Indian Example—Unprocessed Gas Reporting (Arm's-Length Dedicated Contract) in an Index Zone with Alternative Dual Accounting

The following is based on a sample statement. Statements may vary. Be sure to read carefully and contact royaltyvaluation@onrr.gov if you need further assistance!

The lease and contracts for this example meet all the following conditions:

- ✓ The gas produced is from an **Indian** oil and gas lease located **within an index zone**.
- ✓ The lease contains a major portion provision (or provides for the Secretary to determine value) and requires accounting for comparison.
- ✓ Gas value for royalty purposes is based on the higher of the index-based value in 30 CFR §1206.172(d) or gross proceeds under §1206.174(b) for **unprocessed gas** sold under an **arm's-length dedicated contract** (§1206.172(b)(3)).
    - *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* (§1206.171).
- ✓ The lessee elected **alternative dual accounting** to satisfy the "accounting for comparison" lease provision.

If you have any questions regarding whether this example applies to your situation, please contact royaltyvaluation@onrr.gov. You can find a map of Indian index zones on ONRR's website: Indian Gas Index Zone.

NOTE: As this example proceeds, "you" refers to the lessee or their designee as defined in §1206.20: "the person whom the lessee designates to report and pay the lessee's royalties for a lease."

This example addresses reporting and calculations for the following product codes. The **BLUE** letters refer to fields on the sample statement.

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Products/Items:	Location in Statement:
PC 04 Unprocessed Gas	"Gross Wellhead Mcf" **(A)** and "Gross Wellhead MMBtu" **(B)** in the statement's "Wellhead Information" section
Sales Unit Price	"Price Per MMBtu" **(C)** in the statement's "Wellhead Settlement" section

The assumptions below are for purposes of this example only. The assumptions provide the basis to show you how to perform the necessary calculations. Your situation may vary from these assumptions. Please contact royaltyvaluation@onrr.gov with specific questions.

Assumptions for this example:

1. The gas is produced from an Indian lease in the Central Rocky Mountain (CRM) index zone.
2. The gas is valued as unprocessed gas (the contract provides for payment based on the $/MMBtu value of unprocessed gas).
3. The "Compressor Fuel" **(D)** and "System Fuel" **(E)** deductions are 100% disallowed because they are costs to place the product in marketable condition.
4. The price per MMBtu shown on the statement is the actual contract price. The statement price does not include any deductions or netted fees from the purchaser to place gas into marketable condition on the lessee's behalf.
5. The gas is sold under an arm's-length dedicated contract.
6. The gas is eventually processed downstream.
7. The royalty rate is 18%.
8. The production month is January 2019 (as shown on the example statement).
9. The index zone price is the January 2019 price for Central Rocky Mountain found on ONRR.gov.
10. The lessee has NO ownership in the processing plant.
11. The volume-weighted-average Btu content, calculated from the statement, is 1046 Btu/Mcf.

This example walks you through the royalty calculation, accounting for comparison, and reporting for Product Code 04 and completes relevant fields on a sample Form ONRR-2014. This example covers only valuation-related fields in the order they appear on the Form ONRR-2014. You can find more

information about product codes, complete instructions on filing the Form ONRR-2014, and other reporting topics in the ONRR Reporter and Payor Handbooks.

Locating the Indian Index Zone Price

Each month ONRR publishes natural gas prices for six Indian Index Zones as referenced in §1206.172. You can find the prices on the Indian Gas Index Zone Prices web page.

Determining Dual Accounting

Many Indian leases require accounting for comparison, or "dual accounting." The following is one example of dual accounting language:

> *"… and that royalty will be computed on the value of gas or casinghead gas, or on the products thereof (such as residue gas, natural gasoline, propane, butane, etc.),* ***whichever is the greater****."* (Emphasis added)

Dual accounting may not be the only requirement of your lease. Your reporting may also be subject to other requirements. Please read the complete details of your lease to be sure you meet all the provisions in it.

There are two calculation choices for dual accounting – actual and alternative. You make this election using the Form ONRR-4410 Part B. Section 1206.173(a)(2)(ii) states:

> *You may elect to begin using the alternative methodology for dual accounting at the beginning of any month. The first election to use the alternative methodology will be effective from the time of election through the end of the following calendar year. Thereafter, each election to use the alternative methodology must remain in effect for 2 calendar years. You may return to the actual dual accounting method only at the beginning of the next election period or with the written approval of ONRR and the tribal lessor for tribal leases, and ONRR for Indian allottee leases in the designated area.*

Assume, for this example, that the lessee chose **alternative dual accounting**.

If you elect **actual dual accounting** for your unprocessed gas, you must use §1206.181 to establish processing costs when neither you nor someone acting on your behalf processes the gas. Under §1206.181, you must use the first applicable of the four given methods to establish processing costs for dual accounting purposes. Please also be mindful of the additional

regulatory requirements in this sections (§§1206.176, 179, 180). Collectively, all of these obligations must be satisfied in order to use actual dual accounting. For assistance in ensuring you meet all these obligations, please contact royaltyvaluation@onrr.gov.

When calculating royalties due for gas sold under an arm's-length dedicated contract, you should follow this process:

A. Calculate the gross proceeds received for the gas sale under §1206.174.
B. Calculate the alternative dual accounting value under §1206.172 and §1206.173.
C. Compare the values determined in steps 1 and 2 and report and pay on the higher value.

Part A – Calculate the Gross Proceeds

PC 04 – Unprocessed Gas

Under §1206.175(a), "[f]or unprocessed gas, you must pay royalties on the quantity and quality at the facility measurement point that BLM either allowed or approved." Under §1206.171, ONRR defines the point of royalty measurement as the facility measurement point. In this example, we will use "RMP" to represent the approved royalty measurement point.

Step 1:

Determine the gas sales volume and heat content (MMBtu):

- Identify the royalty-bearing gas volume and heat content measured at the royalty measurement point:
  - In this example, the sample statement includes "Gross Wellhead Mcf" (volume) **(A)** and "Gross Wellhead MMBtu" (heat content) **(B)** measured at the RMP
  - Do not use the "Total Settled MMBtu." That is not the full amount measured at the RMP because of the deductions of "Compressor Fuel" **(D)** and "System Fuel" **(E)**. In our assumptions, we noted that these deductions are 100% disallowed because they are costs of placing the product in marketable condition.
- The sales volume is 261.95 Mcf and the Gas MMBtu is 274.08 MMBtu

Step 2:

Calculate the gas sales value:

- Multiply the gas MMBtu determined under Step 1 (274.08 MMBtu) **(B)** by the gas sales unit price ($1.50930/MMBtu) **(C)**

- The gas sales price may not be reduced by any costs of placing the gas into marketable condition under §1206.174(h)
- The total gas sales value is $413.67

PC 04 Gas Sales Value (Step 2):

$$PC\ 04\ sales\ value = gas\ MMBtu\ \times\ gas\ sales\ unit\ price$$
$$PC\ 04\ sales\ value = 274.08\ MMBtu\ \times\ \$1.50930/MMBtu$$
$$PC\ 04\ sales\ value = \$413.67$$

Step 3:

Calculate the Royalty Value Prior to Allowances (RVPA):

- Multiply the gas sales value found under Step 2 ($413.67) by the royalty rate (18%)
- The total RVPA is $74.46

PC 04 Royalty Value Prior to Allowances (RVPA) (Step 3):

$$PC\ 04\ RVPA = sales\ value\ \times\ royalty\ rate$$
$$PC\ 04\ RVPA = \$413.67\ \times\ 0.18$$
$$PC\ 04\ RVPA = \$74.46$$

Step 4:

Calculate the Royalty Value Less Allowances (RVLA):

- In this example, we assume there are no transportation costs so the lessee may not take any allowances
- With no transportation allowances taken, the RVPA and RVLA are the same
- The RVLA is $74.46



You may take a transportation allowance on PC 04 for your reasonable, actual, allowable transportation costs, following applicable transportation allowance regulations at 30 CFR §1206.177-178

PC 04 Royalty Value Less to Allowances (RVLA) (Step 4):

$$PC\ 04\ RVLA = RVPA - transportation\ allowances$$
$$PC\ 04\ RVLA = \$74.46 - \$0.00$$
$$PC\ 04\ RVLA = \$74.46$$

Part B - Alternative Dual Accounting Index Zone Calculations

Having completed part A, you now calculate the alternative dual accounting value in part B:

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A. ~~Calculate the gross proceeds received for the gas sale under §1206.174~~.
B. Calculate the alternative dual accounting value under §1206.172 and §1206.173.
C. Compare the values determined in parts A and B and report and pay on the higher value.

Step 1:

- The regulations at §1206.173 governing alternative dual accounting provide the following equation:

Alternative dual accounting equation (Step 1):

$$V_{alt} = RMP \times IZP \times (1 + I)$$

Where:

$$V_{alt} = Value\ under\ the\ alternative\ dual\ accounting\ method$$
$$RMP = MMBtu\ at\ the\ approved\ royalty\ meter$$
$$IZP = Index\ zone\ price$$
$$I = Increment\ for\ alternative\ dual\ accounting$$

Step 2:

Identify the MMBtu at the approved royalty measurement point (RMP):

- In this example, the "Gross Wellhead MMBtu" **(B)** at the royalty measurement point is 274.08 MMBtu

Royalty Measurement Point MMBtu (Step 2):

$$RMP = 274.08\ MMBtu$$

- NOTE: You will need the "Gross Wellhead Mcf" (volume) **(A)** at the approved royalty measurement point for royalty reporting on the ONRR-2014. This volume is 261.95 Mcf.

Step 3:

Locate the index zone price on the Indian Gas Index Zone Prices web page. In this example, assume the lease is in the Central Rocky Mountain index zone.

- The production month is January 2019
- The index zone price is $3.98/MMBtu

Index Zone Price (Step 3):

$$IZP = \$3.98/MMBtu$$

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Step 4:

Identify the increment (I) you need to use for the calculation (*see* §1206.173(b)(2)(ii) *for the published copy of the sample chart below*). The applicable Btu is the volume-weighted-average Btu for the property computed from measurements at the royalty measurement point(s) for gas production from the lease (§1206.173(b)(3)). The increment also depends on whether or not you have plant ownership interest.

- In this example, the weighted average Btu content calculated from the statement is 1046 Btu/Mcf (at 14.73 psi), based on the regulations at §1206.173(b)(3)
- Assume no plant ownership
- The increment is .0275

Increment (Step 4):

$$I = .0275$$

Btu Range	No Plant Ownership	Yes Plant Ownership
1001 to 1050	.0275	.0375
1051 to 1100	.0400	.0625
1101 to 1150	.0425	.0750
1151 to 1200	.0700	.1225
1201 to 1250	.0975	.1700
1251 to 1300	.1175	.2050
1301 to 1350	.1400	.2400
1351 to 1400	.1450	.2500
1401 to 1450	.1500	.2600
1451 to 1500	.1550	.2700
1501 to 1550	.1600	.2800
1551 to 1600	.1650	.2900
1601 to 1650	.1850	.3225
1651 to 1700	.1950	.3425
1701+	.2000	.3550

Step 5:

Calculate the alternative dual accounting value:

- Multiply the RMP (274.08 MMBtu) **(B)** by the index zone price ($3.98/MMBtu) by 1 plus the increment (.0275)
- The alternative dual accounting value is $1,120.84

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Alternative dual accounting value (Step 5):

$$V_{alt} = RMP \times IZP \times (1 + I)$$
$$V_{alt} = 274.08\ MMBtu \times \$3.98/MMBtu \times (1 + .0275)$$
$$V_{alt} = 274.08\ MMBtu \times \$3.98/MMBtu \times 1.0275$$
$$V_{alt} = \$1{,}120.84$$

Step 6:

Calculate the Royalty Value Prior to Allowances (RVPA) and the Royalty Value Less Allowances (RVLA) of the alternative dual accounting value:

- Multiply the alternative dual accounting value calculated under Step 9 ($1,120.84) by the royalty rate (18%)
- The RVPA is $201.75

Alternative dual accounting Royalty Value Prior to Allowances (RVPA) (Step 6a):

$$Alternative\ dual\ accounting\ RVPA = alternative\ dual\ accounting\ value\ \times\ royalty\ rate$$
$$Alternative\ dual\ accounting\ RVPA = \$1{,}120.84\ \times\ 0.18$$
$$Alternative\ dual\ accounting\ RVPA = \$201.75$$

- When you value a gas product using the index zone price, you may not take a transportation allowance (§1206.172(d)(8))
- With no allowances, the RVLA will equal the RVPA
- The alternative dual accounting RVLA is $201.75

Alternative dual accounting Royalty Value Less Allowances (RVLA) (Step 6b):

$$Alternative\ dual\ accounting\ RVLA = Alternative\ dual\ accounting\ RVPA$$
$$Alternative\ dual\ accounting\ RVLA = \$201.75$$

Part C – Comparing the Values Determined in Parts A and B

Having completed parts A and B, you now compare the values determined in parts A and B and report and pay on the higher value:

A. ~~Calculate the gross proceeds received for the gas sale under §1206.174~~.
B. ~~Calculate the alternative dual accounting value under §1206.172 and §1206.173~~.
C. Compare the values determined in parts A and B and report and pay on the higher value.

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Compare the alternative dual accounting RVLA calculated in Part B, Step 6 to the total RVLA of the gross proceeds under the arm's-length dedicated sales contract from Step 4:

- The alternative dual accounting RVLA from Step 6b is $201.75
- The RVLA for the gross proceeds of the gas sold under the arm's-length dedicated contract from Step 4 is $74.46
- The alternative dual accounting RVLA is higher at $201.75. Therefore, you should report using this value.

Compare values (Step 7):

$$V_{alt}\ RVLA = \$201.75$$
$$Total\ gross\ proceeds\ RVLA = \$74.46$$
$$\$201.75 > \$74.46$$

Here is what the final royalty reporting looks like:

PC	Sales Volume	Gas MMBtu	Sales Value	RVPA	TA	PA	RVLA
04	261.95	274.08	$1,120.84	$201.75			$201.75

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