United States Department of the Interior

OFFICE OF NATURAL RESOURCES REVENUE
P.O. Box 25165
Denver, Colorado 80225-0165

May 17, 2023

Subject: Updating the December 18, 2014, Reporter Letter Rescinding the August 8, 2013, Reporter Letter titled Royalty on Gas Used or Lost Along a Pipeline Prior to the Point of Sale.

Dear Reporter:

This reporter letter replaces the reporter letter dated December 18, 2014, entitled "Rescinding the August 8, 2013, Reporter Letter titled Royalty on Gas Used or Lost Along a Pipeline Prior to the Point of Sale." The purpose of this updated letter is to:

1. Restate the Office of Natural Resources Revenue's (ONRR) guidance regarding gas used or lost along a pipeline;
2. Update references to ONRR's regulations for changes under the Consolidated Federal Oil & Gas and Federal & Indian Coal Valuation Reform Rule (2016 Valuation Rule) related to valuing gas used or lost along a pipeline; and
3. Clarify how to value and report such gas.

<u>Royalties on Natural Gas Used or Lost</u>

ONRR's regulations provide that royalty is due on all gas produced from Federal and Indian leases except for:

- gas used on, or for the benefit of, the lease[1]; and
- a reasonable amount of residue gas used to operate a gas processing plant.[2]

The regulations do not allow for gas used or lost in the operation of a transportation system to be royalty-free. However, the regulations do allow lessees to include, as part of a transportation allowance, certain costs of gas used or lost.

In this letter, the general description of gas used or lost encompasses gas that is used, lost, unaccounted for, or retained as a fee under the terms of a sales or service agreement.[3] The volume of gas used or lost is generally the difference between the volume of gas measured at the royalty settlement point and the volume of gas measured at the downstream sales meter or at the inlet meter of the gas processing plant.

[1] See 30 CFR § 1202.150(b) for Federal gas and 30 CFR § 1202.555 for Indian gas. Please note, to the extent of any inconsistency with these sections, that lease terms shall govern.
[2] See 30 CFR § 1202.151(b) for processed residue gas used to operate a processing plant.
[3] See 30 CFR § 1206.141(d) for Federal unprocessed gas and 30 CFR § 1206.142(e) for processed gas.

This volume can usually be identified in gas gathering, transportation, or processing contracts and is typically shown on monthly contractual statements under labels such as:

- Contractual Field Deducts
- Contractual Fuel
- Raw Field Deducts
- Pipeline Fuel/Use/Usage
- Line Loss
- Fuel Retained
- Compression Fuel
- Lost and Unaccounted, L&U

The list of example labels above is not exhaustive.

These statements apply to reports filed by or on behalf of all Federal and Indian lessees, whether the lessee files its own reports or retains the services of another to prepare and file reports.

Federal Gas - Valuation and Reporting of Pipeline Fuel/Loss

In most situations, a lessee does not sell the gas used or lost along the pipeline. If the gas used or lost was retained under the terms of a sales or service agreement, the lessee should determine royalty value using the same royalty valuation method as for the rest of the gas that the lessee sells.[4] If the gas was used or lost outside the terms of a contract, then the lessee should value the gas using the index-based method under 30 CFR § 1206.141(e).

Lessees should report any royalty-bearing gas that the transporter uses or loses prior to processing on the Report of Sales and Royalty Remittance (Form ONRR-2014) using product code 15 and transaction code 01.

Lessees should not include any MMBtu-equivalent volumes of condensate recovered along the pipeline in the volume and value reported under product code 15. Lessees should report drip/pipeline condensate using product code 05, with the volumes reported as barrels and the value established under the oil regulations at 30 CFR Part 1206 Subpart C.

For additional detail, please refer to the valuation example, titled "2016 Valuation Rule Federal Processed Gas Reporting," on the https://onrr.gov website.

Federal Gas – Transportation Allowances

Lessees may be eligible to take a transportation allowance for the reasonable, actual costs to transport royalty-bearing gas to a sales point away from the lease.[5] The regulations allow for the costs of compression, dehydration, and treatment of gas only when they are required for transportation and exceed the services necessary to place the gas into

[4] See 30 CFR § 1206.142(e) for processed gas and 30 CFR § 1206.141(d) for unprocessed gas.
[5] See 30 CFR § 1206.152.

marketable condition.[6] Gas used along a pipeline system is typically used for these services. Therefore, lessees may only include the cost of the used gas as part of a transportation allowance when the transporter uses it to compress, dehydrate, or treat the gas <u>beyond</u> the marketable condition requirement.

Limitations and conditions on claiming transportation allowances apply to certain valuation situations, as follows:

- For arm's-length transportation:
  - Actual line losses can be included in the transportation allowance.[7]
  - Theoretical line losses can only be included in the transportation allowance if they are part of rates charged under a Federal Energy Regulatory Commission (FERC) or State regulatory-approved tariff.[8]
- For non-arm's-length transportation:
  - Actual line losses should not be included in the transportation allowance.
  - Theoretical line losses should not be in the transportation allowance because they are not based on actual costs.[9]
- Lessees should not take a transportation allowance if they elect to, or are required to, value Federal gas using the index-based valuation method.[10,11]

Once eligible transportation costs have been compiled, lessees should allocate the compiled costs among all products being transported, whether royalty-bearing or not.[12] You may not take a transportation allowance that exceeds fifty percent of the royalty value of the product being transported.[13]

<u>Indian Gas - Valuation and Reporting of Pipeline Fuel/Loss</u>

In most cases, a lessee does not sell gas used or lost along the pipeline. Unless stated otherwise in the lease, Indian lessees should value the gas as follows:

- For Indian gas produced in an index zone, lessees should determine the value of such gas under 30 CFR § 1206.172. If performing actual dual accounting, include gas used or lost as part of the processed gas value.
- For Indian gas produced in a non-index zone, lessees should determine the value under 30 CFR § 1206.174.

You should report any royalty-bearing gas that the transporter uses or loses prior to processing on the Form ONRR-2014 using product code 15 and transaction code 01.

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[6] See 30 CFR § 1206.153(b)(9).
[7] See 30 CFR § 1206.153(b)(7).
[8] See 30 CFR § 1206.153(b)(7).
[9] See 30 CFR § 1206.154(a).
[10] See 30 CFR § 1206.142(d)(3).
[11] See 30 CFR § 1206.142(f)(1).
[12] See 30 CFR § 1206.152(b).
[13] See 30 CFR § 1206.152(e)(1).

You should not include any MMBtu-equivalent volumes of condensate recovered along the pipeline in the volume and value reported under product code 15. You should report drip/pipeline condensate using product code 05, with the volumes reported as barrels and the value established under the oil regulations at 30 CFR Part 1206 Subpart B.

Indian Gas - Transportation Allowances

Lessees may be eligible to take a transportation allowance, in some situations, for the reasonable, actual costs to transport the royalty-bearing gas to a sales point away from the lease.[14] The regulations allow for the costs of compression, dehydration, and treatment of gas only when they are required for transportation and exceed the services necessary to place the gas into marketable condition.[15] Gas used along a pipeline system is typically used for these services. Therefore, Indian lessees may only include the cost of the used gas as part of a transportation allowance when the transporter uses it to compress, dehydrate, or treat the gas <u>beyond</u> the marketable condition requirement.

Limitations and conditions on claiming transportation allowances apply to certain valuation situations, such as:

- For arm's-length transportation, Indian lessees may include actual and theoretical line losses in the transportation allowance.[16]
- For non-arm's-length transportation, neither actual nor theoretical line losses can be claimed in the transportation allowance.[17]
- Indian lessees should not take a transportation allowance if:
    - Indian gas is valued using an index-zone price[18]; or
    - Indian gas is valued using a major portion price.[19]

Indian lessees should allocate eligible transportation costs among all products being transported, whether royalty-bearing or not.[20]

In addition to correctly calculating royalty due, lessees should also comply with requirements to file appropriate forms and supporting documentation.[21] For transportation allowances under arm's-length contracts, lessees are required to submit a copy of the lessee's arm's-length transportation contract(s) and all subsequent amendments within two months of the date when the allowance is claimed on the Form

[14] See 30 CFR § 1206.177.
[15] See 30 CFR § 1206.178(f)(9).
[16] See 30 CFR § 1206.178(f)(7).
[17] See 30 CFR § 1206.178(f)(7).
[18] See 30 CFR § 1206.172(d)(8).
[19] See preamble to Amendments to Gas Valuation Regulations for Indian Leases, published in the Federal Register at 65 FR 62612.
[20] See 30 CFR 1206.177(b).
[21] Indian allowance forms and contracts should be sent to ONRR via email at ONRRIndianForms@onrr.gov.

ONRR-2014.[22] Transportation allowances claimed under a non-arm's-length or no-contract situation should be followed with actual cost information to support the allowance on Form ONRR-4295, Gas Transportation Allowance Report, within three months after the end of the 12-month period to which the allowance applies.[23]

Audit Information

Consistent with 30 CFR § 1217.50, ONRR will initiate and conduct audits of federal and Indian leases to ensure accurate reporting of production and timely and accurate payment of revenues due.

Guidance Information

This letter does not require any lessee to perform any type of restructured accounting or require any lessee to recalculate and pay royalties. It is valuation guidance and general information for reporting and paying royalties on gas used or lost along a pipeline. Nevertheless, if this letter causes you to discover an error in a previous report, 30 CFR § 1210.30 requires the filing of an accurate and complete amended report within 30 days of the discovery of the error. The failure to correct inaccurate reporting may result in civil penalties under 30 CFR Part 1241.

This letter is not an appealable Decision, Order, Notice of Noncompliance, or Civil Penalty Notice under 30 CFR Part 1290 Subpart B or 30 CFR Part 1241. If ONRR issues you an Order, Notice of Noncompliance, or Civil Penalty Notice at a later date in accordance with the matters addressed in this letter, ONRR will provide the appeal rights at that time.

Please note that the citations refer to ONRR's current published regulations. If these regulations change, please use the most recent applicable version. For detailed regulatory language, please visit the https://ecfr.gov website and select Title 30 – Mineral Resources, Chapter XII: Office of Natural Resources Revenue, Department of the Interior (1200-1299).

If you have questions, or need valuation assistance, please contact ONRR's Royalty Valuation Guidance team at RoyaltyValuation@onrr.gov.

Sincerely,

AMY LUNT Digitally signed by AMY LUNT
Date: 2023.05.17 10:21:45 -06'00'

Amy Lunt
Program Manager
Royalty Valuation Guidance

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[22] See 30 CFR § 1206.178(a)(1)(i).
[23] See 30 CFR § 1206.178(b)(1)(ii).