COPAS
Council of Petroleum Accountants Societies

Turning Energy Into Synergy

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COMMENTS ON ADVANCE NOTICE OF PROPOSED RULEMAKING ON FEDERAL OIL AND GAS VALUATION

The Council of Petroleum Accountants Societies (COPAS) appreciates the opportunity to comment on the ONRR ANPR on Federal oil and gas valuation that was published in the Federal Register on May 27, 2011 (pages 30878-30881). COPAS has been in existence for over 50 years and our members within the Revenue Committee have extensive experience with ONRR rules and royalty valuation, determining applicable deductions, adjustments, audits and other royalty matters on a regular basis, and have been providing comments to similar Federal Register Notices for decades. Therefore, we submit our comments to the ONRR to aid in the development of the new oil and gas valuation regulations.

We have taken all the items for which input was requested in the ANPR, and for those items for which we have experience we offer the following comments.

In regards to the timing on changes of this magnitude to the valuation regulations, industry will need at least 12 months (more than 12 months may be necessary depending on the complexity of the change) from the time the final rule is published to implement the changes for system programming, accounting set-up and all the applicable testing. Additionally, companies should still have the option to request a value determination for any federal lease oil or gas production (30 CFR 1206.107).

A. Use of Index Prices to Value Oil and Gas

The ONRR is seeking comment on the existing use of index pricing to determine the value of production for oil royalty purposes and whether the use of index pricing should be expanded or altered.

COPAS Comment: To ensure consistency in the regulations, the provision for valuing oil that is not sold under an arm's length contract produced from leases in the Rocky Mountain Region at

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30 CFR 1206.103(b)(2) should be added to 30 CFR 1206.103(a) for production from leases in California and Alaska.

Additionally, the ONRR is considering the use of index pricing in valuing Federal gas for royalty purposes. Please consider the following:

- We seek input on how well index prices currently represent the value for oil and gas produced in different regions or areas of the country, such as states on the Gulf of Mexico coast (including Texas, Louisiana, Mississippi, and Alabama, as well as onshore areas within those states), the Midwest (including Oklahoma and North Dakota), the Southwest (including New Mexico and the Permian and San Juan Basin areas), the Rocky Mountain area (including Wyoming, Montana, and Colorado and Utah outside the San Juan Basin), the West Coast states (primarily California), and Alaska. Please identify what index publications you believe apply to what parts of these areas and the relative advantages and disadvantages, and strengths and weaknesses, of using each of the identified published index prices.

COPAS Comment: We support the use of index pricing for valuing Federal gas for simplification purposes as it eliminates pricing adjustments, non-arms-length transportation/processing calculations and true-ups, unbundling of arms-length transportation/processing agreements and related true-ups, and special keepwhole accounting reporting requirements. It would also streamline federal audits and it does represent market value.

With that said, the use of index pricing needs to be revenue neutral and should not include any Safety Net calculations as currently required for Indian Gas Valuation (30 CFR 1206.172(e)), Accounting for Comparison or Dual Accounting (30 CFR 1206.152 (b)(1)(i), or 1206.155 or 1206.173 or 1206.176), special keepwhole accounting requirements (Oil & Gas Payor Handbook Volume III--Product Valuation 4.3.5), or any true-up requirements (non-arms-length transportation and processing deductions and unbundling for 3rd party transportation and processing rates). Additionally, we recommend a process be developed where any identified corrections and/or adjustments to the ONRR prescribed rates are rolled forward into the following month or year, versus having to require prior period adjustments be filed for all the impacted properties. We also recommend index-based valuation be optional.

- In addition, we seek input on how to best value this gas for royalty purposes in situations where gas from Federal leases is produced in areas not covered by index pricing, or where limited reported spot market activity exists.

COPAS Comment: Gross Proceeds/updated regulations could still be used, although further discussion with industry is needed to more accurately identify how to handle non-arms-length transactions in these areas.

- Does the concentration of Federal production in some areas of the country create any potential problems with relying on index prices in those areas, now or in the future?

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COPAS Comment: Not that we are aware.

- Finally, we request comment on whether ONRR should use published index prices to value Federal oil and gas sold under non-arm's-length contracts as well as arm's-length contracts.

COPAS Comment: Index pricing should be available to be used for both non-arm's-length and arm's-length contracts and be optional for both.

B. Transportation Allowance

The ONRR is examining possible alternatives to the requirement to track actual costs for determining transportation and to address the bundling issue. Please consider the following:

- If ONRR were to adopt index-based valuation, the point at which the index prices are compiled and published may or may not be the point of actual sale for particular gas, and the costs of transportation to the actual point of sale may not be relevant. However, the index pricing point would be remote from the lease or unit in virtually all circumstances, and value at the index pricing point may not reflect value at or near the lease or unit. If ONRR employed index prices to value Federal oil and gas for royalty purposes, what methods should be considered that would adjust for location differences between the lease or unit and the index pricing and publication point?

COPAS Comments: There needs to be a location differential with an escalation factor and a separate component for fuel. Additionally, we recommend a periodic review be done to ensure the differentials/adjustments are reasonable. Provisions for extraordinary transportation allowances also need to continue - 30 CFR 1206.156(c)(3).

- In the interest of simplifying the determination and verification of location adjustments, should ONRR consider prescribing either a fixed differential amount per unit volume (thousand cubic feet (Mcf) or million British thermal units (MMBtu)) or a fixed percentage to be deducted from the index value to account for location differences?

COPAS Comments: To best reach revenue neutrality, a fixed amount per mmbtu for the "infrastructure costs or transportation fee" plus a fixed percentage for the fuel component should be used as it best represents true transportation costs.

- Should ONRR apply a fixed differential amount per unit volume to all production in a particular area or that is transported through a particular pipeline? Would a flat percentage of the index value (perhaps with a cap) be preferable, either on a regional or nationwide basis?

COPAS Comments: Different rates are needed for onshore and offshore transportation, for coalbed methane and conventional gas, and for each index point. Additionally, to be revenue neutral they may need to be by pipeline. A flat percentage of the index value with a cap is not preferred because it would be difficult to be revenue neutral.

C. Processed Gas and Processing Allowance

The ONRR is considering accounting for the value of liquid hydrocarbons contained in the gas stream by applying an adjustment or "bump" to the index price, applicable to residue gas when gas is processed, in lieu of valuing residue gas and extracted liquid products separately, calculating the actual processing costs, and deducting those costs from the value of the extracted liquids (the procedure required under 30 CFR 1206.153(a) and 1206.158 through 1206.159).

This adjustment could be based on, or could incorporate, a number of components, including the following:

- Gas quality (either Btu content or gallons per Mcf (GPM)).

COPAS Comments: We support the use of a processing bump for the btu at either the lease or completion level, with the exception of where gas is processed under a keepwhole contract that does not have a processing lift or liquid credit (sometimes referred to as keepwhole plus contract).

- The differential between the gas price and the oil or natural gas liquids (NGL) price similar to a "frac spread" or a "processing margin."

COPAS Comments: To be revenue neutral you do need to recognize the differential between liquid and gas pricing.

- Certain plant operation factors, such as shrinkage, producer processing costs, and plant operations costs.

COPAS Comments: See next comment.

We also seek input regarding whether such an approach could eliminate the burden of accounting for allowable costs to process gas and reduce or eliminate the potential for disputes over unbundling of gas plant charges, without reduction in royalty value. The ONRR could calculate this adjustment on a monthly basis and make it available on our website expressed in the form of a price per unit volume (MMBtu or Mcf).

COPAS Comments: For simplification purposes, we support the use of a component that takes into account plant operations, shrinkage, processing and plant operation costs. It needs to take into account both the processing fees and plant fuel charges. Having the ONRR calculate and post them on their website would ensure everyone uses the correct pricing and differentials/adjustments/bumps, but it is critical that the postings be done timely.

ONRR could maintain current reporting requirements for processed gas and NGLs but establish a fixed processing allowance. This fixed allowance could be either on a nationwide basis for all Federal gas or on a narrower basis, such as offshore and onshore leases; offshore regions and onshore basins; or gas-plant-specific.

COPAS Comments: If revenue neutral, a broader calculation like type of plant (cryogenic, absorption, lean oil, etc.) would be easier to administer, but to be revenue neutral it may need to be gas-plant-specific. Similar to the transportation allowance, provisions to address extraordinary processing allowances need to continue - 30 CFR 1206.158(d)(2)(i) & (ii).

COPAS appreciates the opportunity to provide comments to this advanced notice of proposed rulemaking. If you have any questions regarding our comments, please contact me at (918) 661-4381.

Sincerely,

Robert O. Wilkinson

Robert O. Wilkinson
COPAS Revenue Committee Subcommittee Chairperson