

§ 1206.152 Valuation standards—un-processed gas.

(a)(1) This section applies to the valuation of all gas that is not processed and all gas that is processed but is sold or otherwise disposed of by the lessee pursuant to an arm's-length contract prior to processing (including all gas where the lessee's arm's-length contract for the sale of that gas prior to processing provides for the value to be determined on the basis of a percentage of the purchaser's proceeds resulting from processing the gas). This section also applies to processed gas that must be valued prior to processing in accordance with §1206.155 of this part. Where the lessee's contract includes a reservation of the right to process the gas and the lessee exercises that right, §1206.153 of this part shall apply instead of this section.

(2) The value of production, for royalty purposes, of gas subject to this subpart shall be the value of gas determined under this section less applicable allowances.

(b)(1)(i) The value of gas sold under an arm's-length contract is the gross proceeds accruing to the lessee except as provided in paragraphs (b)(1)(ii), (iii), and (iv) of this section. The lessee shall have the burden of demonstrating that its contract is arm's-length. The value which the lessee reports, for royalty purposes, is subject to monitoring, review, and audit. For purposes of this section, gas which is sold or otherwise transferred to the lessee's marketing affiliate and then sold by the marketing affiliate pursuant to an arm's-length contract shall be valued in accordance with this paragraph based upon the sale by the marketing affiliate. Also, where the lessee's arm's-length contract for the sale of gas prior to processing provides for the value to be determined based upon a percentage of the purchaser's proceeds resulting from processing the gas, the value of production, for royalty purposes, shall never be less than a value equivalent to 100 percent of the value of the residue gas attributable to the processing of the lessee's gas.

(ii) In conducting reviews and audits, ONRR will examine whether the contract reflects the total consideration actually transferred either directly or

indirectly from the buyer to the seller for the gas. If the contract does not reflect the total consideration, then the ONRR may require that the gas sold pursuant to that contract be valued in accordance with paragraph (c) of this section. Value may not be less than the gross proceeds accruing to the lessee, including the additional consideration.

(iii) If the ONRR determines that the gross proceeds accruing to the lessee pursuant to an arm's-length contract do not reflect the reasonable value of the production because of misconduct by or between the contracting parties, or because the lessee otherwise has breached its duty to the lessor to market the production for the mutual benefit of the lessee and the lessor, then ONRR shall require that the gas production be valued pursuant to paragraph (c)(2) or (c)(3) of this section, and in accordance with the notification requirements of paragraph (e) of this section. When ONRR determines that the value may be unreasonable, ONRR will notify the lessee and give the lessee an opportunity to provide written information justifying the lessee's value.

(iv) *How to value over-delivered volumes under a cash-out program.* This paragraph applies to situations where a pipeline purchases gas from a lessee according to a cash-out program under a transportation contract. For all over-delivered volumes, the royalty value is the price the pipeline is required to pay for volumes within the tolerances for over-delivery specified in the transportation contract. Use the same value for volumes that exceed the over-delivery tolerances even if those volumes are subject to a lower price under the transportation contract. However, if ONRR determines that the price specified in the transportation contract for over-delivered volumes is unreasonably low, the lessee must value all over-delivered volumes under paragraph (c)(2) or (c)(3) of this section.

(2) Notwithstanding the provisions of paragraph (b)(1) of this section, the value of gas sold pursuant to a warranty contract shall be determined by ONRR, and due consideration will be given to all valuation criteria specified in this section. The lessee must request a value determination in accordance with paragraph (g) of this section for

gas sold pursuant to a warranty contract; provided, however, that any value determination for a warranty contract in effect on the effective date of these regulations shall remain in effect until modified by ONRR.

(3) ONRR may require a lessee to certify that its arm's-length contract provisions include all of the consideration to be paid by the buyer, either directly or indirectly, for the gas.

(c) The value of gas subject to this section which is not sold pursuant to an arm's-length contract shall be the reasonable value determined in accordance with the first applicable of the following methods:

(1) The gross proceeds accruing to the lessee pursuant to a sale under its non-arm's-length contract (or other disposition other than by an arm's-length contract), provided that those gross proceeds are equivalent to the gross proceeds derived from, or paid under, comparable arm's-length contracts for purchases, sales, or other dispositions of like-quality gas in the same field (or, if necessary to obtain a reasonable sample, from the same area). In evaluating the comparability of arm's-length contracts for the purposes of these regulations, the following factors shall be considered: price, time of execution, duration, market or markets served, terms, quality of gas, volume, and such other factors as may be appropriate to reflect the value of the gas;

(2) A value determined by consideration of other information relevant in valuing like-quality gas, including gross proceeds under arm's-length contracts for like-quality gas in the same field or nearby fields or areas, posted prices for gas, prices received in arm's-length spot sales of gas, other reliable public sources of price or market information, and other information as to the particular lease operation or the saleability of the gas; or

(3) A net-back method or any other reasonable method to determine value.

(d)(1) Notwithstanding any other provisions of this section, except paragraph (h) of this section, if the maximum price permitted by Federal law at which gas may be sold is less than the value determined pursuant to this section, then ONRR shall accept such

maximum price as the value. For purposes of this section, price limitations set by any State or local government shall not be considered as a maximum price permitted by Federal law.

(2) The limitation prescribed in paragraph (d)(1) of this section shall not apply to gas sold pursuant to a warranty contract and valued pursuant to paragraph (b)(2) of this section.

(e)(1) Where the value is determined pursuant to paragraph (c) of this section, the lessee shall retain all data relevant to the determination of royalty value. Such data shall be subject to review and audit, and ONRR will direct a lessee to use a different value if it determines that the reported value is inconsistent with the requirements of these regulations.

(2) Any Federal lessee will make available upon request to the authorized ONRR or State representatives, to the Office of the Inspector General of the Department of the Interior, or other person authorized to receive such information, arm's-length sales and volume data for like-quality production sold, purchased or otherwise obtained by the lessee from the field or area or from nearby fields or areas.

(3) A lessee shall notify ONRR if it has determined value pursuant to paragraph (c)(2) or (c)(3) of this section. The notification shall be by letter to the ONRR Director for Office of Natural Resources Revenue or his/her designee. The letter shall identify the valuation method to be used and contain a brief description of the procedure to be followed. The notification required by this paragraph is a one-time notification due no later than the end of the month following the month the lessee first reports royalties on a Form ONRR-2014 using a valuation method authorized by paragraph (c)(2) or (c)(3) of this section, and each time there is a change in a method under paragraph (c)(2) or (c)(3) of this section.

(f) If ONRR determines that a lessee has not properly determined value, the lessee shall pay the difference, if any, between royalty payments made based upon the value it has used and the royalty payments that are due based upon the value established by ONRR. The lessee shall also pay interest on that difference computed pursuant to

§1218.54 of this chapter. If the lessee is entitled to a credit, ONRR will provide instructions for the taking of that credit.

(g) The lessee may request a value determination from ONRR. In that event, the lessee shall propose to ONRR a value determination method, and may use that method in determining value for royalty purposes until ONRR issues its decision. The lessee shall submit all available data relevant to its proposal. The ONRR shall expeditiously determine the value based upon the lessee's proposal and any additional information ONRR deems necessary. In making a value determination ONRR may use any of the valuation criteria authorized by this subpart. That determination shall remain effective for the period stated therein. After ONRR issues its determination, the lessee shall make the adjustments in accordance with paragraph (f) of this section.

(h) Notwithstanding any other provision of this section, under no circumstances shall the value of production for royalty purposes be less than the gross proceeds accruing to the lessee for lease production, less applicable allowances.

(i) The lessee must place gas in marketable condition and market the gas for the mutual benefit of the lessee and the lessor at no cost to the Federal Government. Where the value established under this section is determined by a lessee's gross proceeds, that value will be increased to the extent that the gross proceeds have been reduced because the purchaser, or any other person, is providing certain services the cost of which ordinarily is the responsibility of the lessee to place the gas in marketable condition or to market the gas.

(j) Value shall be based on the highest price a prudent lessee can receive through legally enforceable claims under its contract. If there is no contract revision or amendment, and the lessee fails to take proper or timely action to receive prices or benefits to which it is entitled, it must pay royalty at a value based upon that obtainable price or benefit. Contract revisions or amendments shall be in writing and signed by all parties to an

arm's-length contract. If the lessee makes timely application for a price increase or benefit allowed under its contract but the purchaser refuses, and the lessee takes reasonable measures, which are documented, to force purchaser compliance, the lessee will owe no additional royalties unless or until monies or consideration resulting from the price increase or additional benefits are received. This paragraph shall not be construed to permit a lessee to avoid its royalty payment obligation in situations where a purchaser fails to pay, in whole or in part or timely, for a quantity of gas.

(k) Notwithstanding any provision in these regulations to the contrary, no review, reconciliation, monitoring, or other like process that results in a re-determination by ONRR of value under this section shall be considered final or binding as against the Federal Government or its beneficiaries until the audit period is formally closed.

(l) Certain information submitted to ONRR to support valuation proposals, including transportation or extraordinary cost allowances, is exempted from disclosure by the Freedom of Information Act, 5 U.S.C. §552, or other Federal law. Any data specified by law to be privileged, confidential, or otherwise exempt will be maintained in a confidential manner in accordance with applicable law and regulations. All requests for information about determinations made under this subpart are to be submitted in accordance with the Freedom of Information Act regulation of the Department of the Interior, 43 CFR part 2.

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§ 1206.153 Valuation standards—processed gas.

(a)(1) This section applies to the valuation of all gas that is processed by the lessee and any other gas production to which this subpart applies and that is not subject to the valuation provisions of §1206.152 of this part. This section applies where the lessee's contract includes a reservation of the right to process the gas and the lessee exercises that right.