

WYOMING OFFICE OF STATE LANDS AND INVESTMENTS

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POLICY

Effective Date
March 1, 2014

Computation of State of Wyoming Royalties Buy/Sell Agreements

Section 7 (a) of the Wyoming Board of Land Commissioners' Chapter 18 Rules states in part, "Royalties for oil and gas and other kindred hydrocarbons ... shall be based on the total consideration received for state production." This requirement may be potentially overlooked by some royalty payers (operators/lessees/purchasers) in the marketing of the State's interest in crude oil and natural gas. On previous occasions, the State experienced underpayment of royalties from "buy/sell swaps/exchanges" for crude oil. A seller would sell oil to a refinery and a second non-transparent reciprocal agreement was also employed where that seller received gravity adjustment rebates, location differential adjustments and a like volume of West Texas Intermediate Crude in the pipe, which was then sold into multiple purchaser contracts at NYMEX pricing or better. This exchange resulted in Wyoming produced crude replaced with WTI-like volumes that allowed for higher sales values to the seller with no royalties paid on the considerations received. Although not a completed event within Wyoming, the total transaction delivered State crude to a refiner with excess capacity which ultimately demanded and received a higher price. This additional transaction constituted a part of total consideration. Companies involved in these transactions, when audited, were required to pay on the transaction (consideration) difference for the crude. Interest was assessed and paid on the underpayment at 18% per annum.

If a company is involved in any type of reciprocal agreement similar to the example above, the company must notify the Office of State Lands and Investments and be prepared to pay royalties on any valuation increase resulting from such transactions where and when they occurred or show cause as to why no additional royalty is due from such transactions. If this information is discovered during an audit, all applicable interest and penalties will be applied to discovered underpayments of royalty.

To reiterate, transactions to be considered would be any type of buy/sell swap or exchange, any exchange type agreement, any overall balancing agreement, any lease or area balancing agreement, any payment netting agreement, any crude oil or gas exchange balancing agreement or any premium or decrement to price where a component thereof is based on any volumetric exchange.

<u>Effective Date:</u> March 1, 2014	<u>Revision/Review Date:</u> March 1, 2019
<u>Summary of Revision/Review:</u> To be Completed in 2019	<u>Supersedes Existing Policy:</u> Any policy and/or documentation prior to March 1, 2014