ipaa
America's Oil & Gas Producers

July 25, 2011

Hyla Hurst
MS61013C
Office of Natural Resources Revenue
United States Department of Interior
P.O. Box 25165
Denver, Colorado 80225

Subject: Docket Number ONRR-2-11-0005
RIN 1012-AA01
Advance Notice of Proposed Rulemaking
Federal Oil and Gas Valuation

These comments are submitted on behalf of the Independent Petroleum Association of America (IPAA) with regard to the U.S. Department of Interior, Office of Natural Resources Revenue (ONRR) Advanced Notice of Proposed Rulemaking (ANOPR) for existing regulations governing the valuation of oil and natural gas from Federal onshore and offshore leases, for royalty purposes that was published in the Federal Register on May 27, 2011.

The IPAA represents approximately 6000 independent oil and natural gas producers who, on average, employ roughly 11 full time employees each. These producers have the potential to be significantly and adversely affected by the ANOPR. Independent producers drill approximately 94 percent of America's oil and natural gas wells; produce about 54 percent of America's oil and more than 85 percent of America's natural gas.

These comments address a number of issues related to the regulations governing the valuation of oil and natural gas royalties collected from federal onshore and offshore leases.

Use of Index Prices to Value Oil and Gas

Section A of the ANOPR discusses the use of index prices to value oil and natural gas. IPAA finds the use of index pricing "indexing" for the valuation of oil and natural gas royalties to be problematic. The derivation of pricing in the oil and natural gas industry is contract specific, complex and likely to differ from company to company based on negotiated terms. Specifically, indexing causes problems for the accounting function of our members because unless the underlying sales price of a particular transaction agrees with the respective index price, there will always be an underpayment or overpayment that will require accounting recognition and attention for the companies involved in the sales transactions.

The use of index prices reflects the average value of oil and natural gas in the area represented by the index; however, it does not reflect the actual price each producer is receiving for their oil and natural gas production. Each producer negotiates its sales contract based on the quality and concentration of the oil and natural gas that producer has available to sell from a certain field or area. Rarely will two producers in the same field or area receive the same price for their production. The best value for royalty purposes is the actual value received by each producer. The source of an index price is tied to market centers and index price points using the sales prices and volumes of the most prominent producer marketers, which is not representative of IPAA's members who vary greatly in size and whose production may be quite a distance from the market centers. To value federal royalties based on index pricing will actually create a more complex system than current law. The resultant system will be an overly burdensome process that may be insurmountable for America's smaller producers.

Transportation Allowance:

Section B addresses the transportation allowances under current law and how potential changes may affect oil and natural gas producers. It is IPAA's belief that transportation allowances should be based on the actual unit price charged in an arm's length agreement with a pipeline or common carrier to a producer. We support allowing these unit prices to be negotiated, published (FERC tariff rates) or fixed price to reflect the actual cost to each producer to transport oil and natural gas to the market.

In addition, the ANOPR also asks whether the ONRR's use of index-based valuation for transportation costs will adequately reflect the value of that transportation. The adoption of index-based transportation is not a reality for individual oil and natural gas producers. Producers spend enormous amounts of time calculating allowable transportation charges currently in effect per Federal regulations. Applying a fixed differential amount per unit volume to all production will not simplify the Federal royalty reporting process.

Processed Gas and Processing Allowances:

If there is a methodology to calculate an average value instead of actual value received by each producer; some producers will benefit and some will be harmed.

The proposed procedure for valuation of processed gas and processing allowances is more complicated and inefficient. It is very probable an adjustment or "bump" will not be reflective of actual product value depending on the location. Each processing plant contract has different terms and conditions for each producer depending, again, on many factors including Btu content, percentage of liquids, plant efficiency, producer volumes and other factors. Therefore, the value of the product the ONRR describes will not be reflective of the actual value received by each producer.

In addition, the decision to process or not process bears certain commercial risks such that processing margins may swing positively or negatively. Depending on the structure of the arrangement, the decision to process or not to process may be held by a third-party other than the producer. Furthermore, the outcome of these decisions is not known until the gas processing plant allocations and statements are received, which is typically 45 days after the production month. This is a post-production activity and expense that should remain outside of the calculation of royalty. The posting by ONRR of an adjustment on a monthly basis for allowable costs for processed gas is not reflective of actual market conditions.

Conclusion:

The U.S oil and natural gas industry supports 9.2 million U.S. jobs and more than 7.5 percent of the U.S. economy. The industry has paid more than $150 billion in royalty revenues to the Federal Treasury through 2010. IPAA understands the intent of the ONRR is to create regulations that offer greater simplicity, certainty, clarity, and consistency in royalty valuation. However, IPAA is hopeful these regulations will take into account the concerns of IPAA members and the impact any new regulations will place on the cost of doing business. IPAA supports the use of actual price received and actual cost to transport oil and natural gas for royalty valuation purposes.

If there are questions regarding these comments or if additional information is required, please contact Dan Naatz at IPAA, (202) 857-4722.

Sincerely,

Daniel T. Naatz
Vice President, Federal Resources