

§ 1206.170 What does this subpart contain?

This subpart contains royalty valuation provisions applicable to Indian lessees.

(a) This subpart applies to all gas production from Indian (tribal and allotted) oil and gas leases (except leases on the Osage Indian Reservation). The purpose of this subpart is to establish the value of production for royalty purposes consistent with the mineral leasing laws, other applicable laws, and lease terms. This subpart does not apply to Federal leases.

(b) If the specific provisions of any Federal statute, treaty, negotiated agreement, settlement agreement resulting from any administrative or judicial proceeding, or Indian oil and gas lease are inconsistent with any regulation in this subpart, then the Federal statute, treaty, negotiated agreement, settlement agreement, or lease will govern to the extent of that inconsistency.

(c) You may calculate the value of production for royalty purposes under methods other than those the regulations in this title require, but only if you, the tribal lessor, and ONRR jointly agree to the valuation methodology. For leases on Indian allotted lands, you and ONRR must agree to the valuation methodology.

(d) All royalty payments you make to ONRR are subject to monitoring, review, audit, and adjustment.

(e) The regulations in this subpart are intended to ensure that the trust responsibilities of the United States with respect to the administration of Indian oil and gas leases are discharged in accordance with the requirements of the governing mineral leasing laws, treaties, and lease terms.

§ 1206.171 What definitions apply to this subpart?

The following definitions apply to this subpart and to subpart J of part 1202 of this title:

Accounting for comparison means the same as dual accounting.

Active spot market means a market where one or more ONRR-acceptable publications publish bidweek prices (or if bidweek prices are not available, first of the month prices) for at least

one index-pricing point in the index zone.

Allowance means a deduction in determining value for royalty purposes. Processing allowance means an allowance for the reasonable, actual costs of processing gas determined under this subpart. Transportation allowance means an allowance for the reasonable, actual cost of transportation determined under this subpart.

Approved Federal Agreement (AFA) means a unit or communitization agreement approved under departmental regulations.

Area means a geographic region at least as large as the defined limits of an oil or gas field, in which oil or gas lease products have similar quality, economic, or legal characteristics. An area may be all lands within the boundaries of an Indian reservation.

Arm's-length contract means a contract or agreement that has been arrived at in the marketplace between independent, nonaffiliated persons with opposing economic interests regarding that contract. For purposes of this subpart, two persons are affiliated if one person controls, is controlled by, or is under common control with another person. The following percentages (based on the instruments of ownership of the voting securities of an entity, or based on other forms of ownership) determine if persons are affiliated:

(1) Ownership in excess of 50 percent constitutes control.

(2) Ownership of 10 through 50 percent creates a presumption of control.

(3) Ownership of less than 10 percent creates a presumption of noncontrol which ONRR may rebut if it demonstrates actual or legal control, including the existence of interlocking directorates. Notwithstanding any other provisions of this subpart, contracts between relatives, either by blood or by marriage, are not arm's-length contracts. ONRR may require the lessee to certify the percentage of ownership or control of the entity. To be considered arm's-length for any production month, a contract must meet the requirements of this definition for that production month as well as when the contract was executed.

Audit means a review, conducted under generally accepted accounting

and auditing standards, of royalty payment compliance activities of lessees or other persons who pay royalties, rents, or bonuses on Indian leases.

BIA means the Bureau of Indian Affairs of the Department of the Interior.

BLM means the Bureau of Land Management of the Department of the Interior.

Compression means raising the pressure of gas.

Condensate means liquid hydrocarbons (normally exceeding 40 degrees of API gravity) recovered at the surface without resorting to processing. Condensate is the mixture of liquid hydrocarbons that results from condensation of petroleum hydrocarbons existing initially in a gaseous phase in an underground reservoir.

Contract means any oral or written agreement, including amendments or revisions thereto, between two or more persons and enforceable by law that with due consideration creates an obligation.

Dedicated means a contractual commitment to deliver gas production (or a specified portion of production) from a lease or well when that production is specified in a sales contract and that production must be sold pursuant to that contract to the extent that production occurs from that lease or well.

Drip condensate means any condensate recovered downstream of the facility measurement point without resorting to processing. Drip condensate includes condensate recovered as a result of its becoming a liquid during the transportation of the gas removed from the lease or recovered at the inlet of a gas processing plant by mechanical means, often referred to as scrubber condensate.

Dual Accounting (or *accounting for comparison*) refers to the requirement to pay royalty based on a value which is the higher of the value of gas prior to processing less any applicable allowances as compared to the combined value of drip condensate, residue gas, and gas plant products after processing, less applicable allowances.

Entitlement (or *entitled share*) means the gas production from a lease, or allocable to lease acreage under the terms of an AFA, multiplied by the operating rights owner's percentage of in-

terest ownership in the lease or the acreage.

Facility measurement point (or *point of royalty settlement*) means the point where the BLM-approved measurement device is located for determining the volume of gas removed from the lease. The facility measurement point may be on the lease or off-lease with BLM approval.

Field means a geographic region situated over one or more subsurface oil and gas reservoirs encompassing at least the outermost boundaries of all oil and gas accumulations known to be within those reservoirs vertically projected to the land surface. Onshore fields are usually given names and their official boundaries are often designated by oil and gas regulatory agencies in the respective States in which the fields are located.

Gas means any fluid, either combustible or noncombustible, hydrocarbon or nonhydrocarbon, which is extracted from a reservoir and which has neither independent shape nor volume, but tends to expand indefinitely. It is a substance that exists in a gaseous or rarefied state under standard temperature and pressure conditions.

Gas plant products means separate marketable elements, compounds, or mixtures, whether in liquid, gaseous, or solid form, resulting from processing gas. However, it does not include residue gas.

Gathering means the movement of lease production to a central accumulation or treatment point on the lease, unit, or communitized area; or a central accumulation or treatment point off the lease, unit, or communitized area as approved by BLM operations personnel.

Gross proceeds (for royalty payment purposes) means the total monies and other consideration accruing to an oil and gas lessee for the disposition of unprocessed gas, residue gas, and gas plant products produced. Gross proceeds includes, but is not limited to, payments to the lessee for certain services such as compression, dehydration, measurement, or field gathering to the extent that the lessee is obligated to perform them at no cost to the Indian lessor, and payments for gas processing rights. Gross proceeds, as applied to

gas, also includes but is not limited to reimbursements for severance taxes and other reimbursements. Tax reimbursements are part of the gross proceeds accruing to a lessee even though the Indian royalty interest is exempt from taxation. Monies and other consideration, including the forms of consideration identified in this paragraph, to which a lessee is contractually or legally entitled but which it does not seek to collect through reasonable efforts are also part of gross proceeds.

Index means the calculated composite price (\$/MMBtu) of spot-market sales published by a publication that meets ONRR-established criteria for acceptability at the index-pricing point.

Index-pricing point (IPP) means any point on a pipeline for which there is an index.

Index zone means a field or an area with an active spot market and published indices applicable to that field or area that are acceptable to ONRR under § 1206.172(d)(2).

Indian allottee means any Indian for whom land or an interest in land is held in trust by the United States or who holds title subject to Federal restriction against alienation.

Indian tribe means any Indian tribe, band, nation, pueblo, community, rancheria, colony, or other group of Indians for which any land or interest in land is held in trust by the United States or which is subject to Federal restriction against alienation.

Lease means any contract, profit-share arrangement, joint venture, or other agreement issued or approved by the United States under a mineral leasing law that authorizes exploration for, development or extraction of, or removal of lease products—or the land area covered by that authorization, whichever is required by the context. For purposes of this subpart, this definition excludes Federal leases.

Lease products means any leased minerals attributable to, originating from, or allocated to a lease.

Lessee means any person to whom the United States, a tribe, and/or individual Indian landowner issues a lease, and any person who has been assigned an obligation to make royalty or other payments required by the lease. This

includes any person who has an interest in a lease (including operating rights owners) as well as an operator or payor who has no interest in the lease but who has assumed the royalty payment responsibility.

Like-quality lease products means lease products which have similar chemical, physical, and legal characteristics.

Marketable condition means a condition in which lease products are sufficiently free from impurities and otherwise so conditioned that a purchaser will accept them under a sales contract typical for the field or area.

Minimum royalty means that minimum amount of annual royalty that the lessee must pay as specified in the lease or in applicable leasing regulations.

Natural gas liquids (NGL's) means those gas plant products consisting of ethane, propane, butane, or heavier liquid hydrocarbons.

Net-back method (or work-back method) means a method for calculating market value of gas at the lease under which costs of transportation, processing, and manufacturing are deducted from the proceeds received for, or the value of, the gas, residue gas, or gas plant products, and any extracted, processed, or manufactured products, at the first point at which reasonable values for any such products may be determined by a sale under an arm's-length contract or comparison to other sales of such products.

Net output means the quantity of residue gas and each gas plant product that a processing plant produces.

Net profit share means the specified share of the net profit from production of oil and gas as provided in the agreement.

ONRR means the Office of Natural Resources Revenue, Department of the Interior. ONRR includes, where appropriate, tribal auditors acting under agreements under the Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. 1701 *et seq.* or other applicable agreements.

Operating rights owner (or working interest owner) means any person who owns operating rights in a lease subject to this subpart. A record title owner is the owner of operating rights under a

lease except to the extent that the operating rights or a portion thereof have been transferred from record title (see BLM regulations at 43 CFR 3100.0-5(d)).

Person means any individual, firm, corporation, association, partnership, consortium, or joint venture (when established as a separate entity).

Point of royalty measurement means the same as facility measurement point.

Processing means any process designed to remove elements or compounds (hydrocarbon and nonhydrocarbon) from gas, including absorption, adsorption, or refrigeration. Field processes which normally take place on or near the lease, such as natural pressure reduction, mechanical separation, heating, cooling, dehydration, desulphurization (or "sweetening"), and compression, are not considered processing. The changing of pressures and/or temperatures in a reservoir is not considered processing.

Residue gas means that hydrocarbon gas consisting principally of methane resulting from processing gas.

Sales type code means the contract type or general disposition (e.g., arm's-length or non-arm's-length) of production from the lease. The sales type code applies to the sales contract, or other disposition, and not to the arm's-length or non-arm's-length nature of a transportation or processing allowance.

Spot sales agreement means a contract wherein a seller agrees to sell to a buyer a specified amount of unprocessed gas, residue gas, or gas plant products at a specified price over a fixed period, usually of short duration. It also does not normally require a cancellation notice to terminate, and does not contain an obligation, or imply an intent, to continue in subsequent periods.

Takes means when the operating rights owner sells or removes production from, or allocated to, the lease, or when such sale or removal occurs for the benefit of an operating rights owner.

Work-back method means the same as net-back method.

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§ 1206.172 How do I value gas produced from leases in an index zone?

(a) *What leases this section applies to.* This section explains how lessees must value, for royalty purposes, gas produced from Indian leases located in an index zone. For other leases, value must be determined under § 1206.174.

(1) You must use the valuation provision of this section if your lease is in an index zone and meets one of the following two requirements:

(i) Has a major portion provision;

(ii) Does not have a major portion provision, but provides for the Secretary to determine the value of production.

(2) This section does not apply to carbon dioxide, nitrogen, or other nonhydrocarbon components of the gas stream. However, if they are recovered and sold separately from the gas stream, you must determine the value of these products under § 1206.174.

(b) *Valuing residue gas and gas before processing.* (1) Except as provided in paragraphs (e), (f), and (g) of this section, this paragraph (b) explains how you must value the following four types of gas:

(i) Gas production before processing;

(ii) Gas production that you certify on Form ONRR-4410, Certification for Not Performing Accounting for Comparison (Dual Accounting), is not processed before it flows into a pipeline with an index but which may be processed later;

(iii) Residue gas after processing; and

(iv) Gas that is never processed.

(2) The value of gas production that is not sold under an arm's-length dedicated contract is the index-based value determined under paragraph (d) of this section unless the gas was subject to a previous contract which was part of a gas contract settlement. If the previous contract was subject to a gas contract settlement and if the royalty-bearing contract settlement proceeds per MMBtu added to the 80 percent of the safety net prices calculated at § 1206.172(e)(4)(i) exceeds the index-based value that applies to the gas under this section (including any adjustments required under § 1206.176), then the value of the gas is the higher