



May 8, 2015

Office of Natural Resources Revenue
Building 85, Room A-614
Denver Federal Center
West 6th Ave. & Kipling St.
Denver, CO 80225
Attn: Mr. Armand Southall

Re: Comments pertaining to RIN 1012-AA13; ONRR Proposed Rule relating to the valuation for royalty purposes of Oil and Gas Produced from Federal Onshore and Offshore Leases and Coal Produced from Federal and Indian Lands (the “Proposed Rule”)

Dear Mr. Southall:

Apache Corporation (“Apache”), on behalf of itself and its affiliated and subsidiary companies, respectfully submits this letter in comment on the referenced Proposed Rule. Apache is aware of comments submitted by the Council of Petroleum Accountants Societies (“COPAS”) and the Independent Petroleum Association of America (“IPAA”), and does hereby adopt such comments and incorporate them herein by reference. Further, Apache submits additional comments on the Proposed Rule as more fully set forth herein.

Apache is an independent oil and gas exploration and production company with operations in the United States, Canada, Egypt, the North Sea, and Australia. Within the United States, Apache operates, and owns record title interests and operating rights interests in, producing onshore and offshore Federal leases. As a result, Apache reports and pays royalties to the Office of Natural Resources Revenue (“ONRR”).

As an active operator on Federal oil and gas leases, Apache desires to have clear and objective guidelines relating to the valuation of royalties from these leases. Such guidelines provide Apache – and other, similarly situated lessees – with the certainty needed to permit it to conduct its operations with an accurate assessment of the economic factors affecting those operations. Unfortunately, ONRR’s Proposed Rule is a step in the wrong direction in this regard. As Apache seeks to remove uncertainty relating to product prices, geologic issues, and operational matters, ONRR now seeks to impose greater uncertainty upon Federal oil and gas lessees and provide itself with the ability to change royalty valuations for practically no reason at all. To the extent the ONRR offers operators more certainty through index pricing, the ONRR discourages its use by inflating index values. For these reasons, and for the reasons further described herein and in the COPAS and IPAA letters, Apache recommends that ONRR revisit its Proposed Rule with a critical eye and substantially revise the Proposed Rule to provide certainty and clarity for the lessee in its valuation of oil and gas royalties on Federal leases.

As an example of the uncertainty that would be created by the Proposed Rule, the default provisions contained in such sections as 1206.104, 1206.105, 1206.143, and 1206.144, grant ONRR the ability to determine – for little or no reason – that a lessee’s royalty valuation is incorrect and then impose upon such lessee ONRR’s view of the proper valuation. Some of the circumstances in which the ONRR may determine royalty value ignore market conditions, such as the circumstance in which oil or gas is sold for 10% less than the lowest “reasonable measures” of market price. The Proposed Rule then contributes to further uncertainty by expressly affording the ONRR the discretion to rely on “[a]ny information” it deems relevant when reaching a royalty valuation. This proposed methodology is arbitrary, unfair, and unduly burdensome on lessees. As a result, Apache believes that the default provisions allowing ONRR to essentially dictate royalty valuations should be removed from the Proposed Rule in their entirety.

Along the lines of the foregoing, ONRR must revise its proposed definition of “misconduct” in section 1206.20. Under the Proposed Rule, a mere inadvertent mistake will qualify as “misconduct” and open the door to ONRR’s ability to assess arbitrary valuations of royalties under the “default rules.” Furthermore, a mistake that constitutes “misconduct” may relate to any duty owed to the United States and not necessarily to the reporting of production or payment of royalty. Even when a mistake relates to royalty, a minor mistake on one lease would open the door for the ONRR to determine royalty value for all of an operator’s Federal leases. Thus, for operators with hundreds of Federal leases, a minor mistake would have serious ramifications. The ONRR must revise the definition of “misconduct” to incorporate an element of intentionality in the lessee’s actions and to relate the mistake to the payment of royalties for a particular lease. Otherwise, the Proposed Rule creates an assumption of malfeasance by a lessee for any mistake or error – no matter how innocent such mistake or error may have been and regardless of whether the mistake has any bearing on the lessee’s production reporting and royalty payment.

In addition to the foregoing, Apache recommends that the valuation of royalties on oil and gas produced by a particular lessee from a particular lease be determined based upon the actual circumstances and events involved in the production and marketing of such oil and gas. Instead, the Proposed Rule creates circumstances under which royalty valuations will be completely disconnected from reality. For example, it has long been understood that the best means of determining the market value of production is through the gross proceeds obtained by the lessee under an arm’s-length contract. In the preamble to the Proposed Rule, the ONRR acknowledges that the consensus of comments received on the Advanced Notice of Proposed Rulemaking recognized this fact. However, under sections of the Proposed Rule such as 1206.110, 1206.111, 1206.112, 1206.152, 1206.153, and 1206.154, ONRR attempts to arbitrarily cap, or limit use of, transportation allowances and deductions, without any opportunity for consideration of actual circumstances. Again, Apache adopts the more specific comments provided by COPAS and IPAA relating to these matters.

With regard to the gas index pricing options (under Sections 1206.141(c) and 1206.142(d)), Apache again reiterates the comments made by COPAS and IPAA. However, Apache would also like to specifically add its voice to the objection raised by both COPAS and

IPAA pertaining to the application of the highest index price even if actual production is unable to flow to such pricing point. Again, in this regard, the Proposed Rule would create an arbitrary valuation of royalties that lacks any relationship to the actual production and marketing of Federal oil and gas. ONRR simply must recognize that valuations of royalties will vary between lessees based upon numerous factors, such as, but not limited to, the location of the applicable leases, availability of infrastructure, pipeline specifications and capacity, and disparate bargaining positions between lessees and third parties providing gathering, processing, transportation, or purchasing services.

As a final specific comment on the Proposed Rule, Apache – like COPAS and IPAA – objects to the proposed classification of the subsea movement of bulk production as “gathering,” thereby disallowing any deduction for costs incurred in such movement. Such a blanket determination again shows ONRR’s complete disregard for the reality of actual circumstances affecting the development, production, and marketing of oil and gas. While there may be circumstances under which the classification of subsea movement of bulk, unprocessed production is appropriately classified as “gathering,” it is inappropriate to apply such a classification in blanket fashion. In the very same manner, Apache agrees that it would be inappropriate to classify such movement as “transportation” in all circumstances. As a result, ONRR needs to develop more objective criteria under which the subsea movement of such production is appropriately classified as either gathering or transportation based upon the actual circumstances affecting such production.

In addition to the specific comments set forth herein above, Apache provides a few more general comments on the Proposed Rule. First, at an absolute minimum, any final rule adopted by ONRR – in whatever form – may only be applied prospectively and, therefore, may not apply to royalty paid prior to the final rule’s effective date. It is unconscionable to think ONRR would make significant changes to the requirements placed upon oil and gas lessees with respect to the valuation of royalties, and then impose those revised requirements upon activities performed by such lessees while they worked diligently to operate under the rules and requirements in existence at the time. The ONRR should also provide ample time for the rule to take effect to allow operators to update their reporting and payment systems.

Additionally, if adopted, the Proposed Rule would effectively place ONRR in the position of judge, jury, and executioner with respect to royalty valuations on federal leases. The “default provisions” along with other terms of the Proposed Rule give ONRR entirely too much authority and discretion to impose arbitrary valuations upon lessees. This would constitute an abuse of power by a governmental agency, and should be remedied before any revision to the royalty valuation rules is enacted.

While Apache recognizes ONRR’s desire to “unbundle” certain processing and transportation costs to scrutinize which costs may be deductible or not, the practical effect of ONRR’s actions is the arbitrary limitation on the deductibility of certain costs that may have negotiated with third parties years ago. To impose these limitations upon lessees now creates an unduly burdensome obligation that will effectively preclude the deduction of valid costs incurred in the processing and transportation of oil and gas, merely because ONRR deems that some portion of these third party charges are associated with placing the product in marketable

condition. ONRR pretends to solve this issue by making an index pricing option available. However, as mentioned above, this index option can result in royalty obligations that are completely disconnected from the reality. Again, in this manner, the Proposed Rule evidences ONRR's disregard for actual circumstances affecting the true market value of oil and gas production, and merely seeks to impose royalty obligations upon ONRR's view of what the values should be.

Apache appreciates the opportunity afforded by ONRR to comment on the Proposed Rule, and we hope that ONRR receives these comments in the light in which they are intended – *i.e.*, to provide ONRR with meaningful insight on the practical effects the Proposed Rule would have on oil and gas operations on Federal leases. Unless the critical issues describe above and incorporated herein by reference are appropriately addressed by ONRR, Apache fears that the Proposed Rule will discourage the ongoing development and production of Federal oil and gas leases.

Respectfully,

Apache Corporation

A handwritten signature in black ink, appearing to read "Urban O'Brien", written over the printed name below.

Urban "Obie" O'Brien

Vice President, Governmental Affairs