

Indian Oil Valuation Negotiated Rulemaking Committee

Meeting 9, September 16, 2013

Building 85 Auditorium, Denver Federal Center, Lakewood Colorado

Final Meeting Summary

Attendees

Committee Members and Alternates

John Barder, Office of Natural Resources Revenue (ONRR)

Theresa Walsh Bayani, ONRR

Deborah Gibbs Tschudy, ONRR (Designated Federal Officer)

Paul Tyler, ONRR

Daniel Riemer, American Petroleum Institute

Morris Miller, American Petroleum Institute (Alternate)

Dee Ross, Chesapeake Energy

Kevin Barnes, Council of Petroleum Accountants Societies

Patrick Flynn, Resolute Energy Corporation

Kathleen Sgamma, Western Energy Alliance (Alternate)

Robert Thompson, Western Energy Alliance

Jeanne Whiteing, Blackfeet Nation

Roger Birdbear, Land Owners Association

Darrel Paiz, Jicarilla Apache Nation (Alternate)

Claire Ware, Joint Business Council of Shoshone and Arapaho Tribes

Perry Shirley, The Navajo Nation

Akhtar Zaman, The Navajo Nation (Alternate)

Marcella Giles, Oklahoma Indian Land/Mineral Owners of Associated Nations (OILMAN)

Manuel Myore, Ute Indian Tribe

Facilitators

Chris Moore, CDR Associates

Laura Sneeringer, CDR Associates

Observers

Janet Price, ONRR

Karl Wunderlich, ONRR

Emily Kennedy, American Petroleum Institute

Kenneth Vogel, FTI Consulting

Keith Specht, Newfield

Valerie Heart Broker, Ft. Berthold Allottee landowner

Sharon Paiz, Jicarilla Apache Tribe

Tim McLaughlin, Nordhaus Law Firm, LLP

Agenda Topics

Monday, September 16, 2013 9:00 AM – 5:00 PM

- Welcome, Recap of Previous Discussions and Agenda Review
- Review of the “Higher of Gross Proceeds or Index Based Formula Price” Proposal Developed at the August Meeting and Identify and Initially Discuss Remaining Issues, Concerns and Questions
- Federal Government/Tribes/Allottees and Industry Caucuses to Review the Proposal and Discuss Remaining Issues, Concerns and Questions
- Report Out from Federal Government/Tribes/Allottees’ and Industry’s Caucuses and Discussion on Remaining Issues, Concerns or Questions
- Confirm Consensus for the Proposal
- Discuss Consultations and Next Steps for Drafting the Rule (Note- a subgroup met the morning of September 17 to refine the plan for Tribe and Allottee consultations.)
- Committee Wrap-Up

Action Items

- CDR Associates will integrate changes from the meeting into the Final Recommendation Report. ONRR staff will review and the Final Report will be sent to all Committee Members.
- CDR Associates will determine whether Committee Members that were not present at the meeting support the recommendation. This includes Bruce Loudermilk from BIA and Jack Vaughn from Peak Energy Resources. (Completed – both representatives indicated support for the recommendation).

Summary of Meeting Discussions

The meeting began with a review of the “Higher of Gross Proceeds or Index Based Formula Price” proposal developed at the August Meeting. The Committee discussed how condensate and royalty in kind should be incorporated, before breaking into caucuses to discuss any final issues, concerns or questions. After the caucuses, the groups discussed remaining issues, and reviewed and modified the updated Draft Committee Recommendations Report language. Each Committee Member was asked whether they could support the recommendation. All Committee Members, with the exception of one (Roger Birdbear) stated that they supported the recommendation. A summary of Roger Birdbear’s objections was added to the Recommendations Report, along with an associated comment from Marcella Giles.

The Committee briefly discussed next steps. The Committee’s Recommendation Report will be finalized, based on the input from this meeting and sent to all Members. Each Committee Member and Alternate will also receive a thank you letter, signed by the Secretary of the Interior. The Committee is not expected to meet again.

ONRR and the Tribes and Allottees met the following morning, September 17th, to refine the Consultation Plan. ONRR will write the Proposed Rule, based on the Committee’s Recommendation Report, feedback from consultations with Tribes and Allottees, and public comments. ONRR hopes to have the proposed rule published in 6 months.

Note that all meeting presentations and handouts will be available on the Committee website at:
http://www.onrr.gov/Laws_R_D/IONR/

Remaining Issues, Concerns and Questions Discussed

Debbie Gibbs Tschudy, of ONRR, reviewed the proposal from the August meeting. The only change since the August meeting is that ONRR will require reporting of crude oil type on Form ONRR-2014, 3 months prior to the effective date of the rule in order to improve accuracy of the differential. ONRR will correlate the crude oil type for these 3 months to the previous 9 months and will use all 12 months to calculate the initial differential. Companies will be informed about the oil type reporting date at least 3 months in advance so they have time to get their systems in place.

Calculation for Determining the Differential

The calculation to establish the differential is shown below. It includes the average major portion price over the previous year, not the average differential between the major portion price and NYMEX Calendar Month Average. The examples in the Final Committee Recommendation Report will updated to make this clear.

$$\text{Index – Based Monthly Formula Price by Designated Area and Oil Type} = \left(\frac{\text{Current Month}}{\text{CMA}} \right) + / - (\text{Roll}) + / - \left[\frac{(\text{NYMEX CMA} - \text{Prev 1yr Avg. } 25\% \text{MP})}{1\text{yr Avg. NYMEX CMA}} \right]$$

It was noted that sales volumes reported as Sales Type Code (STC)-NARM should be included in the array to establish the differential. Specifically, if there is no sale of the crude oil and the value is based on a weighted average of the affiliates' arm's length purchases and/or sales, then the lessee must report using STC-NARM.

Monitoring of the Differential

One of the comments received before the Committee meeting was that ONRR should continue to modify the differential to get to 25% major portion down from the top, even if the gross proceeds (determined by monthly oil sales volumes not reported as STC-OINX) are within the +/- 3% range (i.e., 22-28%). The Committee discussed that the major portion is too variable to require this level of a trigger, which is why the +/- 3% was initially recommended.

One Member asked what happens if ONRR realizes that a 10% modification to the differential is too much. For example, a case may arise in which the 10% modification takes the gross proceeds from below the range to above the range. The Committee agreed that in this case, ONRR could use Secretary's discretion to change the differential, as appropriate. In general, ONRR is hoping to setup the 10% trigger as an automatic function.

Incorporating Condensate

John Barder, of ONRR, described a proposal for incorporating condensate, which included the following. The Committee agreed with this proposal.

- The rule will apply only to condensate reported as Product Code 02 on Form ONRR 2014. This is the condensate that falls out at the well pad and is measured as a liquid, like oil. Product Code 05 and 06 get metered as a gas volume and they are covered under the Indian Gas Valuation Rule.
- There would not be more than one condensate type per designated area. There are very small volumes of condensate being reported, compared to overall oil production, and there is a very small range in API gravity. A few Reservation-specific data examples were shared.

The Committee discussed whether there should be separate designated areas for condensate for Ft. Berthold and Uintah and Ouray, since there is not a significant amount of condensate production. In the end, the Committee decided to keep the designated areas consistent for all oil types, including condensate. If there is not enough production to separate into smaller designated areas, Secretary's discretion can be used to establish value, in a manner that is consistent with lease terms.

The following clarifications were provided:

- Some companies commingle condensate with oil and report it as oil.
- Typically companies will store condensate until they have enough volume to transport it. The regulations do not have a time limit for how long condensate can be stored.

Incorporating Royalty in Kind

John Barder, of ONRR, described a proposal for incorporating royalty in kind. Some members did not think royalty in kind should be considered. The royalty obligation is taken in kind, so major portion does not apply. ONRR explained that the reason to include it is that if a high volume is taken in kind, it would skew monitoring of the transportation/location differential. Members agreed that they cannot assume that the royalty in kind value is the same as the value companies receive for their remaining production.

After discussion as a full Committee and within caucuses, Members agreed to the following proposal:

How royalty in kind will be used to establish the differential

For leases for which royalty is taken in kind, payors will continue to report the entire sales volume reported (8/8ths) on the Form ONRR-2014 and base the sales value on the price the lessee receives for volumes sold (excluding the royalty share of production taken in kind). The array to establish the location/quality differential will include sales reported, less the royalty in kind volumes, as reported on Form ONRR-2014 as Payment Method Code 06.

How royalty in kind will be used to monitor the differential

For leases which royalty is taken in kind now or in the future, lessees will report the full sales volume and base the sales value reported on Form ONRR-2014 on the higher of: 1) the Index-Based Formula Price (reported as STC-OINX) or 2) the price the lessee receives for volumes sold (reported as STC-ARMS), excluding the royalty share of production taken in kind. The royalty in kind share of production will not be considered in determining whether a modification of the designated area-specific differential is needed.

Ensuring Adequate Data Inputs

There was a concern that while all information is subject to audit, they are not completed for all companies. Compliance reviews are used instead. ONRR Members described that they use a risk-based management approach for data reviews. The Office of Inspector General recently completed an audit of ONRR, and said that compliance reviews are allowable as a supplement for an audit. Compliance reviews have enabled ONRR to expand its data review coverage; it is a cost effective way to review reporting on a large scale. ONRR develops a Work Plan at the beginning of the year that outlines what audits will be done based on risk, ensuring that a broad geographic area is covered, and including any hot spots (e.g., major new development in Ft. Berthold). ONRR ensures that at least 25-50% of royalties at each Reservation are reviewed. Additional audits can be added during the year, and compliance reviews can end up turning into audits. ONRR has Cooperative Agreements with six Tribes, who conduct the audits themselves. It was also noted that adjustments are subject to audit.

In addition to its compliance reviews and audits, ONRR conducts automatic upfront edits on reporting. For example, an automatic edit could be initiated to ensure the value reported is at least as high as the Index-based Formula Price. The actual Index-based Formula Price will be added to the Website so payors will not have to do any calculations. They will have to determine whether their gross proceeds value is higher than the listed price.

A concern was raised that the data from ONRR-2014 is not accurate enough. In order to make data as accurate as possible, ONRR asked Tribes and Allottees to coordinate with them by raising any data questions. This concern was added to the Draft Committee Recommendations Report.

Consultations with Tribes and Allottees

Committee Members noted that the overview of the recommendation needs to be simplified for consultations with Tribes and Allottees. Some initial ideas included:

- It may be easier to describe the differential as a % of NYMEX.
- The trigger to monitor the differential can be framed as a protection. Another protection is that all data is still subject to audit, even for companies that pay the Index-based Formula Price.
- Information should describe how Tribes and Allottees are brought up to the 75% level (25% down from the top), thereby increasing royalties across the board.