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Office of Natural Resources Revenue
UNBUNDLING WORKSHOP
Sponsored by the Independent Petroleum Association of New Mexico

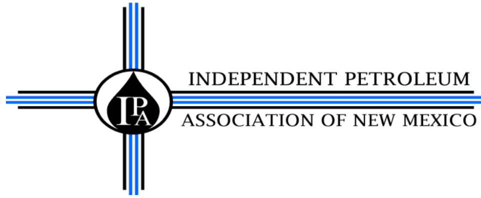
June 24 – 25, 2013
Albuquerque, New Mexico

## June 24 – Industry registrants only

| | | |
|---|---|---|
| 1 pm | Opening remarks and Welcome | Karin Foster |
| 1:05 – 2:05 | An overview and the history of the ONRR unbundling issue | Dennis Cameron |
| 2:05 – 3:35 | Practical aspects for operators to consider when unbundling and reporting to ONRR | Judy Matlock |
| 3:35– 3:45 | Break | |
| 3:45 – 5:30 | The Auditor letter has come, now what? A review of legal arguments and how to respond to ONRR audit findings | Brad Berge<br>Brad Welsh |
| 5:30 – 7:30 | Cocktail reception | |

## June 25 – Government speakers and Congressional delegation invited

| | | |
|---|---|---|
| 9 am – 11 | ONRR presentation of the Marketable condition Rule | Sarah Inderbitzin |
| 11 - 11:10am | Break | |
| 11:10 – 12 | NMTRD presentation | Gilbert Martinez |
| 12 – 1 | Lunch – Ballroom C | |
| 1 – 3:30 | ONRR presentation - Unbundling Cost Allocation – proposed Engineering solutions | Doug Grinley<br>Linda Shishido - Sheahan |
| 3:30 | Concluding remarks | Karin Foster |

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**Industry Speaker Information**

**Dennis Cameron**
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## Dennis C. Cameron

Practice Areas:
Oil and Gas Law
Energy Law
Environmental Law
Products Liability
Class Action Law

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EDUCATION
J.D. with honors, University of Oklahoma, 1987
B.S., Mechanical Engineering with distinction, University of Oklahoma, 1984

EMPLOYMENT
2012 - WPX Energy, Inc., Assistant General Counsel
1987- Of Counsel GableGotwals, Tulsa, Oklahoma

EXPERIENCE
Oil and gas royalty disputes involving government, Indian, and private leases including defense of class actions and qui tam actions.
Representation of oil and gas producers and midstream companies in lawsuits and arbitrations in oil and gas contract disputes.
Negotiating and drafting gas gathering and processing agreements, lease agreements and other related agreements for oil and gas producers and midstream companies.
Products liability cases involving automobiles, mechanical devices, pharmaceuticals, propane odorant, and product liability issues related to owner notifications and product recalls.
Environmental matters involving ground water pollution, surface damages, state and federal permitting issues, superfund sites, private cost recovery actions, toxic torts.

PROFESSIONAL AFFILIATIONS
American Bar Association
- Litigation Section
- Environmental and Natural Resources Law Section
- Tort Trial and Insurance Practice Section
- Chair, Membership Committee 1995-1998
- Member, Membership Committee, 1994-1995
- Chair, ABA-TIPS Automobile Law Committee, 1993-1994
- Chair, National Trial Academy, 2000

Member, Rocky Mountain Mineral Law Foundation
Member, Institute for Energy Law Advisory Board
Oklahoma Bar Association
Texas Bar Association
Tulsa County Bar Association

HONORS
Best Lawyers in America, 2006-2013
Oklahoma Super Lawyer, 2006-2013

ADMITTED TO PRACTICE
United States Circuit Court of Appeals for the Tenth Circuit
Oklahoma Supreme Court and all Oklahoma District Courts
U.S. District Court for the Northern, Eastern, and Western Districts of Oklahoma
State Bar of Texas
Southern Ute Indian Tribal Court

PUBLICATIONS
The Legal Impact of Climate Change: "Preparing Now for Future Regulatory Impact"
Aspatore Publishing 2008

PROFESSIONAL ACTIVITIES
Dennis Cameron has been engaged in the private practice of law with GableGotwals and WPX Energy, Inc. since 1987. He has served as a member of various committees and sections in both the ABA and Tulsa County Bar Associations. Mr. Cameron has served as a lecturer at continuing legal education seminars sponsored by the Oklahoma and Tulsa County Bar Associations, at seminars sponsored by the ABA and at programs sponsored by COPAS and PASO.

WPXENERGY

# DEALING WITH THE “NEW” MARKETABLE CONDITION RULE

# UNBUNDLING AND THE MCR: A MORE PEACEFUL DISCUSSION

# THE ISSUE

WHAT EXPENSES/CHARGES ASSOCIATED WITH THE TRANSPORTATION AND PROCESSING OF **CONVENTIONAL** GAS ARE DEDUCTIBLE FROM FEDERAL/INDIAN ROYALTY

# "WHY SHOULD I CARE?"

- The scope of unbundling is very broad:
  - The impact is not limited to producers who also have midstream assets;
  - If you have Federal Gas that is processed you are potentially subject to its impacts;
  - CBM is impacted but the issues are different factually and legally;
- The Stakes/Dollars at issue are large

# THE STAKES

If what the Agency has done already is upheld- Producers could be facing large underpayment claims for past payments and significant increases in future payments

Example: Ignatio Plant San Juan Basin, NM

Lease to Plant Expense: Cut by 50+%

Plant Processing Charges: Cut by 82%

# HOW DID WE GET HERE?

**HISTORY:**

- The 1988 Federal Regulations
  - Permit the deduction of transportation expenses
  - Permit the deduction of processing expenses
- Arm's Length Contract: Third Party Charges
- Non-Arm's Length Contract: Actual Costs
- **Marketable Condition Rule/Restriction on Third Party Charges**
- Agency Decisions:
  - Once you leave the lease you are transporting/processing

# HOW DID WE GET HERE?

**CBM Cases:**

- ***Devon vs. Kempthorne***: Wyoming CBM
- ***Amoco vs. Watson:*** Colorado CBM

- Legal Concepts;
- CBM is only marketable at the interstate pipeline
- One Time Marketable Condition Rule: Pressure/Gas Quality
- Marketable Condition in Field or Area—Determined by a large % of sales at the well

# HOW DID WE GET HERE?

## What has the Agency Done:

Armed with the one time MCR rule the agency has applied the concept to conventional gas that is processed. As a result:

- Third Party Charges are being “**Unbundled**”
  - Sharp decreases in amount of fees and expenses previously deductible are no longer
- Non-Arm’s Length Allowances are reduced
  - Audit team is reviewing plant equipment and deciding what is in or out

# WHERE DOES THAT LEAVE US?

- ALTERNATIVES/OPTIONS/FUTURE ACTIVITY
  - We must Generate Strong Administrative Records
  - We must be Prepared to Press the Issue
  - We must do a Better Job with Contractual Language
  - If not, we need to unbundle ourselves in a way that is consistent with the regulations and the purpose of the equipment

# WHERE DOES THAT LEAVE US?

- ALTERNATIVES/OPTIONS/FUTURE ACTIVITY
  - We must Generate Strong Administrative Records
    - The *Citation* Case
    - The correct MCR: Compare 1206.152 with 1206.153
    - The *Shashone* Case
    - Detailed Technical Evidence
    - Third Party Unbundling

# WHERE DOES THAT LEAVE US?

- ALTERNATIVES/OPTIONS/FUTURE ACTIVITY
  - We must Generate Strong Administrative Records
  - We must be Prepared to Press the Issue
  - We must do a Better Job with Contractual Language
  - If not, we need to unbundle ourselves in a way that is consistent with the regulations and the purpose of the equipment

# HOW DO WE UNBUNDLE OURSELVES?

- Develop Detailed Schematics of the Gas Process Flow
  - Gas Flow Diagrams from the Lease to the Plant
  - Process Flow Diagrams of the Plant
  - Work with Gas Process Engineers/Plant Operators to Review Equipment for Use/Purpose
- Develop Detailed Accounting Records of Pipe/Plant Costs
  - Capitol Expenses-Initial Build and Subsequent Improvements
  - Monthly Plant Operating & Maintenance Expenses
  - Non-Asset Specific Allocated Costs from other areas e.g. Legal, HR, Accounting, etc.

# HOW DO WE UNBUNDLE OURSELVES?

- If You are Not Pressing the Issue, be Prepared to Consider having to Concede some things
  - Dehydration to Pipeline Specifications-
  - Post NGL Extraction Compression to Pipeline Specifications-
  - Post NGL Extraction Treating of Y-Grade Product Stream to Pipeline Specifications-
  - Keeping in Mind that Arguments Exist that Support Deducting Each of These Items.

JUDITH M. MATLOCK is a partner in the Energy Group of the Denver law firm of Davis, Graham & Stubbs LLP. She has practiced in the area of natural resources law for over thirty years. Her practice includes representing producers in connection with the calculation, payment and reporting of royalties and production taxes. She assists clients with data mining requests and state, federal and Indian audits and appeals. She also conducts in-house training seminars and assists companies with internal royalty compliance self-audits. She also represents producers in connection with private royalty litigation including class action lawsuits. She is a frequent lecturer and writer on energy topics including:

"The 'Duty to Market" Downstream At No Cost To The Lessor (The Alleged Federal 'Duty to Market')", Federal and Indian Oil & Gas Royalty Valuation and Management, Paper 2A (Rocky Mt. Min. Law Fdn. 2000);

"Actions Alleging Underpayment of Royalties," handout for Independent Petroleum Association of Mountain States, Royalty Luncheon, August 16, 2001;

"Post Production Costs," Institute on Natural Gas Transportation & Marketing (Rocky Mt. Min. Law Fdn. 2001);

"The Wyoming Class Action Lawsuits" (an update on post-production cost litigation), handout for Independent Petroleum Association of Mountain States, September 2002;

"Royalty Calculation When the Producer/Lessee is Dealing With An Affiliated Entity," Private Oil & Gas Royalties, Paper No. 9 (Rocky Mt. Min. L. Fdn. 2003);

"What? It's Still Broke? Royalty Valuation and Reporting Issues Arising From Federal Unitization and Communitization Agreements (Takes versus Entitlements)," Federal and Indian Oil and Gas Royalty Valuation & Management IV, Part 15 (Rocky Mt. Min. L. Fdn. 2004) (co-authored with Roman Geissel, MMS);

"Around the Regulations in 50 Minutes – A Practical Application of the Federal and Indian Oil & Gas Valuation Regulations," *Federal and Indian Oil and Gas Royalty management*, Paper No. 2 (Rocky Mtn. Min. Law Fdn. 2007) (with Deborah Gibbs Tschudy);

"Going Forward Methodologies in Class Action Settlements," *Private Oil and Gas Royalties*, Paper No. 9 ((Rocky Mtn. Min. Law Fdn. 2008);

"Federal Natural Gas Valuation," Federal and Indian Oil and Gas Royalty Valuation and Management (Rocky Mt. Min. L. Fdn. 2007) (co-authored with John Price, Chief, Office of Enforcement, MMS, Denver, Colorado).

Workshop on Federal and Indian Oil and Gas Agreement Reporting, co-chair and instructor (Rocky Mtn. Min. Law Fdn. 2013).

# Bradley W. Welsh

Bradley W. Welsh has over ten years of legal experience. His clients consist primarily of ongoing business interests, with an emphasis on assisting the energy industry in both trial and appellate actions. He also frequently represents defendants in cases involving alleged exposure to materials such as silica and asbestos.

Brad was an Articles Editor for Volume 77 (1998-99) of the *Texas Law Review*, and is the author of *Original Jurisdiction Actions as a Remedy for Oklahoma's Decision Deficit*, 57 Okla. L. Rev. 855 (2004). In addition to his state bar admissions, Brad is admitted to practice in the United States District Courts for the Northern, Western and Eastern Districts of Oklahoma, and the United States Courts of Appeals for the Fifth and Tenth Circuits.

**Brad's recent experience includes:**

In energy-related matters, representation in multiple states of both producers and gatherers/processors in disputes concerning contractual and other obligations, and representation of lessees in matters involving the alleged underpayment of oil & gas royalties in litigation and administrative cases. Brad has also assisted an energy client with an extensive investigation of fraud in the delivery of drilling materials.

In general civil litigation, representation of a Southeastern Oklahoma city seeking to sell otherwise unused water to North Texas interests, and representation of a national cell phone carrier asked to relocate from a multi-party network tower as part of a state condemnation proceeding.

In appellate actions, representation of various parties in both extraordinary writ proceedings and appeals from final judgments.

## PRACTICE AREAS

Appellate Law

Energy, Oil & Gas

Litigation (State & Federal)

## EDUCATION

M.A. (Economics), University of Oklahoma, 1996

J.D., University of Texas School of Law, 1999

## HONORS & AWARDS

## PROFESSIONAL AFFILIATIONS

American Bar Association

Oklahoma Bar Association

Texas Bar Association

Tulsa County Bar Association

# INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO

## COMMENTS ON THE FEDERAL MARKETABLE CONDITION RULES

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## "The" Marketable Condition Rule—as ONRR Sees It

At the heart of every marketable condition rule order issued by ONRR is the premise that all "gas" must be placed into marketable condition by producer, at no cost to the lessor. Hence, any effort, to deduct costs associated with, for example, compression will be disallowed—even if the purpose of the compression is to transport the gas—if the gas has not previously reached a pressure acceptable to the applicable "market" for the gas.

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## "The" Marketable Condition Rule—as ONRR Sees It

1. Do the regulations in fact describe more than one marketable condition rule? Are the marketable condition rule obligations impacted by whether the "gas" is processed?

2. What is "marketable condition"? Who is the relevant "purchaser"?

3. Does the purpose served by expenses such as compression and dehydration impact the marketable condition rule analysis?

3

## The Actual Marketable Condition Rules

30 CFR § 1206.152

"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."

This is the rule that ONRR repeatedly references—but it applies only to unprocessed gas. Of course, that makes this rule applicable to coalbed methane and to conventional gas that is not processed for whatever reason. This is the language that informed the decisions in the coalbed methane cases—*Devon* and *Amoco*. It is not, however, the marketable condition rule applicable to a vast quantity of natural gas production.

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## The Actual Marketable Condition Rules

30 CFR § 1206.153

"The lessee must place residue gas and gas plant products in marketable condition and market the residue gas and gas plant products for the mutual benefit of the lessee and the lessor at no cost to the Federal Government."

What is residue gas? Pursuant to § 1206.151, residue gas is "that hydrocarbon gas consisting principally of methane resulting from processing gas." Similarly, gas plant products are "separate marketable elements, compounds, or mixtures, whether in liquid, gaseous, or solid form, resulting from processing gas, excluding residue gas."

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## The Actual Marketable Condition Rules

What, then, is Processing?

By the language of § 1206.151, it is precisely what everyone understands it to be:

"*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, and compression, are not considered processing. The changing of pressures and/or temperatures in a reservoir is not considered processing."

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## The Actual Marketable Condition Rules

30 CFR § 1206.153

"The lessee must place residue gas and gas plant products in marketable condition and market the residue gas and gas plant products for the mutual benefit of the lessee and the lessor at no cost to the Federal Government."

First Conclusion: When gas is processed, the obligation is not to place "gas" in a marketable condition free of cost to the lessor. Rather, it is to place products available after processing, which occurs at plants (and not in gathering systems), in marketable condition.

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## The Actual Marketable Condition Rules

30 CFR § 1206.153

"The lessee must place residue gas and gas plant products in marketable condition and market the residue gas and gas plant products for the mutual benefit of the lessee and the lessor at no cost to the Federal Government."

Second Conclusion: Cases involving coalbed methane production do not control the meaning of the marketable condition rule in cases involving conventional gas that is processed.

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**What is "Marketable Condition"—and Is It a Uniform Standard?**

Irrespective of which of the marketable condition rules is applicable, "marketable condition," pursuant to § 1206.151, refers to "lease products which are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area."

Of this definition, ONRR's predecessor agency has said the following: "The MMS believes that the definition is clear, concise, and equitable. The definition is not subject to manipulation, as one commenter stated. Furthermore, the suggestion that a uniform standard be developed for what is 'marketable' is unrealistic because the gas marketplace is dynamic. The definition, as written, allows MMS the latitude to apply the concept of 'marketable' in a fair and correct manner, now and in future gas markets."

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**Is the Definition of Marketable Condition Subject to "Manipulation"?**

MC: "lease products which are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area."

What is a "sales contract"? Presumably, this language embraces classic "Gas Purchase Agreements" by which producers sell gas at the wellhead to buyers who gather and/or process it. But ONRR regularly disregards that possibility, and instead focuses on deliveries to interstate or intrastate pipelines that expect gas having essentially the attributes of residue gas. The result is to move "the" market for gas downstream, and to impose more costs upon the lessee.

Manipulation?

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**Is the Definition of Marketable Condition Subject to "Manipulation"?**

MC: "lease products which are sufficiently free from impurities and otherwise in a condition that they will be accepted by a purchaser under a sales contract typical for the field or area."

What is the meaning of "typical for the field or area"? Again, in some areas gas is predominantly sold at the wellhead, and is delivered to buyers fully saturated with water vapor, containing elevated levels of $CO_2$ (and sometimes $H_2S$), and with heating values far in excess of residue gas. Those attributes can be entirely acceptable to buyers of conventional gas in some portions of the United States. But ONRR again regularly disregards that possibility, instead presuming that deliveries to interstate pipelines are "the" market that defines what is "typical for the field or area."

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**Is the Definition of Marketable Condition Subject to "Manipulation"?**

The result of ONRR's methodology of defaulting to a downstream market is to impose what amounts to a uniform standard for what counts as "marketable condition," even though the regulations—and MMS—intended precisely the opposite result.

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## Are Certain Types of Expenses Incurred
## Invariably the Responsibility of the Lessee?

ONRR's position is that "treating" or "conditioning" gas to obtain "marketable condition" invariably involves the following expenses, all of which are almost always borne in full by the lessee:

Gathering
Compression
Dehydration
Removal of Acid Gases ("Sweetening")

Available decisions interpreting the regulations, including the transportation and processing allowances, however, do not support that understanding.

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## Are Certain Types of Expenses Incurred
## Invariably the Responsibility of the Lessee?

From a FOIA request we served, we obtained a PowerPoint presentation used during an October 21, 2008 Meeting of MMS's "Unbundling Team":

Treating gas to put it into marketable condition involves:
. . .
Compression—means the process of raising the pressure of the gas . . .

Dehydration—the removal of water vapor

Removal of acid gases—usually called "sweetening" and the removal of hydrogen sulfide or carbon dioxide

Lessees must compress, gather, and dehydrate gas at no cost to the lessor.

Lessees must remove sulphur (sweeten) and carbon dioxide ($CO_2$) at no cost to the lessor.

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## Are Certain Types of Expenses Incurred Invariably <u>the Responsibility of the Lessee?</u>

In *Exxon Corp.*, 118 IBLA 221 (1991), for example, the IBLA made clear that a proper application of the marketable condition rule should not turn upon the mere application of a label (e.g., "compression") or the fact that such charges are incurred at all, but instead must involve a determination of *why* those expenses are incurred. That is why, in *Exxon*, <u>the costs of dehydration were allowed as part of a transportation allowance</u>.

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## Are Certain Types of Expenses Incurred Invariably <u>the Responsibility of the Lessee?</u>

Similarly, in *Xeno, Inc.*, 134 IBLA 172 (1995), the IBLA addressed the deductibility of compression in particular as follows:
The evidence shows that: 'Functionally, the [compressor] serves as part of [transporter's] main delivery system . . . thus, the record before us does not support a finding that the costs of operating the [compressor] are necessary to place the gas in marketable condition, but rather that the compressor is a transportation cost associated with delivery of the gas through the Montana Power Pipeline to the consumer.'

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## Are Certain Types of Expenses Incurred Invariably <u>the Responsibility of the Lessee?</u>

And again, in *Phillips Petroleum Company*, 109 IBLA 4 (1989), the IBLA determined that while compression costs were not deductible as part of a manufacturing or processing allowance, the expenses could be deductible as part of a transportation allowance:
"In this case, to the extent Phillips has incurred costs in moving wet gas from the field to any of its processing plants in order to extract NGLP's and, thereafter, market the production, MMS should determine the amount of those expenses which are deductible as a transportation allowance."

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## Are Certain Types of Expenses Incurred Invariably <u>the Responsibility of the Lessee?</u>

So: ONRR knows that that the allowances for processing and transportation are sufficiently broad to encompass some compression, some dehydration, and perhaps even some treating or sweetening under certain facts. Yet, its instructions to its own auditors are that all such deductions from royalty should invariably be disallowed. Moreover, it now insists that establishing the factual record necessary to move away from its reflexive disallowance of all such costs is the burden of the lessee (via the new *Burlington Resources* decision from the IBLA), even though the very invocation of the marketable condition rule concept requires an initial determination of what sales contracts are typical for a field or area—an anaylsis that ONRR appears routinely to avoid.

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## Can It Really Be This Bad?

Let's Test This Analysis Using ONRR's Own Prior Presentation to the Petroleum Accounting Society of Oklahoma.

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## Treating gas to put it into marketable condition involves:

- Gathering - the movement of lease production to a central accumulation and/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 as approved by BLM or ONRR OCS operations personnel for onshore and OCS leases, respectively." 30 C.F.R. § 1206.151 (federal gas), § 1206.171 (Indian gas)
- Compression – means the process of raising the pressure of the gas. 30 C.F.R. § 1206.151(federal gas), § 1206.171 (Indian gas)
- Dehydration - the removal of water vapor
- Removal of acid gases - usually the removal of hydrogen sulfide ("sweetening") or carbon dioxide. Also referred to as "treatment"

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## Lessees Must Compress, Gather, and Dehydrate Gas at No Cost to the Lessor

- ***The Texas Co.,*** 64 I.D. 76 (1957) - costs of gathering and compression were not deductible in determining the royalty value of the gas because "[t]he lessee has not shown that the gas can be marketed at the pressure with which it comes from the wells"
- ***California Co. v. Udall***, 296 F.2d 384 (D.C. Cir. 1961) - costs of gathering, compression, and dehydration were necessary to put the production into marketable condition because there was "no evidence of a market for the gas in the condition it comes from the wells. The only market, as far as this record shows, was for this gas at certain pressure and certain minimum water and hydrocarbon content"
- ***Devon Energy Corporation v. Kempthorne,*** 551 F.3d 1030 (D.C. Cir. 2008), *cert. denied,*130 S. Ct. 86 (2009) - compression and dehydration are necessary to place gas into marketable condition

ONRR

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## Lessees Must Remove Sulphur (Sweeten) and Carbon Dioxide ($CO_2$) at No Cost to the Lessor

- ***Apache Corp.,***127 IBLA 215 (1993) - ONRR's disallowance of a price reduction for sweetening in determining royalty value was proper
- ***Texaco, Inc. v. Quarterman***, No. 96-CV-008J (D. Wyo. Aug. 20, 1996) - upheld ONRR order requiring Texaco to increase the gross proceeds by the amount the sales price was reduced by a per Mcf fee the purchaser charged to remove hydrogen sulfide
- ***Amoco Prod. Co. v. Watson,*** 410 F.3d 722, 725 (D.C. Cir. 2005), aff'd sub nom., BP Amoco Prod. Co. v. Burton, 549 U.S. 84 (2006) - the Assistant Secretary properly required the lessees to remove $CO_2$ at no cost to the lessor, even though the $CO_2$ removal took place a considerable distance downstream from the leases

ONRR

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**The fact that a purchaser agrees to accept untreated gas does not mean the gas was marketable in its natural state. In other words, the fact that you sell or transfer title at the wellhead does not mean the gas is in marketable condition at the wellhead**

***California Co.*** - "almost anything can be sold, if the price is no consideration. In the record before us there is no evidence of a market for the gas in the condition it comes from the wells. The only market, as far as this record shows, was for this gas at certain pressure and certain minimum water and hydrocarbon content"
***Amoco and Devon*** - the fact that the gas was sold untreated at the well head does not mean it was in marketable condition at the wellhead

**ONRR**

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**The fact that a marketable condition cost also may be part of processing does not make it a deductible processing cost**

- ***Shoshone & Arapaho Tribes v. Hodel***, 903 F.3d 784 (10th Cir. 1990) - upheld ONRR's denial of a deduction for the costs of compressors located at the inlet of a gas processing plant. Even though the compressors increased gas flow pressure within the plant (which was a processing function), they also "increase the gas flow pressure to the level necessary to pass through the pipeline and ultimately to the purchaser of the gas"
- You must allocate the compressor costs between marketable condition and processing
- For example, assume the compressor at the plant inlet boosts pressure to 1500 psi and the pipeline pressure requirement is 1200 psi. How much of that compressor's costs are nondeductible costs to place the gas into marketable condition?

**ONRR**

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**Marketable condition means gas treated so that it is marketable for delivery to the pipeline**

- ***Amoco*** - lessees must treat gas to pipeline $CO_2$ requirements to serve distant markets into which it was sold
- ***Devon*** - gas must be in marketable condition for the market it serves, so must be at pressure needed to enter the pipeline taking it to market
- ***R.E. Yarbrough Co***., 122 IBLA 217, 221 (1993) - compression, dehydration, and gathering costs are necessary to put gas in marketable condition for delivery to pipeline
- ***Shoshone*** - denial of deduction for compression costs because they "increase the gas flow pressure to the level necessary to pass through the pipeline and ultimately to the purchaser of the gas"
- ***The Texas Co***. - denied deduction for cost to compress low pressure gas to the pressure required to enter purchaser's pipeline
- ***J-W Operating Co***.,159 IBLA 1 (2003) - "it has been held repeatedly that the dehydration of gas to meet market specifications for water content and the compression of gas to the pressure required for entry into the buyer's pipeline are not deductible"

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**The marketable condition cases such as *Amoco* and *Devon* apply to conventional gas**

- Neither case distinguished between conventional and coal bed methane gas – both interpret a regulation that applies to all gas
- In *Amoco* some of the gas at issue was conventional gas
- In *Devon*, the District court agreed with DOI that the federal gas rules apply to both CBM and conventional gas
- All of the foundational cases *Amoco* and *Devon* applied dealt with conventional gas. ***The Texas Co.; California Co. v. Udall; Apache Corp.; Texaco, Inc.; Placid Oil Co.; Exxon Co. USA; Mesa; Oryx; Amerada Hess; R.E. Yarbrough Co***.; ***Shoshone; Nexen***; ***Mobil Exploration and Producing; Citation Oil & Gas Corp.***

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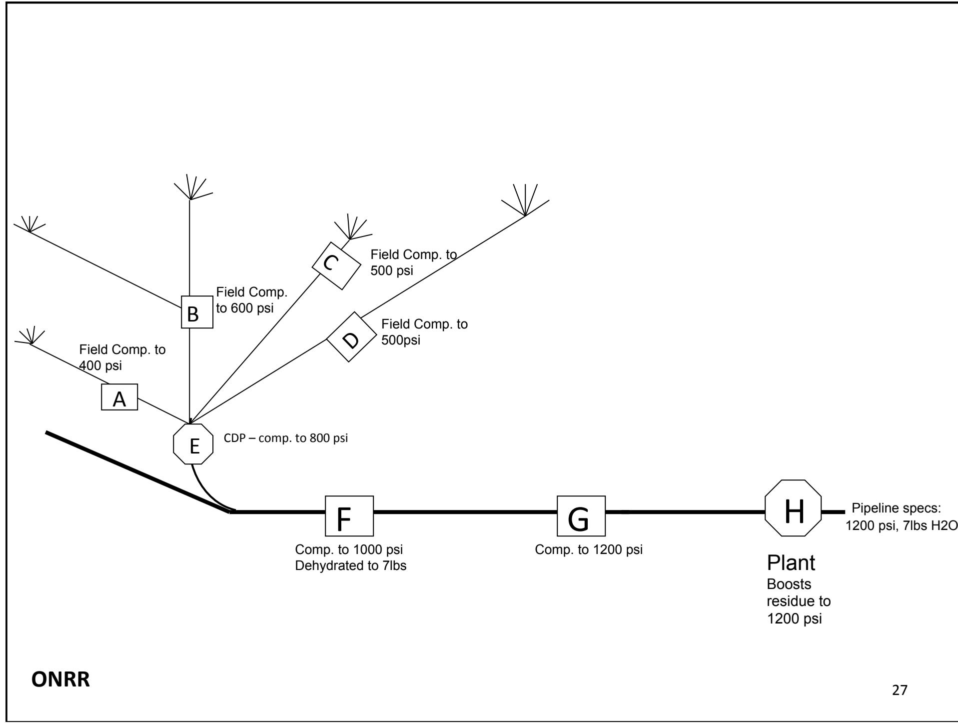

Field Comp. to
500 psi
Field Comp.
to 600 psi
B
C
D
Field Comp. to
500psi
Field Comp. to
400 psi
A
E
CDP – comp. to 800 psi
F
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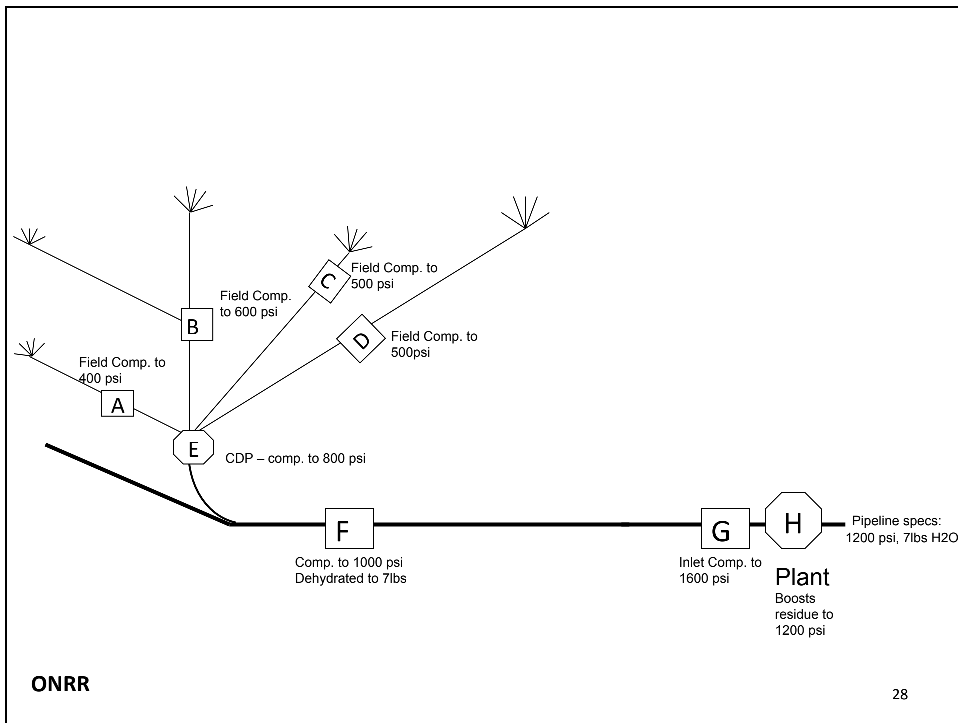
H
Pipeline specs:
1200 psi, 7lbs H2O
Comp. to 1000 psi
Dehydrated to 7lbs
Comp. to 1200 psi
Plant
Boosts
residue to
1200 psi
ONRR
27

Field Comp. to
500 psi
Field Comp.
to 600 psi
B
C
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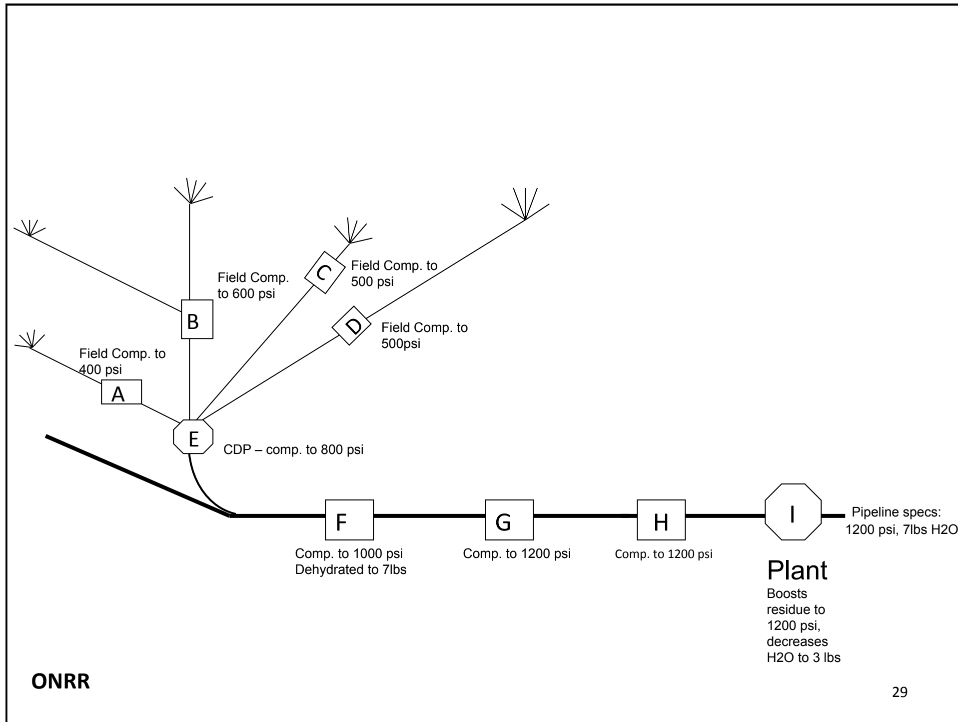
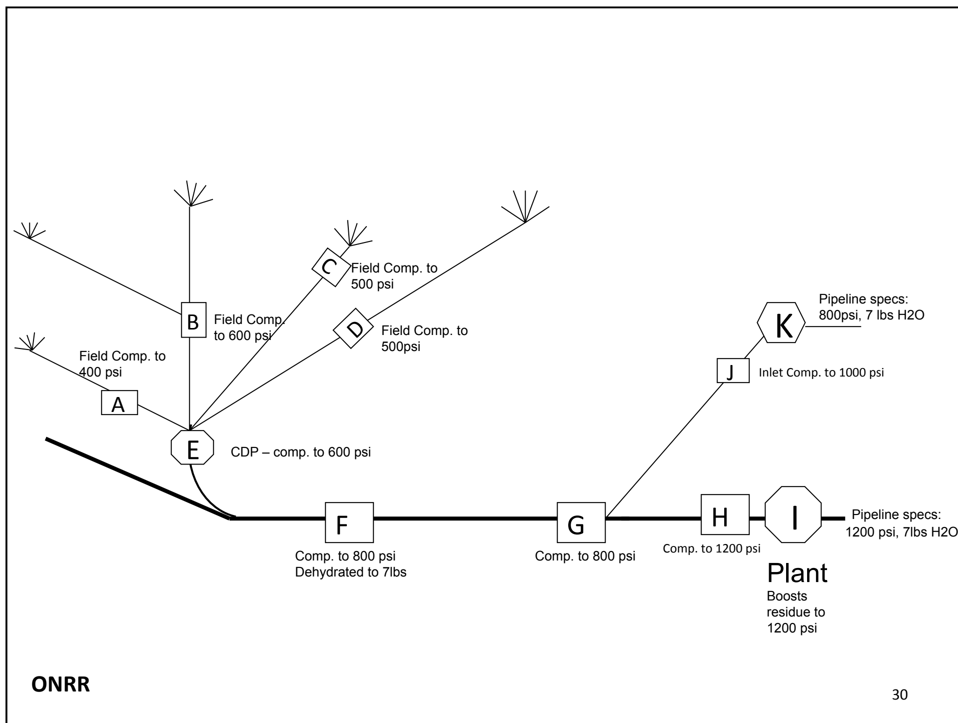
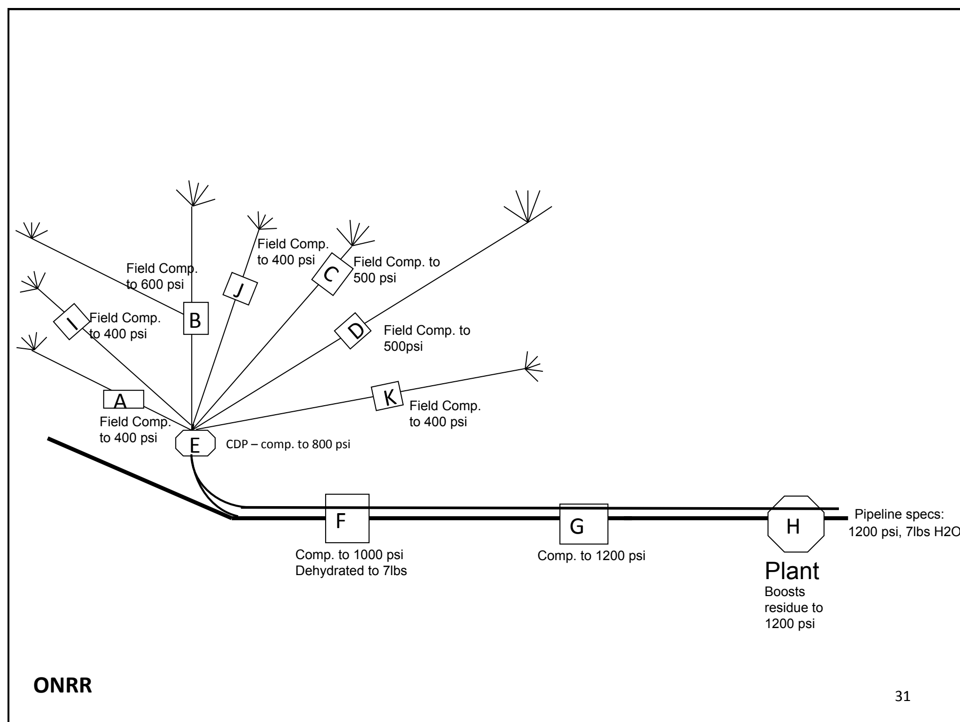
Field Comp. to
500psi
Field Comp. to
400 psi
A
E
CDP – comp. to 800 psi
F
G
H
Pipeline specs:
1200 psi, 7lbs H2O
Comp. to 1000 psi
Dehydrated to 7lbs
Inlet Comp. to
1600 psi
Plant
Boosts
residue to
1200 psi
ONRR
28


Field Comp.
to 600 psi
Field Comp. to
500 psi
Field Comp. to
500psi
Field Comp. to
400 psi
A
B
C
D
E
CDP – comp. to 800 psi
F
G
H
I
Pipeline specs:
1200 psi, 7lbs H2O
Comp. to 1000 psi
Dehydrated to 7lbs
Comp. to 1200 psi
Comp. to 1200 psi
Plant
Boosts
residue to
1200 psi,
decreases
H2O to 3 lbs
ONRR
29


Field Comp. to
500 psi
Field Comp.
to 600 psi
Field Comp. to
500psi
Field Comp. to
400 psi
A
B
C
D
E
CDP – comp. to 600 psi
Pipeline specs:
800psi, 7 lbs H2O
K
J
Inlet Comp. to 1000 psi
F
G
H
I
Pipeline specs:
1200 psi, 7lbs H2O
Comp. to 800 psi
Dehydrated to 7lbs
Comp. to 800 psi
Comp. to 1200 psi
Plant
Boosts
residue to
1200 psi
ONRR
30




## Three Core Concepts:

1. There is no single marketable condition rule, and the concepts associated with unprocessed gas, including those in the *Devon* and *Amoco* decisions, are not applicable to conventional gas that is processed.

2. There should be no uniform application of the marketable condition rule in relation to assumptions about downstream markets defining contracts typical for a field or area.

3. There are no per se rules that make all compression or dehydration part of placing gas in marketable condition. Instead, ONRR must analyze the purpose of those expenses in order to determine if they may be part of a transportation or processing allowance.

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**A Final Word of Caution: Unbundling's Unattractive Stepchild**

Unbundling has resulted in the review of many contracts common to specific plants by ONRR. Hence, ONRR has comparative information concerning the expense of processing, for example, as incurred by various producers at a single plant.

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**A Final Word of Caution: Unbundling's Unattractive Stepchild**

So: Imagine that Producer A enters into a contract in Year X by which it receives, after processing at Plant P, 80% of the value of the resulting NGLs. That contract remains in effect currently.

Also: Producer B enters into a contract in Year Y pursuant to which its pays a fixed fee of 10 cents per Mcf for Plant P to process its gas. That contract also remains in effect currently.

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**A Final Word of Caution: Unbundling's Unattractive Stepchild**

Pursuant to 30 CFR § 1206.158, processing allowances should be premised upon the "reasonable actual costs of processing." Does that language permit ONRR to disallow all processing expenses for all producers in excess of the 10 cent fee?

Section 1206.159(a)(1)(i) tells us that "[f]or processing costs incurred by a lessee under an arm's-length contract, the processing allowance shall be the reasonable actual costs incurred by the lessee for processing the gas under that contract."

In any event, the most favorable processing terms are likely not available to all producers at all times, irrespective of market conditions, volumes delivered, quality of gas production and multiple other factors.

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HOLLAND&HART.

# Bradford C. Berge

## Partner

A trial lawyer since 1980, Mr. Berge helps clients define their problems and implement solutions in the context of commercial and tort litigation. He has successfully represented energy clients and other companies in suits and trials throughout New Mexico. Mr. Berge leverages extensive courtroom experience and brings powerful legal solutions to clients across a range of industries.

Mr. Berge represents a wide range of energy clients in New Mexico's federal and state courts in disputes relating to surface use, subsurface rights, soil and water contamination, royalty issues, carbon dioxide and tertiary recovery, and well site accidents. Recommended by Chambers USA for his perceptiveness and critical judgment, Mr. Berge also has trial experience that covers contracts, personal injury, insurance, mass torts, fiduciary disputes, and class actions. He is admitted to practice before all state and federal courts in New Mexico and Colorado, as well as the Tenth Circuit Court of Appeals.

From 2003-2009, Mr. Berge managed the Environmental and Natural Resources Litigation Practice Group at Holland & Hart.


### Santa Fe

**P** 505-954-7284


### Related Practices

Oil and Gas
Environmental Litigation
Tort Defense
Energy, Environment, and Natural Resources
Litigation
Natural Resources Litigation
Healthcare

### Education

University of Denver College of Law (J.D., 1978)

Pomona College and Colorado College (B.A., 1975)

### Bar Admissions

Colorado

New Mexico

## Experience

### CLASS ACTIONS

Defeated class certification in groundwater contamination case relating to well drilling and completion techniques in the San Juan Basin.

Successfully defended several insurers in putative class actions over modal premium payment policies.

Successfully represented statewide and national classes in suits involving defective radiant heating hose.

### ENERGY AND NATURAL RESOURCES

Representation of national, regional, and local companies before courts and county authorities in matters relating to access, surface use, and drilling restrictions.

Representation of producers of oil, natural gas, and carbon dioxide in individual and class actions relating to royalty obligations.

Successful defense of working interest owners, mineral owners, and lessees in several matters addressing surface and subsurface trespass, nuisance, surface use, and access.

### ENVIRONMENTAL LITIGATION

Defeated class certification in major groundwater contamination case; thereafter obtained defense verdict on all claims asserted by named plaintiffs.

Successful representation of several operators, contractors and pipelines in toxic tort litigation and in arbitration and mediation of disputes related to alleged contamination of water, groundwater, and soil.

**TORT LITIGATION**

Belongs to Holland & Hart's Emergency Response Team, with expertise in the legal implications for companies faced with catastrophic accidents.

Lead defense counsel for several operators and contractors in suits over well site accidents, drilling and completion accidents, and trespasser claims.

Lead defense counsel in multiple cases involving construction accidents, dram shop claims, healthcare, and medical issues.

## Honors & Awards

- Listed as the Santa Fe Natural Resources Law Lawyer of the Year by *The Best Lawyers in America®* 2013
- Martindale Hubbell AV Peer Rated
- Named in Chambers USA as a leading litigator in New Mexico (Litigation)
- Listed in Best Lawyers in America (Environmental, Natural Resources, Personal Injury Litigation) and Southwest Super Lawyers (Personal Injury)
- Member, American Board of Trial Advocates

## Memberships & Affiliations

- Member, New Mexico State Bar
- Member, Colorado Bar Association
- Member, American Bar Association (Litigation Section, Toxic Torts and Environmental Committee)
- New Mexico Supreme Court's Uniform Jury Instructions (Civil) Committee (2001-2006)

## News

**Holland & Hart and its Attorneys Recognized by Chambers USA**

**Holland & Hart Earns National Honors from Chambers USA**

**Brad Berge Named Fellow of Litigation Counsel of America**

**Southwest Super Lawyers Recognizes Holland & Hart Attorneys**

**Southwest Super Lawyers Recognizes Holland & Hart Attorneys**

**Holland & Hart Santa Fe Attorneys Recognized as 'Super Lawyers'**

**97 Holland & Hart Attorneys Named Best Lawyers in America**

**89 Holland & Hart Attorneys Named Leaders by Super Lawyers**