CAMRO
Colorado Alliance of Mineral and Royalty Owners
7675 W. 14th Ave. Suite 106 Lakewood, CO 80214

CAMRO 2017 Conference and Annual Meeting.
June 23-24 2017

Pinehurst Country club
6255 W. Quincy Ave.
Denver CO 80235

Early Registration (ends April 10) 2017

Member	$100.00
Non Member	$200.00

Registration April 11 to May 31 2017

Member	$125.00
Non Member	$225.00

Late Registration ,ends June 19 2017

Member	$150.00
Non Member	$250.00

Non member registration includes 1 year membership to CAMRO

Room Reservations
Courtyard Southwest-Lakewood
7180 West Hampden Avenue Lakewood CO 80227
Rate $144 per night will apply through May 23, 2017
for the nights of June 22-25 2017
Call the hotel directly 303 985 9696 and ask for CAMRO room block, or online at CAMRO.us/events and click on Room Reservations.

Conference Coordinators

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To Register:

Online at CAMRO.us
By telephone call Cristy or Debra
By USPS using this form
Make check payable to CAMRO and mail to:

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April, 2017

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Protecting Our Property Rights - Protecting Our Future

Gas Gathering and Processing Agreements by Don Phend

Last February we discussed the actual physical operations involved in Gas Processing. This month's column will discuss the agreements and contracts involved in these activities. These agreements are a significant part of determining the valuation of natural gas for royalty payments. Although Producers are usually reluctant to show details of these agreements to royalty owners, they are nevertheless there, lurking just below the surface of the numbers on your royalty pay detail statement.

Basic Case – Gathering, Dehydration and Compression only.

In a simple situation, the wellhead gas does not need to be processed in a Gas Plant to separate Natural Gas Liquids, in order to be placed in a marketable condition. However, the gas still needs to be Gathered from the individual well, and moved to a point where it can enter a market pipeline. This "Gathering System" typically consists of small diameter pipes, and operates at a relatively low pressure.

It usually consists of a network of pipes consolidating gas from multiple wells to a "Central Delivery Point", or "CDP", where the gas is compressed to the market pipeline pressure and injected into the market pipeline. The gas may also require that certain Dehydration and Treating processes be performed to remove unacceptable levels of moisture or contaminants, in order to meet Market Pipeline specifications.

This type of arrangement is usually governed by a "Gathering Agreement". The parties to this agreement are termed the "Gatherer" (the part that operates the gathering system network" and the "Shipper" (the party that operates the wells connected to the Gathering System. In many cases the Gatherer and the Shipper are independent third parties. However it is not unusual for the Gatherer and Shipper to be the same entity. In addition, many situations have multiple tiered parties involved in this process. I am aware of some situations in Colorado where the operator of a group of wells constructs its own initial gathering system, which gathers gas to a Central Delivery Point where it is transferred to a second independent Gatherer, which in turn moves the gas to another central delivery point, where it is transferred to yet a third independent Gatherer.

The Gathering Contract specifies what services are to be rendered by the Gatherer, and what compensation is to be provided to the Gatherer for those services. Typically, a fee is charged in cents per MCF or cents per MMBTU shipped. This fee may be fixed, or variable depending on certain conditions. For example, many Gathering Agreements specify a higher fee if the Gathering System is operated at a lower pressure. This lower pressure will allow the Shipper's wells to produce at a higher volume, because they are not "bucking line pressure". In such case, the Shipper is hopefully better off economically, because the higher gathering fee is more than offset by higher production volumes.

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2017 Colorado Legislature

The General Assembly is scheduled to adjourn on May 10. One last minute bill was introduced by its sponsors Representative Dave Young, and Representative Mike Foote.

HB17-1336
Additional Protections Forced Pooling Order

Concerning additional protections for oil and gas interest owners subject to forced pooling of oil and gas resources.

Current law authorizes forced pooling, a process by which any interested person–typically an oil and gas operator–may apply to the Colorado oil and gas conservation commission for an order to pool oil and gas resources located within a particularly identified drilling unit. After giving notice to interested parties and holding a hearing, the commission can adopt an order to force owners of oil and gas resources within the drilling unit who have not consented to the application (nonconsenting owners) to allow an oil and gas operator to produce the oil and gas within the drilling unit notwithstanding the owners' lack of consent.

The bill specifies that:

- At least a majority of the royalty interest owners must join in the application before the commission can enter a forced pooling order;
- The hearing notice must be given at least 90 days before the hearing;

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The Gathering Contract may also provide that a certain amount of fuel may be used by the Gatherer for running compressors or other equipment. This fuel allowance may be a specified percent, or actual fuel used. In addition, many contracts allow the Gatherer to keep any liquids (called "Condensate" or "Drips") that fall out into the gathering line. These Drips are typically heavier hydrocarbons with significant monetary value, and the Gatherer can sell them and keep the proceeds as part of the arrangement. In these cases, the Gatherer is only required to "redeliver" to the Shipper the gas volume net of the fuel use and Drips. The Gatherer also receives a monetary fee.

Complex Case – Gas Requires Processing at a Gas Plant

The above example, where the gas from multiple wells only needs to be gathered to a central point, perhaps dehydrated and treated, and compressed to be injected into a Sales Pipeline, is common in Colorado. However, much of Colorado's gas has a high heat content, is rich in Natural Gas Liquids content, and requires processing in a Gas Plant in order to be placed in a marketable condition. This involves yet another layer of contracts and arrangements in order to provide Gas Plant type services. These are known as Gas Processing Agreements.

First, the gas in this arrangement still needs to be Gathered from multiple wells, and moved to a Central Delivery Point, which in this case happens to be the inlet of a Gas Plant. This Gathering function may be provided by the well's operator, a third party Gatherer, the Gas Plant itself, or some combination of these. In the situation where the Gas Plant is also the Gatherer, a separate fee may be charged for the initial Gathering service, or it may be "bundled" as part of the Gas Processing agreement.

Gas Processing Agreements are usually classified as one of three types:

- Keep-Whole Agreements
- Percentage of Proceeds (POP) Agreements
- Fee Based Agreements.

In addition, contracts may contain elements from some or all of these agreements.

Keep-Whole Agreements

In a basic Keep-Whole Agreement, the Gas Processor agrees to purchase the entire wellhead volume gas from the Producer, for the price of Reside Gas. In such a case, if a given well produced 1,000 MMBTUs of raw gas, the Gas Processor would pay the Producer the price of residue gas for 1,000 MMBTUs. For example, if the price of residue gas was $3.00 per MMBTU, the payment by the Gas Producer would be 1,000 x $3.00, or $3,000.

As discussed in last month's column, residue gas usually has the lowest value per MMBTU of any of the refined products at the tailgate of the plant (Residue Gas, and Natural Gas Liquids such as Ethane, Propane, Iso Butane, Normal Butane and Pentane). The amount of "gaseous" gas is reduced by the removal of the Natural Gas Liquids from the product stream. This reduced volume is often called "Shrink".

The profit mechanism for the Gas Processor is that it gets to sell the valuable Natural Gas Liquids for their own account, and only has to pay the Producer for the shrink volume at the lower Residue Gas price. The Producer does not receive any compensation for the higher value of the Natural Gas Liquids. This enhanced value is sometimes referred to as "Liquids Uplift". I view this difference as a constructive "Processing Fee", which can be readily valued.

To put some numbers to this (sorry, I am an accountant and I can't help it):

Assume, in the above example, with 1,000 MMBTUs of wellhead gas, and a Residue Gas price of $3.00, and that 200 MMBTUs of this wellhead production is converted to Natural Gas Liquids worth $7.00 per MMBTU:

Processor sells actual residue gas	
(800x $3.00)	$2,400
Processor sells liquids	
(200 X $7.00)	1,400
Processor pays Producer for the residue actually sold	
(800 x $3.00)	(2,400)
Processor pays Producer for the value of Shrink	
(200 x $3.00)	600)
Gross Revenue to Processor	
	$800

Keep whole agreements often incorporate other element, such as some allowance for fuel. In such cases, if a 3% fuel allowance was specified, the above calculations would start at 970 MMBTUs instead of 1,000. Additionally, the agreement may specify an artificial price for valuing either the residue gas and/or the Shrink. For example, if the price was specified at a published Index Price less 2 cents, and the Gas Processor was able to sell the actual gas for the Index Price plus 3 cents, the Gas Processor would be able to keep the additional revenue.

Percentage of Proceeds Agreement

A Percentage of Proceeds (POP) agreement is basically a volume sharing arrangement between a Producer and a Gas Processor. For example, such an agreement may specify that the Gas Processor will retain 20% of the MMBTUs of Residue Gas, and 30% of the Natural Gas Liquids, as compensation for the Gas Processor's services. The Gas Processor can sell their percentage of each of the products for their own account, which is their Gross Revenue. I also view this volume that is given up in exchange for processing services as a constructive "Processing Fee", which can be readily valued.

The Gas Processor may return the Producer's volumes of processed products back to them at the plant tailgate, so they can make their own deal on the open market. Or alternatively, many agreements specify that the Gas Processor will purchase the processed products at some agreed-upon amount, usually based on a published Index Price. Many of these arrangements in Colorado are structured where the Producer takes back the Processed Gas at the plant tailgate to sell on the market themselves, but allows the Gas Processor to buy the Natural Gas Liquids at an agreed-upon amount.

Typically the volumes that are credited to the Producer in this type of contract are net volumes at the plant tailgate, which have been reduced for "Fuel, Lost and Unaccounted For" (FLU) volumes. There is no compensation to the Producer for these lost volumes, in contrast to a true Keep-Whole agreement, where the Producer receives the full wellhead volume, albeit at a lower price.

Fee Based Agreements

In a Fee Based processing agreement, the Gas Processor generally charges the Producer a per-unit-of-volume fee, typically per MMBTU or MCF, in exchange for processing services. This fee may be fixed, or subject to variations based on certain conditions. For example, it is not unusual for an additional fee to be charged due to CO2 content being above a specified percentage. Also, many agreements incorporate an annual escalator factor, usually based on the Consumer Price Index, or some other published index.

A Fee Based Agreement may also allow for a specified amount of Fuel, Lost and Unaccounted For volume as an allowance, for which the Gas Processor does not have to reimburse the Producer. The volume used to calculate a fee in this type of contract can vary. I have seen agreements that were based on wellhead volumes, volumes delivered to plants, and other defined volumes as well.

Dedication of Geographic Areas to Gas Gatherer or Gas Processor

It is common for a Gathering / Processing agreement to incorporate terms defining an "Area of Mutual Interest" (AMI) which dedicates all of a Producer's wells, either currently existing, or drilled in the future, to a specific contract. These agreements typically "run with the land" so that any future purchaser of these wells or undeveloped acreage is also bound to these original Gathering / Processing agreements. This basically means that once the agreement is in place, the Producer, or any future Producer, is not able to "shop" for a better deal at a competing Processing company. From the Gas Processor's point of view however, this type of guarantee is necessary to insure future volume throughput, since building a Gas Processing Plant is an expensive and capital intensive project, and this dedicated volume would substantially reduce future risk.

What Does This Mean to a Royalty Owner?

It is important to note that these types of contracts are usually entered into between independent business entities, and each party has the ability to negotiate towards the terms of the contract. (The issue of related party transactions will be discussed in a future column – it should be real fun). It would seem that in most cases, such an arrangement should be mutually beneficial to both the Producer and the Gas Gatherer / Processor.

The Producer has raw gas at the wellhead that it wants to sell, and hopefully make a profit on its drilling investment. The Gas Gatherer / Processor has also made an investment in its facilities that it hopes to utilize to also make a profit. It is a good example of a symbiotic relationship.

However, the royalty owner has no say in determining the terms of these processing agreements. They are merely "along for the ride". The two important question for royalty owners are:

- Are these processing costs being passed on to royalty owners?
- And if so, should they be?

This will be the topic of next month's column.

Continued Legislature From Page 1

• Before entry of a pooling order, the prospective drilling unit operator must give the affected interest owners a clearly stated, concise, neutral explanation of the laws governing forced pooling; and

• The operators of drilling units shall, before commencing drilling operations, file an electronic report with the commission that states the number and location of nonconsenting owners, and the commission shall post the reports in a searchable database on its website.

CAMRO strongly opposed this bill.

The following points were made in testimony submitted to the House Committee on Transportation and energy.

In Oil and Gas development pooling is a necessity to bring small tracts together into a unit where drilling can occur in a way that will minimize the economic waste of excessive drilling, and the depletion of reservoir energy which would lead to physical waste of the hydrocarbons. These scientific decisions to pool willing and non-consenting tract owners are best left to the expertise of the Commission.

Determining the division of ownership interests in a pooled unit requires careful examination of the deeds, assignments, and leaseholds all deriving from the original land patent. It is a rare circumstance that 100 percent of the ownership in a pooled unit is determined. This requires the producer to request a hearing to pool the non-consenting mineral owners. In this case they are non consenting because they cannot be located, or some curative action must take place to perfect title. This bill does not address this.

*This bill confuses us because we cannot determine who or what it is trying to protect. Is it the non operating working interest? The **CAMRO** member who wishes to have minerals developed? Or is it royalty interest owners?*

The part of this bill that would require a majority threshold is confusing how would it be determined? Would it be by net mineral acres owned? Or by individual owning entity. Would all of the shareholders in a corporation be counted?

Lets imagine for simplicity that a neighborhood was subdivided yesterday, and each household was correctly titled to own the minerals under their demised lot. Would the state want to pit a neighbor who wishes to benefit economically from leasing and receiving royalty income against a neighbor who wishes not to lease? Under a scenario like this civility and order are destroyed.

This sets up that classic failure of democracy in which a majority tyrannizes a minority. This is why we set up commissions, and have a representative form of government. To avoid this kind of confrontation the state must reserve its police power of eminent domain to itself not unlawfully delegate it to the citizenry.

Now lets imagine that same neighborhood decades from now what might the chains of title look like? In that light this bill is impractical.

Colorado's pooling law affords the minority mineral interest owner certain protection that if they suspect that their minerals are being drained they can request a hearing before the commission and by proving the fact force their way into the pooled unit. This bill takes that protection away.

The bill was amended to eliminate the majority threshold. However CAMRO will still oppose it when it is introduced for debate in the Senate.