§ 1206.102 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 §1206.110 or §1206.111. 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 ONRR 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, ONRR may require that you value the oil sold under that contract either under §1206.103 or at the total consideration received.

(2) You must value the oil under §1206.103 if ONRR 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) ONRR 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 ONRR 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 §1206.102(a) or §1206.103 to value your production for royalty purposes.
(i) If you use §1206.102(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 exchange agreement(s). If ONRR determines that any arm’s-length exchange agreement does not reflect reasonable location or quality differentials, ONRR may require you to value the oil under §1206.103. You may not otherwise use the price or differential specified in an arm’s-length exchange agreement to value your production.
(ii) When you elect under §1206.102(d)(2)(i) to use §1206.102(a) or §1206.103, you must make the same election for all of your production from the same unit, communitization agreement, or lease (if the lease is not part of a unit or communitization agreement) that your affiliates resell at arm’s length. You may not change your election more often than once every 2 years.
(e) If you value oil under paragraph (a) of this section:
(1) ONRR may require you to certify that your or your affiliate’s arm’s-length contract provisions include all of the consideration the buyer must pay, either directly or indirectly, for the oil.
(2) You must base value on the highest price the seller can receive through legally enforceable claims under the contract.
(i) If the seller fails to take proper or timely action to receive prices or benefits it is entitled to, you must pay royalty at a value based upon that obtainable price or benefit. But you will owe no additional royalties unless or until the seller receives monies or consideration resulting from the price increase or additional benefits, if:
(A) The seller makes timely application for a price increase or benefit allowed under the contract;
(B) The purchaser refuses to comply; and
(C) The seller takes reasonable documented measures to force purchaser compliance.
(ii) Paragraph (e)(2)(i) of this section will not permit you to avoid your royalty payment obligation where a purchaser fails to pay, pays only in part, or pays late. Any contract revisions or amendments that reduce prices or benefits to which the seller is entitled must be in writing and signed by all parties to the arm’s-length contract.