



# United States Department of the Interior

## OFFICE OF NATURAL RESOURCES REVENUE

P.O. Box 25165  
Denver, Colorado 80225-0165

DEC 5 2011

Dear Reporter:

This letter provides guidance on how to properly report, pay, and value royalties on oil produced from Federal and Indian leases in the Bakken formation in North Dakota and Montana. This letter also provides you with Office of Natural Resources Revenue (ONRR) reporting and valuation contact information. We are providing this guidance to new and existing reporters because of the rapid increase in oil production from the Bakken formation. Our goal is to proactively ensure reporters timely and properly report and pay royalties on Bakken oil production.

### **General Information**

#### Reporting Information

Please call your royalty and production reporting contacts prior to reporting royalties or production from the Bakken formation to ONRR. We want to ensure we have all the lease, agreement, and well information necessary for you to report accurately.

- Your company contact for reporting royalties on Report of Sales and Royalty Remittance, Form MMS-2014 is on our website at: <http://www.onrr.gov/FM/PDFDocs/coassign.pdf> or 1-800-525-9167.
- Your company contact for reporting production on Oil and Gas Operations Report, Form MMS-4054 (OGOR), is on our website at: <http://www.onrr.gov/FM/PDFDocs/operasgn.pdf> or 1-800-525-7922.

If you flare or vent any gas, you must report it on the form OGOR-B. For more information regarding emissions related to your operations, please refer to 43 CFR § 3160, Notice to Lessees and Operators of Onshore Federal and Indian Oil and Gas Leases Royalty or Compensation for Oil and Gas Lost (NTL-4A), and the appropriate State regulatory agency.

For general information on reporting royalties, please refer to the *Minerals Revenue Reporter Handbook (2003)*. For general information on reporting production data, please refer to the *Minerals Production Reporter Handbook (2002)*. Both manuals are located on our website at: <http://www.onrr.gov/FM/Handbooks/default.htm>.

If you are a new royalty or production reporter, we recommend that you attend reporter training. Our website has additional information on upcoming training opportunities at: <http://onrr.gov/FM/Training/default.htm>. Also, please refer to the New Payor Checklist on our website at: <http://www.onrr.gov/FM/PayorChecklist.htm>.

If you are a new Operator, please refer to the New Operator Checklist on our website at: <http://www.onrr.gov/FM/OperatorChecklist.htm>.

## **Oil Valuation**

Both Federal and Indian oil valuation is based on whether the oil is sold arm's-length (*i.e.* to an unaffiliated third party) or non-arm's-length (*i.e.* to an affiliate).

### Federal Oil Valuation

*Arm's-length transactions (30 CFR § 1206.102):* If you or your affiliate sell crude oil at arm's-length (*i.e.* to an unaffiliated third party), value is generally based on your gross proceeds (30 CFR § 1206.102(a)). However, if you or your affiliate enter into an exchange agreement or multiple sequential arm's-length exchange agreements, then under 30 CFR § 1206.102(d), you may elect to either value your production based on your or your affiliate's gross proceeds (30 CFR § 1206.102(a)) or on the indices in the non-arms length valuation regulations discussed below (30 CFR § 1206.103).

*Non-arm's-length transactions (30 CFR § 1206.103(b)):* If you or your affiliate sell oil under non-arm's-length transactions (*i.e.* to an affiliated party), then your oil is valued based on the regulations for oil produced from the Rocky Mountain Region as follows:

- If you have an ONRR-approved tendering program, then the value for oil produced from your leases in the tendering program is based on the highest winning bid for tendered volumes. (30 CFR § 1206.103(b)(1)).
- If you do not have an ONRR-approved tendering program, you may elect to value the oil based on either:
  - (1) The volume-weighted average of you or your affiliate's arm's-length sales prices (if at least 50 percent of the oil that you and your affiliates produce from the field or area is sold at arm's-length) (30 CFR § 1206.103(b)(2)); or
  - (2) A NYMEX price adjusted for location and quality (30 CFR § 1206.103(b)(3)).

*Adjustments (30 CFR § 1206.112):* When using NYMEX or exchange agreements to determine the royalty value for your crude oil production, the quality and/or location adjustments you take must follow the requirements under 30 CFR § 1206.112.



## Indian Oil Valuation

*Arm's-length transactions (30 CFR § 1206.52):* If you or your affiliate sell crude oil at arm's-length, then value is generally based on the gross proceeds you or your affiliate receive (30 CFR § 1206.52(a)). However, if you or your affiliate enter into an exchange agreement or multiple sequential exchange agreements, value may be based on NYMEX (30 CFR § 1206.52(e)(1)) or your affiliate's non-arm's-length sales (30 CFR § 1206.52(e)(1)).

*Non-arm's-length transactions (30 CFR § 1206.53):* If you or your affiliate sell or transfer oil under non-arm's-length transactions, then your oil is generally valued at the volume-weighted average of the gross proceeds you or your affiliate paid or received, including a refining affiliate, for purchases or sales under arm's-length contracts using criteria identified at 30 CFR § 1206.53.

*Major Portion Pricing (30 CFR § 1206.54):* For both arm's-length and non-arm's-length contracts, your lease may contain a major portion provision. If your lease does contain a major portion provision, then you have to value the oil produced from that lease using the highest price paid or offered for a major portion of the production.

*Adjustments (30 CFR § 1206.52(e)(1), (2), and (3)):* When using NYMEX or exchange agreements to determine the royalty value for your crude oil production, any quality and/or location adjustments you take must follow the requirements described under 30 CFR § 1206.52(e)(1), (2), and (3).

## Transportation Allowances

In general, if you do not sell your oil at or near the lease, unit, or communitized area, you may deduct the cost of transporting production to the point of sale (30 CFR §§ 1206.56 (Indian oil) and 1206.109 (Federal oil)). To claim transportation allowances, you must adequately document actual costs you paid to transport the oil (30 CFR § 1207.5). *Citation Oil and Gas Corporation*, IBLA 2005-245 (Mar. 31, 2008), *aff'd Citation Oil and Gas Corp. v. Dept. of the Interior*, No. H-8-1977 (S.D. Tex. Sept. 13, 2010), *aff'd* No. 10-20729, 2011 U.S. App. LEXIS 21448 (5<sup>th</sup> Cir. Oct. 21, 2011) (*Citation*).

Any oral agreements you negotiate must be placed in written form (30 CFR § 1207.5) and retained in accordance with the record retention requirements of 30 USC 1724(f) (Federal oil) and 30 USC 1713 (Indian oil).

Allowable costs may include:

- For Federal leases, trucking, rail, line loss, and other fees as identified at 30 CFR §1206.110 (arm's-length transportation) or 30 CFR §1206.111 (non arm's-length transportation);
- For Indian leases, reasonable actual costs (30 CFR §§ 1206.56 and 1206.57(b)).

You are responsible for placing the production in marketable condition. Non-allowable costs to place production in marketable condition include, but are not limited to, the costs of gathering and separation (30 CFR §§ 1206.55 (Indian oil) and 1206.106 (Federal oil)).

Please refer to 30 CFR Part 1206 for further details regarding regulatory requirements. If you have any questions regarding valuation, email [RoyaltyValuation@onrr.gov](mailto:RoyaltyValuation@onrr.gov) or call the Royalty Valuation Office at (303) 231-3307.

#### Audit Information

Consistent with 30 CFR §1217.50, ONRR will initiate and conduct audits of Federal and Indian leases in the Bakken formation to ensure accurate reporting of royalty production and timely and accurate payment of revenues due.

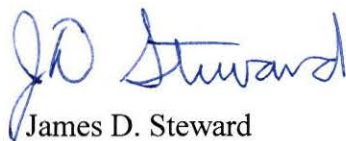
#### Guidance Information

This letter does not require you to perform any type of restructured accounting or require you to recalculate and pay royalties. It is merely valuation guidance and general information for reporting and paying royalties on oil produced from the Bakken formation under ONRR's current regulations.

The guidance provided in this letter is not an appealable decision or order under 30 CFR Part 1290. If ONRR issues you an order at a later date based on this guidance, we will provide your 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 <http://ecfr.gpoaccess.gov> and select Title 30 – Mineral Resources, Chapter XII (1200).

Sincerely,

A handwritten signature in blue ink that reads "James D. Steward". The signature is written in a cursive style with a large initial "J".

James D. Steward  
Program Director  
Financial & Program Management