Indian Oil Valuation Negotiated Rulemaking Committee

Meeting 5, October 24-25, 2012
Building 85 Auditorium, Denver Federal Center, Lakewood Colorado

Meeting Participants

Committee Members and Alternates
Steve Graham, Bureau of Indian Affairs (Alternate)
John Barder, Office of Natural Resources Revenue (ONRR)
Deborah Gibbs Tschudy, ONRR (Designated Federal Officer (DFO))
Donald Sant, ONRR
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
Robert Thompson, III, Western Energy Alliance (Alternate) – Day 1
Kathleen Sgamma, Western Energy Alliance (Alternate) – Day 2
Jeanne Whiteing, Blackfeet Nation (Alternate) – Day 2
Roger Birdbear, Land Owners Association
Darrel Paiz, Jicarilla Apache Nation
Claire Ware, Joint Business Council of Shoshone and Arapaho Tribes
Marcella Giles, Oklahoma Indian Land/Mineral Owners of Associated Nations (OILMAN)
Eddie Lagrone, Oklahoma Indian Land/Mineral Owners of Associated Nations (OILMAN) (Alternate)
Perry Shirley, The Navajo Nation
Manuel Myore, Sr., Ute Indian Tribe

Facilitators
Chris Moore, CDR Associates
Laura Sneeringer, CDR Associates

Observers
John Kunz, DOI Office of the Solicitor, Denver
Stephen Simpson, DOI Office of the Solicitor, Washington, DC
Tim McLaughlin, Nordhaus Law Firm, LLP
Sharon Paiz, Jicarilla Apache Nation
Karl Wunderlich, ONRR

Agenda Topics

Wednesday, October 24, 2012 9:00 AM – 5:00 PM

- Welcome, Recap of Previous Discussions and Agenda Review
- Review of Industry's Recommended Major Portion Methodology, as Originally Presented on the September 11 Conference Call
- Sample Major Portion Methodology at the Reservation and Field Level and at 50% + 1 barrel and 75% *John Barder, ONRR*
- Federal Government/Tribes/Allottees and Industry Caucuses to Discuss How the Sample Major Portion Analysis Affects Initial Methodology Ideas

- Federal Government/Tribes/Allottees Recommended Major Portion Methodology
- Caucuses and Refined Methodology Discussions

Wednesday, October 24, 2012 9:00 AM – 3:00 PM

- Caucuses and Refined Methodology Discussions
- Review of schedule, action items and next steps

Action Items

- All Committee members will provide their availability for 2013 meetings by filling out the doodle scheduler at: http://www.doodle.com/q8bp5r8ng22fdp7t
- An ad hoc Subcommittee will 1) obtain information on the number of payors per field on all reservations/Indian lands (except Oklahoma) and 2) review initial criteria ideas develop by tribes, allottees and the Federal government and recommend whether they are appropriate and/or if criteria needs to be added or deleted. More information about the Subcommittee's scope is available at the end of this summary.
- Individual tribal representatives will use the information from the Subcommittee to provide initial recommendations on where fields may be combined on their reservation. Marcella Giles/Eddie Lagrone will do the same for Oklahoma. This will likely be done in consultation with ONRR.
- Deborah Gibbs Tschudy, Dan Riemer and Perry Shirley will continue to serve as the Executive Committee for the next meeting, and will work with CDR to develop the agenda.
- The next meeting is scheduled for December 11-12, 2012 at the Building 85 Auditorium at the Denver Federal Center, Lakewood Colorado.

Summary of the Meeting Discussion

In preparation for the meeting, ONRR conducted a sample data analysis to determine the difference in royalty payments when conducting a major portion analysis at the reservation and field level. An overview of this presentation is described below, followed by a description of the key issues the Committee discussed over the two days and a review of proposals that were continually updated and refined throughout the meeting. Finally, the next steps/action items sections provides details for an ad hoc Subcommittee that will collect data and make preliminary recommendations on criteria for when fields might be combined.

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

Presentation of Sample Major Portion Analysis

Sample Major Portion Methodology at the Reservation and Field Level and at 50% + 1 barrel and 75%
John Barder, of ONRR, began his presentation with a description of the number of fields, payors, oil types the API gravity range for each reservation. He then shared results of major portion calculations for Wind River and Fort Berthold at the reservation and field level, at both the 50%+1 and 75% major portion. In order for him to conduct calculations at the field level, Clare Ware tied fields to leases for Wind River, and BIA did the same for Ft. Berthold.

John also described the normalization process. Normalization for quality was only used for the reservation calculations since it was assumed that each field had the same oil type and API gravity. The API gravity ranges used were based on industry standards. Transportation deductions from the 2014 were incorporated to show the value at the lease (i.e., a netback value from the place the oil was sold) for both the reservation and field calculations. For more detailed information, refer to John's presentation, which will be available on the Committee website.

Key Issues Discussed Throughout the Meeting

The following topics were discussed throughout the two days:

Economic Factors
There is a concern on the part of industry that calculating a major portion at an area larger than a field is not taking economic factors into account, such as where oil transport infrastructure is located and geographical factors such as large rivers and mountains. Industry's perspective is that that since the buyer and seller negotiate a price based on quality and location, location needs to be considered in the calculation of the major portion. The purpose of the transportation deduction is to get the value of the oil back to the lease, thereby considering location. The group discussed how to normalize for location, but could not find a solution.

ONRR described that the intent of the major portion calculation is to fulfill the Federal government's Trust responsibility to maximize revenue for tribes and allottees. The intent is not to ensure all that producers are on an equal footing regarding the location and related costs of their production. There is nothing in the regulation or lease requiring transportation to be considered.

As the meeting continued, members began to consider including economic factors as a potential criteria for combining fields. For example, fields could be combined that generally go to the same market center. Industry representatives reminded the group that when a broader area is used, a lot more assumptions need to be considered and included; while analysis at the field level automatically takes economic factors into account. The only way a calculation would need to be further refined at the field level is if there is a very different oil type or API quality.

Limited Payors
In fields where there are less than three payors, ONRR is constrained in publishing its calculated major portion value because it would result in sharing a company's proprietary financial information. ONRR believes that this is the case for a number of fields on Indian reservations or allottee land.

Industry would like this issue to be explored further to determine how ONRR can protect proprietary information and also have transparency regarding its MP calculations. Industry advocates that since the major portion is a value, not an actual price, this should not be an issue.

ONRR responded that the only potential way around this issue would be to get approval from every company and this would be very unlikely.

Industry noted there is no language in regulations that says there has to be a minimum number of payors. ONRR's response was that since 1944, its practice has been to expand areas where there are less than three payors so there is a large enough number to have an array of payors. Having an array is important so that if a tribe or allottee has a lessor without significant market power and that produces oil at a lower value, the former would still get a higher value for their resource because of a combination of payors, some of whom are likely to have obtained higher sales prices.

Administrative Factors
ONRR does not have information in its system to tie fields to leases and must depend on BIA, tribes or industry for information. It is therefore expected that obtaining this data for system setup may be problematic. Additionally, ongoing maintenance and updating of field data may also be challenging. Fields expand, there may be leases that are not in designated fields at the time of the major portion calculation, there may be misreporting,

etc. It was noted that producing wells are associated with fields within 60 days of well production. Therefore, field data will always be available by the time the major portion analysis is being conducted. The group preliminarily discussed how field data could be effectively collected. One idea was for industry to report field name. Another idea was to reinstate something like the PIFF so that field information only needs to be reported once.

In the sample calculation, the field level analysis was a lot more time consuming due to the number of fields – having to run 9 field calculations instead of 2 reservation calculations. While John did have to do the extra step of normalization for the reservation level, he described it as an easy process.

Several Committee Members noted that while they understand why the field analysis was difficult due to setup and manual calculation, they thought it should be easier in the future as the process could be automated and normalization would no longer be required. ONRR noted that some parts of the process will be able to be automated, but not the entire process.

Crude Type

A concern was raised that determining oil type can be subjective as different publications have different criteria and lists, which are not necessarily independent or reliable sources. An industry representative noted that determination of crude type by ONRR could be arbitrary and capricious. ONRR's response was that such a designation would not be arbitrary and capricious if industry is provided this information. ONRR would want to consider general oil types (e.g., sweet, sour, asphaltic, black wax and yellow wax) in designation of crude types.

Another concern was that oil type is not necessary since lease agreements say "like-gravity" and the regulation says "like quality". ONRR explained that it would not be meeting the intent of the lease and regulation if two different oil types were compared in the same major portion array.

Regulatory/ Legal Considerations

One person noted that it will be a challenge to designate an area because lease language generally says "field", and lease language is supreme.

Regarding interest, one person described an IBLA decision that makes it impossible for ONRR to waive interest on industry payments until it completes its major calculation. The Indian Gas Rule does allow ONRR to toll interest payments.

Potential Criteria for Designating Area

Tribes, allottees and Federal government agencies brainstormed an initial list of potential criteria for designating an area. This was shared with the industry group, but a detailed discussion did not occur. Initial ideas included:

- Reasonable sample size (>2 payors)
- Same crude type (e.g., sweet, sour, asphaltic, black wax, yellow wax)
- Same gravity (e.g., 40-45, below 40 and above 45)
- Same geographic area (e.g., field, county, reservation)
- Same market served
    - access to similar infrastructure (e.g., refineries, pipelines, rail lines, major roads)
    - no challenging geographical divides (e.g., large rivers)

If the Committee decides ONRR will designate areas that are smaller than reservations but larger than fields, criteria for making these determinations will need to be defined in the regulation.

One member suggested that one option would be to calculate the major portion at either 50% + 1 barrel at the reservation level or at 75% at the field level.

Proposals Shared Throughout the Meeting

1. Review of Industry's Recommended Major Portion Methodology, as Originally Presented on the September 11 Conference Call

Dan Riemer, representative of the American Petroleum Institute, provided a review of industry's recommended major portion methodology, as originally presented on the September 11, 2012 conference call. The proposed methodology includes:

- Major portion price should be calculated at the field level. If there are multiple API gravities in a field (i.e., a variance of more than 2 degrees), separate major portion analysis should be conducted within the same field.
- Major portion should be defined as 50% + 1 barrel.
- ONRR should publish individual field major portion prices within 12 months. The industry group would prefer to see published prices within 6 months, but they understand that more time may be needed to improve data accuracy by giving data time to settle.
- Industry would provide the following data:
  - The field name as designated by state agencies. More discussion is needed to determine if this can be a one-time setup, or whether it would need to be reported on the 2014.
  - API gravity: This data could potentially be linked through the OGOR report, but more information is needed to determine if this is possible.
- Industry wants more discussion on the following:
  - Why crude type information may be necessary.
  - How condensate would be handled.
- To be consistent with Indian Gas Rule, late interest should not accrue until major portion prices are published.
- ONRR should maintain and publicize a list of all Indian leases that do not contain a major portion provision.

2. Tribes/Allottees/Federal Government Recommended Major Portion Methodology

Perry Shirley, of the Navajo Nation, described the tribes/allottees/Federal government updated major portion methodology, as described in Appendix A. It includes:

- Using only information that is re reported on the 2014. This could include payors from federal land. It would not include payors from state or fee land as this information is not readily available.
- Using 75% for a major portion calculation.
- Industry would need to provide the following information: API gravity and oil type at production (e.g., asphaltic or sweet). The Committee needs to determine how to obtain required data for a field-level analysis, which may include industry providing field names.
- API quality would be normalized in 5 degree bands.
- ONRR can designate the appropriate area for the major portion calculation (e.g., reservation, field or something in between). The area used to calculate major portion can vary by reservation.

Some of the reasons for expanding beyond the field include: to have enough payors to be transparent with data, maximize price received by tribes and allottees; calculation at the field level is challenging from an administrative standpoint; and such a provision would be consistent with the Indian Gas Rule. Industry noted that consistency with the Indian Gas Rule on this issue is not relevant because oil is marketed differently that gas.

3. Industry Updated Recommended Major Portion Methodology

Dan Riemer, representative of the American Petroleum Institute, in response to the previous Federal Government/Tribes/Allottees proposal, presented an updated concept. It included:

- Major portion for the vast majority of Indian lands would be calculated at the field level.
- However, if there is some compelling reason and efficiency gained by combining fields, industry is willing to consider this. This would involve starting at the field level and expanding out, if appropriate.
- The combined fields would need to be comparable in crude quality and location.
- The gravity band concept has merit. There are some natural breaks for gravity (e.g., 40-45, below 40, above 45). Each 5 degree band could be a separate array within a field.
- Major portion would be calculated at 75% at the field level.
- Industry is willing to include any published data on the 2014.

4. Federal Government/Tribes/Allottees Updated Recommended Major Portion Ideas

Debbie Gibbs Tshudy, of ONRR, described additional ideas from the tribes/allottees/Federal government group. These ideas were based on initial "out of the box" brainstorming. They require additional consideration to ensure practicality and support among the entire /tribes/allottees/Federal government group. The ideas include:

A. 75% major portion at the field level, with a requirement that there must be 3 or more payors. Criteria and procedures would need to be developed for combing fields if there are not 3 or more payors. Additional enforcement, beyond civil penalties, would be added to the Rule to ensure accurate and timely reporting by industry.
B. 75% major portion at the field level, but if there are not 3 or more payors a NYMEX price could be used to determine major portion.
C. 75% major portion at the field level and change the regulation to give the Secretary of Interior discretion to define fields, instead of depending on states. ONRR would list field designations on its website. In some cases this could be a field (as currently defined). It could also be a reservation or somewhere in between. This would be a lot of work to setup, but it would provide flexibility.

Ad Hoc Subcommittee Scope

The Committee formed an ad hoc Subcommittee for the following tasks. This information is refined based on a conference call on November 2, 2012.

1) Identify the field names on Indian reservations (except Oklahoma due to the number of fields).

2) Obtain information on the number leases and payors per field on all reservations (except Oklahoma). Specifically, determine where there are not 3 or more payors at the field level. This requires additional information to tie leases to fields.

    - If possible, determine whether sub field analyses will be required due to different oil types and API gravities within a field or combined fields. The goal is to determine where fields have 3 or less payors so this detailed analysis would only be needed on fields with few payors.

    - If possible, obtain information from BLM on Federal payors in areas with fewer than 3 payors. Note: If the Committee decides to include non-Indian payors, this information will need to be applied consistently in all major portion calculation arrays, regardless of the number of payors.

3) Review initial criteria ideas from the tribes, allottees and Federal government agencies and recommend whether they are appropriate and/or if criteria needs to be added or deleted.

4) Provide initial recommendations on where fields may be combined. This activity would be completed by individual tribes, likely in consultation with ONRR. The process would include reviewing maps showing fields and infrastructure, along with information on the number of payors in each field.

5) Where there is not an Indian representative of a specific reservation on the subcommittee, ONRR may do a first cut to identify fields where there are less than three payors, and, as appropriate, identify possible combinations of fields to meet the criteria. An ultimate decision in the future on potential combination of fields would be conducted by ONRR in consultation with the respective tribe.

Type of information that will be helpful

- Maps with reservation boundaries, fields name, leases boundaries and lease identification numbers.
- Infrastructure maps (e.g., location of refineries, pipelines, rail lines, roads)

Initial ideas on where to obtain information

- Morris Miller has detailed maps of: Fort Berthold, S. Ute and Jicarilla
- Steve Graham and John Barder will coordinate with BIA Energy and Management (Jeff Hunt) to obtain the following for all reservations:
  - Map with the reservation boundary, fields and lease numbers
  - Map with reservation boundary, fields and infrastructure
  - Spreadsheets with field names and associated leases and cooperating agreements

Initial Criteria Ideas

- Reasonable sample size (>2 payors)
- Same crude type (e.g., sweet, sour, asphaltic, black wax, yellow wax)
- Same gravity (e.g., 40-45, below 40 and above 45)
- Same geographic area (e.g., field, county, reservation)
- Same market served
  - access to similar infrastructure (e.g., refineries, pipelines, rail lines, major roads)
  - no challenging geographical divides (e.g., large rivers)

Appendix A: Tribes/Allottees/Federal Government Concept Paper for Major Portion Calculation

Lease Term Elements	Proposal	Comments
Highest Price Paid or Offered	Use only values reported to ONRR on Form MMS-2014, not all prices in the field or area (e.g. State and fee). ONRR may calculate using a different data sources, but ONRR must first publish in the Federal Register.	• Resolves barriers in implementing major portion due to ONRR's inability to obtain and identify only arm's-length prices or prices from non-Federal and non-Indian lands. • Provides ONRR with alternative data sources if needed, consistent with the Indian gas rule. If an alternative source is used, would have to be published in the Fed Reg, again, similar to the Indian gas Rule.
For the major portion of the oil	Major portion would be the 25th percentile from the highest price down in the array.	• Given the limited pricing data proposed above, the higher percentage is a reasonable approach. • Would not have to justify/support two different major portion percentages (oil and gas) under the same lease language. • Consistent with the Indian Gas Rule.
Of same gravity oil	Use oil type and API gravity price bulletin bands to normalize for price.	• Sweet and sour crude oils have long been recognized as different quality oils. • API gravity has long been recognized as a quality parameter. Would use gravity "bands" to establish like-quality oils equivalent to the ranges in posted price bulletins for the area; e.g. 5 degree bands. • Prices would not be normalized within the "bands." • ONRR would define like-quality for specific areas if warranted, but ONRR must publish determination in Fed Reg. Example would be an area with 33 to 36 degree API gravity range, but price bulletin has a different adjustment above and below 35 degrees.
Sold from the field where the leased lands are situated	Use reservation or ONRR designated area similar to the Indian gas rule.	• The regulations on major portion have included consideration of field or area since 1942. • Using reservation or ONRR-designated areas avoids the need to rely on definition of a field by various states that may define fields using different considerations or relying on industry to consistently report this information. • Use of reservation or ONRR-designated areas provides certainty, is consistent with the data available to ONRR, and is consistent with the Indian Gas Rule.