Indian Oil Valuation Rule

Indian Oil Negotiated Rulemaking Committee

Presented by John Barder, May 1, 2012

Indian Oil Valuation

- Background
- General Valuation Approach
- How to Value Oil Under an Arm's-length and Non-Arm's-length Contract
- Major Portion Valuation
- Transportation Allowances
- Transportation form filing requirements

Background

- Indian Oil Valuation Final Rule was published in Federal Register on December 17, 2007 (72 FR 71231)

- Effective date of the Rule was February 1, 2008

The Final Rule

What the Rule Did Not Do

- Did not change the major portion provision
- Did not change the Transportation allowance provision

What the Rule Did

- Adds more certainty to the valuation of oil produced from Indian lands
- Eliminates reliance on oil posted prices for non-arm's-length sales by eliminating the benchmarks
- Promised to convene a negotiated rulemaking to address the major portion and allowance provision of the rule

Application of Rule

- Applies to all oil produced from Indian (tribal and allotted) oil and gas leases
- Except leases on the Osage Indian Reservation, Osage County, Oklahoma
- If our rule is inconsistent with a Federal statute, a settlement agreement or written agreement or an express provision of an oil and gas lease then the statute, agreement, or provision will govern.

General Valuation Approach

- Value is based on lessee's or its affiliate's arm's-length gross proceeds
- Value could be based on volume-weighted price calculations
- Non-arm's-length value is not established from posted prices
- Primary measures for valuing oil do not include using NYMEX or spot market index pricing
- "Benchmarks" outlined at CFR 1206.52(c) were deleted

General Valuation Approach

Crude Oil Production and Marketing

- Oil produced from Indian leases is marketed differently than oil produced from Federal leases
- Majority of crude is sold at arm's length at the lease
- Only one instance where the lessee or its affiliate refines oil produced from the lessee's leases before arm's-length sale
- Most oil produced from Indian leases is not transported or exchanged to Cushing, Oklahoma
- Difficult to obtain reliable location and quality differentials

How to Value Oil Sold or Exchanged Under an Arm's Length Contract

Arm's-Length Sales Agreement(s)

- Oil is sold under an arm's-length sales contract
- Oil is sold or transferred to your affiliate or another person under a non-arm's-length contract, and that affiliate or person, or another affiliate of either of them, then sells the oil under an arm's-length contract
- Oil is valued under Section 1206.52
- Gross Proceeds less transportation allowance, and applicable location and quality differential

How to Value Oil Not Sold Under an Arm’s-Length Contract before it is refined

- Unit value for oil not sold under an arm’s-length contract is:
  - The volume-weighted average of the gross proceeds paid or received by you or your affiliate
- When calculating unit value:
  - Use only purchases or sales of other like-quality oil produced from the field
  - Or the same area if you do not have sufficient arm’s-length purchases or sales of oil produced from the field

How to Value Oil Under an Arm's Length Exchange Agreement

- If Oil is exchanged by lessee or lessee's affiliate under an arm's-length, or multiple sequential arm's-length exchange agreements then oil is valued under Section 1206.52
- Gross Proceeds or NYMEX price less transportation allowance, and applicable location and quality differential

Transportation Allowances

Summary of current regulations

- Form MMS-4110 must be filed for both arm's length and non-arm's length arrangements
- Advanced estimates are required for non-arms length arrangements
- The rate of return is the S & P's BBB rate

Marketable Condition

- Lessees must place oil in marketable condition and market the oil for the mutual benefit of the lessee and the Indian lessor at no cost to the lessor, unless the lease agreement provides otherwise.

Major Portion

- **Major Portion Means**
  - The highest price paid or offered at the time of production for the major portion of oil production from the same field. The major portion will be calculated using like-quality oil sold under arm's-length contracts from the same field (or if necessary to obtain a reasonable sample, from the same area) for each month. The major portion is that price at which 50% by volume plus one Bbl of oil is sold starting from the bottom.

Royalty Value for Indian Oil

- **30 CFR 1206.54**
  - For any Indian leases that provide that the Secretary may consider the highest price paid or offered for a major portion of production, in determining value for royalty purposes, if data are available to compute a major portion, ONRR will where practicable, compare the value determined in accordance with this section with the major portion. The value to be used in determining the value of production, for royalty purposes, will be the higher of those two values.

Major Portion Value Calculation

Sales Volume (BBLS)	Price ($/BBL)	Summation (%)
2700	$100.00	100.00
1000	$99.50	73.00
1500	$99.00	63.00
1000	$98.50	48.00
2000	$98.00	38.00
1800	$97.50	18.00
10,000		

- The price at which 50% plus 1 BBL of the oil is sold

Other Ideas to Fulfill the Major Portion Requirement

- Similar to the method above (gas major portion calculation).
- Formula price that takes into consideration the major portion requirement.
- Gross proceeds price with a percentage bump for major portion.

THE END