation and processing
Index-Based Option Overview

Can I use the index-based option for my gas sales?

- I sell my gas at arm’s length – No
- I sell/transfer my gas to an affiliate who sells it at arm’s length – Yes
- I sell my gas to an affiliate who then sells my gas under multiple arm’s-length contracts – Yes

The index option must be used for two consecutive years after your election

Regs: 30 CFR §§1206.141, 1206.142
Index-Based Option – Key Concepts

• If you elect to use the index-based option to value your unprocessed gas, residue gas, or NGLs
  • No unbundling required
  • Report 2014 lines using OINX Sales Type Code
  • The index you choose must be in an ONRR- approved publication
    • Platts Inside FERC’s Gas Market Report
    • Natural Gas Intelligence Bidweek Survey
    • Argus Natural Gas Americas

Regs: 30 CFR §§1206.141(c), 1206.142(d)
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Oil Valuation

- **Arm’s-length exchange**
  - Choose **Non-arm’s-length sale or transfer, then arm’s-length sale**
    - Choose **Non-Arm’s Length**
      - **California, Alaska**
        - **ANS**
          - **Adjustments**
      - **Rocky Mountains**
        - **AL sales/purchases or NYMEX w/o roll**
          - **Adjustments**
      - **Everywhere else**
        - **NYMEX w/roll**
          - **Adjustments**

- **Arm’s Length**
  - **Choose Minimum 2-year election**

- **Gross proceeds**
- **Adjustments**

**Regs:** 30 CFR §§1206.101, 1206.102
Oil Valuation:
Arm’s Length

- Generally, accept gross proceeds under arm’s-length sales contracts

Regs: 30 CFR §1206.101
Oil Valuation: Exchanges or Affiliate Sales

If you sell or transfer oil to an affiliate and the affiliate sells arm’s length, or if you dispose of the oil under an arm’s-length exchange, you can make an election to value:

1. based on gross proceeds from the arm’s-length sale or exchange; or
2. use non-arm’s-length valuation (election no more frequently than every 2 years)

Regs: 30 CFR §1206.101
## Oil Valuation: Non-Arm’s Length

<table>
<thead>
<tr>
<th>Three Regions</th>
<th>Valuation Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td>California or Alaska</td>
<td>ANS average spot price</td>
</tr>
<tr>
<td>Rocky Mountain Region</td>
<td>Arm’s-length sales/purchases</td>
</tr>
<tr>
<td>• MT, ND, SD, WY, CO*, &amp; UT*</td>
<td>OR NYMEX without the roll (2-year election)</td>
</tr>
<tr>
<td>Rest of the country</td>
<td>NYMEX with the roll</td>
</tr>
<tr>
<td>• Other states</td>
<td></td>
</tr>
<tr>
<td>• Outer Continental Shelf (OCS)</td>
<td></td>
</tr>
<tr>
<td>• *Four Corners region of CO &amp; UT</td>
<td></td>
</tr>
</tbody>
</table>

Regs: 30 CFR §1206.102
Oil Value Adjustments

Royalty is based on the value of oil at the lease. The regulations recognize that, when you value oil based on prices at distant markets, it is appropriate to adjust the value for:

- Location
  - Transportation allowances
  - Location differentials
- Quality
  - Posted quality differentials
  - Quality banks

Regs: 30 CFR §§1206.101, 102, 113
Oil Valuation Example

1) Use NYMEX with the roll = $45/bbl

2) No actual exchange to Cushing, so use the published WTI Differential = -$3.50/bbl

3) Use actual exchange agreement for adjustment = - $2.75/bbl

4) Use actual costs of transportation = $1.25/bbl

Value for Royalty Purposes:

\[ \$45 - (\$3.50 + \$2.75) = \$38.75/bbl \]

Transportation Allowance

\[ \$1.25 = \$1.25/bbl \]
AGENDA

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Sales Type Codes - Overview

• Why do we use Sales Type Codes?
  • Audit and compliance
  • Economic analysis
  • Revenue data

• Relates to sales contract, NOT transportation or processing contract

• Multiple sales methods → multiple lines
Sales Type Codes – ARMS, NARM, OINX

<table>
<thead>
<tr>
<th>Sales Type Code</th>
<th>Sales Type Name</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARMS</td>
<td>Arm’s length</td>
<td>• Use ARMS when the first disposition of your Federal oil or gas production is an arm's-length sale.</td>
</tr>
</tbody>
</table>
| NARM            | Non-arm’s length| • Use NARM when you value your Federal oil or gas production based on your affiliate's gross proceeds under its arm's-length sale.  
                  • Do not use NARM when you are valuing your production under an index-based option. |
| OINX            | Index           | • Use OINX when you value your Federal oil or gas production using an index-based option. |
# Sales Type Codes – POOL, APOP

<table>
<thead>
<tr>
<th>Sales Type Code</th>
<th>Sales Type Name</th>
<th>Description</th>
</tr>
</thead>
</table>
| **POOL**        | Pooled sales                         | • When you aggregate production from multiple properties and then sell or exchange your oil, gas, or gas plant products under multiple contracts, you should use POOL.  
• In a pooling situation, you will determine value by computing a weighted average of the prices for all arm’s-length sales at all downstream sales outlets. |
| **APOP**        | Arm's-length percentage of proceeds   | • This sales type code is no longer in use for Federal production.                                                                         |

**Note!** POOL should no longer be used for PC 07, unless the sale really is a pooled situation.
### Sales Type Codes – AG(XX)

<table>
<thead>
<tr>
<th>Sales Type Code</th>
<th>Sales Type Name</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AG(XX)</td>
<td>Hold for Default Provision</td>
<td>• If ONRR values your production using the default method, ONRR will assign you an AG sales type code.</td>
</tr>
</tbody>
</table>
Valuation Guidance

**Who:** Royalty Valuation

**What:** Non-binding, consistent, supported by case law, statute, and regulations, case specific

**When:** Ideally *before* you are contacted by ONRR compliance teams

**Where:** royaltyvaluation@onrr.gov

**Why:** Timely and in-depth knowledge of regulations & policy, includes cites to case law & regulations, case specific

**How:** Email (preferred), phone call, letter

Regs: 30 CFR §§1206.108, 1206.148
Questions Anytime

royaltyvaluation@onrr.gov