

§ 206.111 How do I determine a transportation allowance under a non-arm's-length transportation arrangement?

(a) If you or your affiliate have a non-arm's-length transportation contract or no contract, including those situations where you or your affiliate perform your own transportation services, calculate your transportation allowance based on your or your affiliate's reasonable, actual transportation costs using the procedures provided in this section.

(b) Base your transportation allowance for non-arm's-length or no-contract situations on your or your affiliate's actual costs for transportation during the reporting period, including:

(1) Operating and maintenance expenses under paragraphs (d) and (e) of this section;

(2) Overhead under paragraph (f) of this section;

(3) Depreciation under paragraphs (g) and (h) of this section;

(4) A return on undepreciated capital investment under paragraph (i) of this section; and

(5) Once the transportation system has been depreciated below ten percent of total capital investment, a return on ten percent of total capital investment under paragraph (j) of this section.

(c) Allowable capital costs are generally those for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the transportation system.

(d) Allowable operating expenses include:

(i) Operations supervision and engineering;

(ii) Operations labor;

(iii) Fuel;

(iv) Utilities;

(v) Materials;

(vi) Ad valorem property taxes;

(vii) Rent;

(viii) Supplies; and

(ix) Any other directly allocable and attributable operating expense which you can document.

(e) Allowable maintenance expenses include:

(i) Maintenance of the transportation system;

(ii) Maintenance of equipment;

(iii) Maintenance labor; and

(iv) Other directly allocable and attributable maintenance expenses which you can document.

(f) Overhead directly attributable and allocable to the operation and maintenance of the transportation system is an allowable expense. State and Federal income taxes and severance taxes and other fees, including royalties, are not allowable expenses.

(g) To compute depreciation, you may elect to use either a straight-line depreciation method based on the life of equipment or on the life of the reserves which the transportation system services, or a unit-of-production method. After you make an election, you may not change methods without MMS approval. You may not depreciate equipment below a reasonable salvage value.

(h) This paragraph describes the basis for your depreciation schedule.

(1) If you or your affiliate own a transportation system on June 1, 2000, you must base your depreciation schedule used in calculating actual transportation costs for production after June 1, 2000, on your total capital investment in the system (including your original purchase price or construction cost and subsequent reinvestment).

(2) If you or your affiliate purchased the transportation system at arm's length before June 1, 2000, you must incorporate depreciation on the schedule based on your purchase price (and subsequent reinvestment) into your transportation allowance calculations for production after June 1, 2000, beginning at the point on the depreciation schedule corresponding to that date. You must prorate your depreciation for calendar year 2000 by claiming part-year depreciation for the period from June 1, 2000 until December 31, 2000. You may not adjust your transportation costs for production before June 1, 2000, using the depreciation schedule based on your purchase price.

(3) If you are the original owner of the transportation system on June 1, 2000, or if you purchased your transportation system before March 1, 1988, you must continue to use your existing depreciation schedule in calculating actual transportation costs for production in periods after June 1, 2000.

(4) If you or your affiliate purchase a transportation system at arm's length from the original owner after June 1, 2000, you must base your depreciation schedule used in calculating actual transportation costs on your total capital investment in the system (including your original purchase price and subsequent reinvestment). You must prorate your depreciation for the year in which you or your affiliate purchased the system to reflect the portion of that year for which you or your affiliate own the system.

(5) If you or your affiliate purchase a transportation system at arm's length after June 1, 2000, from anyone other than the original owner, you must assume the depreciation schedule of the person who owned the system on June 1, 2000.

(i)(1) To calculate a return on undepreciated capital investment, multiply the remaining undepreciated capital balance as of the beginning of the period for which you are calculating the transportation allowance by the rate of return provided in paragraph (i)(2) of this section.

(2) The rate of return is the industrial bond yield index for Standard and Poor's BBB rating. Use the monthly average rate published in "Standard and Poor's Bond Guide" for the first month of the reporting period for which the allowance applies. Calculate the rate at the beginning of each subsequent transportation allowance reporting period.

(j)(1) After a transportation system has been depreciated at or below a value equal to ten percent of your total capital investment, you may continue to include in the allowance calculation a cost equal to ten percent of your total capital investment in the transportation system multiplied by a rate of return under paragraph (i)(2) of this section.

(2) You may apply this paragraph to a transportation system that before June 1, 2000, was depreciated at or below a value equal to ten percent of your total capital investment.

(k) Calculate the deduction for transportation costs based on your or your affiliate's cost of transporting each product through each individual transportation system. Where more than

one liquid product is transported, allocate costs consistently and equitably to each of the liquid products transported. Your allocation must use the same proportion as the ratio of the volume of each liquid product (excluding waste products with no value) to the volume of all liquid products (excluding waste products with no value).

(1) You may not take an allowance for transporting lease production that is not royalty-bearing.

(2) You may propose to MMS a cost allocation method on the basis of the values of the products transported. MMS will approve the method if it is consistent with the purposes of the regulations in this subpart.

(1)(1) Where you transport both gaseous and liquid products through the same transportation system, you must propose a cost allocation procedure to MMS.

(2) You may use your proposed procedure to calculate a transportation allowance until MMS accepts or rejects your cost allocation. If MMS rejects your cost allocation, you must amend your Form MMS-2014 for the months that you used the rejected method and pay any additional royalty and interest due.

(3) You must submit your initial proposal, including all available data, within 3 months after first claiming the allocated deductions on Form MMS-2014.

§ 206.112 What adjustments and transportation allowances apply when I value oil using index pricing?

When you use index pricing to calculate the value of production under § 206.103, you must adjust the index price for location and quality differentials and you may adjust it for certain transportation costs, as specified in this section.

(a) If you dispose of your production under one or more arm's-length exchange agreements, then each of the conditions in this paragraph applies.

(1) You must adjust the index price for location/quality differentials. You must determine those differentials from each of your arm's-length exchange agreements applicable to the exchanged oil.