

§ 206.100

shall apply to determine transportation costs when establishing value using a netback valuation procedure or any other procedure that requires deduction of transportation costs.

Subpart C—Federal Oil

SOURCE: 65 FR 14088, Mar. 15, 2000, unless otherwise noted.

§ 206.100 What is the purpose of this subpart?

(a) This subpart applies to all oil produced from Federal oil and gas leases onshore and on the Outer Continental Shelf (OCS). It explains how you as a lessee must calculate the value of production for royalty purposes consistent with the mineral leasing laws, other applicable laws, and lease terms.

(b) If you are a designee and if you dispose of production on behalf of a lessee, the terms “you” and “your” in this subpart refer to you and not to the lessee. In this circumstance, you must determine and report royalty value for the lessee’s oil by applying the rules in this subpart to your disposition of the lessee’s oil.

(c) If you are a designee and only report for a lessee, and do not dispose of the lessee’s production, references to “you” and “your” in this subpart refer to the lessee and not the designee. In this circumstance, you as a designee must determine and report royalty value for the lessee’s oil by applying the rules in this subpart to the lessee’s disposition of its oil.

(d) If the regulations in this subpart are inconsistent with:

- (1) A Federal statute;
- (2) A settlement agreement between the United States and a lessee resulting from administrative or judicial litigation;
- (3) A written agreement between the lessee and the MMS Director establishing a method to determine the value of production from any lease that MMS expects at least would approximate the value established under this subpart; or
- (4) An express provision of an oil and gas lease subject to this subpart, then the statute, settlement agreement, written agreement, or lease provision

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will govern to the extent of the inconsistency.

(e) MMS may audit and adjust all royalty payments.

§ 206.101 What definitions apply to this subpart?

The following definitions apply to this subpart:

Affiliate means a person who controls, is controlled by, or is under common control with another person. For purposes of this subpart:

(1) Ownership or common ownership of more than 50 percent of the voting securities, or instruments of ownership, or other forms of ownership, of another person constitutes control. Ownership of less than 10 percent constitutes a presumption of noncontrol that MMS may rebut.

(2) If there is ownership or common ownership of between 10 and 50 percent of the voting securities or instruments of ownership, or other forms of ownership, of another person, MMS will consider the following factors in determining whether there is control under the circumstances of a particular case:

- (i) The extent to which there are common officers or directors;
- (ii) With respect to the voting securities, or instruments of ownership, or other forms of ownership: the percentage of ownership or common ownership, the relative percentage of ownership or common ownership compared to the percentage(s) of ownership by other persons, whether a person is the greatest single owner, or whether there is an opposing voting bloc of greater ownership;
- (iii) Operation of a lease, plant, or other facility;
- (iv) The extent of participation by other owners in operations and day-to-day management of a lease, plant, or other facility; and
- (v) Other evidence of power to exercise control over or common control with another person.

(3) Regardless of any percentage of ownership or common ownership, relatives, either by blood or marriage, are affiliates.

ANS means Alaska North Slope (ANS).

Area means a geographic region at least as large as the limits of an oil

field, in which oil has similar quality, economic, and legal characteristics.

Arm's-length contract means a contract or agreement between independent persons who are not affiliates and who have opposing economic interests regarding that contract. To be considered arm's length for any production month, a contract must satisfy this definition for that 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, designees or other persons who pay royalties, rents, or bonuses on Federal leases.

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

Condensate means liquid hydrocarbons (normally exceeding 40 degrees of API gravity) recovered at the surface without processing. Condensate is the mixture of liquid hydrocarbons resulting 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, between two or more persons, that is enforceable by law and that with due consideration creates an obligation.

Designee means the person the lessee designates to report and pay the lessee's royalties for a lease.

Exchange agreement means an agreement where one person agrees to deliver oil to another person at a specified location in exchange for oil deliveries at another location. Exchange agreements may or may not specify prices for the oil involved. They frequently specify dollar amounts reflecting location, quality, or other differentials. Exchange agreements include buy/sell agreements, which specify prices to be paid at each exchange point and may appear to be two separate sales within the same agreement. Examples of other types of exchange agreements include, but are not limited to, exchanges of produced oil for specific types of crude oil (e.g., West Texas Intermediate); exchanges of produced oil for other crude oil at other

locations (Location Trades); exchanges of produced oil for other grades of oil (Grade Trades); and multi-party exchanges.

Field means a geographic region situated over one or more subsurface oil and gas reservoirs and encompassing at least the outermost boundaries of all oil and gas accumulations known within those reservoirs, vertically projected to the land surface. State oil and gas regulatory agencies usually name onshore fields and designate their official boundaries. MMS names and designates boundaries of OCS fields.

Gathering means the movement of lease production to a central accumulation or treatment point on the lease, unit, or communitized area, or to a central accumulation or treatment point off the lease, unit, or communitized area that BLM or MMS approves for onshore and offshore leases, respectively.

Gross proceeds means the total monies and other consideration accruing for the disposition of oil produced. Gross proceeds also include, but are not limited to, the following examples:

- (1) Payments for services such as dehydration, marketing, measurement, or gathering which the lessee must perform at no cost to the Federal Government;
- (2) The value of services, such as salt water disposal, that the producer normally performs but that the buyer performs on the producer's behalf;
- (3) Reimbursements for harboring or terminaling fees;
- (4) Tax reimbursements, even though the Federal royalty interest may be exempt from taxation;
- (5) Payments made to reduce or buy down the purchase price of oil to be produced in later periods, by allocating such payments over the production whose price the payment reduces and including the allocated amounts as proceeds for the production as it occurs; and
- (6) Monies and all other consideration to which a seller is contractually or legally entitled, but does not seek to collect through reasonable efforts.

Index pricing means using ANS crude oil spot prices, West Texas Intermediate (WTI) crude oil spot prices at

Cushing, Oklahoma, or other appropriate crude oil spot prices for royalty valuation.

Index pricing point means the physical location where an index price is established in an MMS-approved publication.

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 oil or gas—or the land area covered by that authorization, whichever the context requires.

Lessee means any person to whom the United States issues an oil and gas lease, an assignee of all or a part of the record title interest, or any person to whom operating rights in a lease have been assigned.

Location differential means an amount paid or received (whether in money or in barrels of oil) under an exchange agreement that results from differences in location between oil delivered in exchange and oil received in the exchange. A location differential may represent all or part of the difference between the price received for oil delivered and the price paid for oil received under a buy/sell exchange agreement.

Market center means a major point MMS recognizes for oil sales, refining, or transshipment. Market centers generally are locations where MMS-approved publications publish oil spot prices.

Marketable condition means oil sufficiently free from impurities and otherwise in a condition a purchaser will accept under a sales contract typical for the field or area.

MMS-approved publication means a publication MMS approves for determining ANS spot prices, other spot prices, or location differentials.

Netting means reducing the reported sales value to account for transportation instead of reporting a transportation allowance as a separate entry on Form MMS-2014.

Oil means a mixture of hydrocarbons that existed in the liquid phase in natural underground reservoirs, remains liquid at atmospheric pressure after passing through surface separating facilities, and is marketed or used as a

liquid. Condensate recovered in lease separators or field facilities is oil.

Outer Continental Shelf (OCS) means all submerged lands lying seaward and outside of the area of lands beneath navigable waters as defined in Section 2 of the Submerged Lands Act (43 U.S.C. 1301) and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control.

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

Quality differential means an amount paid or received under an exchange agreement (whether in money or in barrels of oil) that results from differences in API gravity, sulfur content, viscosity, metals content, and other quality factors between oil delivered and oil received in the exchange. A quality differential may represent all or part of the difference between the price received for oil delivered and the price paid for oil received under a buy/sell agreement.

Rocky Mountain Region means the States of Colorado, Montana, North Dakota, South Dakota, Utah, and Wyoming, except for those portions of the San Juan Basin and other oil-producing fields in the “Four Corners” area that lie within Colorado and Utah.

Sale means a contract between two persons where:

- (1) The seller unconditionally transfers title to the oil to the buyer and does not retain any related rights such as the right to buy back similar quantities of oil from the buyer elsewhere;
- (2) The buyer pays money or other consideration for the oil; and
- (3) The parties' intent is for a sale of the oil to occur.

Spot price means the price under a spot sales contract where:

- (1) A seller agrees to sell to a buyer a specified amount of oil at a specified price over a specified period of short duration;
- (2) No cancellation notice is required to terminate the sales agreement; and
- (3) There is no obligation or implied intent to continue to sell in subsequent periods.

Tendering program means a producer's offer of a portion of its crude oil produced from a field or area for competitive bidding, regardless of whether the production is offered or sold at or near the lease or unit or away from the lease or unit.

Trading month means the span of time during which crude oil trading occurs and spot prices are determined, generally for deliveries of production in the following calendar month. For example, for ANS spot prices, the trading month includes all business days in the calendar month. For other spot prices, for example, the trading month may include the span of time from the 26th of the previous month through the 25th of the current month.

Transportation allowance means a deduction in determining royalty value for the reasonable, actual costs of moving oil to a point of sale or delivery off the lease, unit area, or communitized area. The transportation allowance does not include gathering costs.

§ 206.102 How do I calculate royalty value for oil that I or my affiliate sell(s) under an arm's-length contract?

(a) The value of oil under this section is the gross proceeds accruing to the seller under the arm's-length contract, less applicable allowances determined under §§ 206.110 or 206.111. This value does not apply if you exercise an option to use a different value provided in paragraph (d)(1) or (d)(2)(i) of this section, or if one of the exceptions in paragraph (c) of this section applies. Use this paragraph (a) to value oil that:

(1) You sell under an arm's-length sales contract; or

(2) You sell or transfer to your affiliate or another person under a non-arm's-length contract and that affiliate or person, or another affiliate of either of them, then sells the oil under an arm's-length contract, unless you exercise the option provided in paragraph (d)(2)(i) of this section.

(b) If you have multiple arm's-length contracts to sell oil produced from a lease that is valued under paragraph (a) of this section, the value of the oil is the volume-weighted average of the values established under this section

for each contract for the sale of oil produced from that lease.

(c) This paragraph contains exceptions to the valuation rule in paragraph (a) of this section. Apply these exceptions on an individual contract basis.

(1) In conducting reviews and audits, if MMS determines that any arm's-length sales contract does not reflect the total consideration actually transferred either directly or indirectly from the buyer to the seller, MMS may require that you value the oil sold under that contract either under § 206.103 or at the total consideration received.

(2) You must value the oil under § 206.103 if MMS determines that the value under paragraph (a) of this section does not reflect the reasonable value of the production due to either:

(i) Misconduct by or between the parties to the arm's-length contract; or

(ii) Breach of your duty to market the oil for the mutual benefit of yourself and the lessor.

(A) MMS will not use this provision to simply substitute its judgment of the market value of the oil for the proceeds received by the seller under an arm's-length sales contract.

(B) The fact that the price received by the seller under an arm's-length contract is less than other measures of market price, such as index prices, is insufficient to establish breach of the duty to market unless MMS finds additional evidence that the seller acted unreasonably or in bad faith in the sale of oil from the lease.

(d)(1) If you enter into an arm's-length exchange agreement, or multiple sequential arm's-length exchange agreements, and following the exchange(s) you or your affiliate sell(s) the oil received in the exchange(s) under an arm's-length contract, then you may use either § 206.102(a) or § 206.103 to value your production for royalty purposes.

(i) If you use § 206.102(a), your gross proceeds are the gross proceeds under your or your affiliate's arm's-length sales contract after the exchange(s) occur(s). You must adjust your gross proceeds for any location or quality differential, or other adjustments, you received or paid under the arm's-length