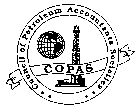


**COPAS 202x Model Form Accounting Procedure Interpretation**

**MODEL FORM INTERPRETATION MFI – 5x**

**Publication/Revision Date –**

**Draft 4 – January 7, 2021**



*Copyright © 202x by the Council of Petroleum Accountants Societies, Inc. (COPAS)*

Table of Contents

[FOREWORD i](#_Toc92392510)

[INSTRUCTIONS FOR COMPLETING ii](#_Toc92392511)

[ACCOUNTING PROCEDURE 1](#_Toc92392512)

[INTEPRETATION 2](#_Toc92392513)

[I. GENERAL PROVISIONS 2](#_Toc92392514)

[1. DEFINITIONS 2](#_Toc92392515)

[2. STATEMENTS AND BILLINGS 9](#_Toc92392516)

[3. ADVANCES AND PAYMENTS 10](#_Toc92392517)

[4. ADJUSTMENTS 12](#_Toc92392518)

[5. EXPENDITURE AUDITS 14](#_Toc92392519)

[6. APPROVAL BY PARTIES 18](#_Toc92392520)

[II. DIRECT CHARGES 19](#_Toc92392521)

[1. RENTALS AND ROYALTIES 19](#_Toc92392522)

[2. LABOR 20](#_Toc92392523)

[3. MATERIAL 27](#_Toc92392524)

[4. TRANSPORTATION 27](#_Toc92392525)

[5. SERVICES 27](#_Toc92392526)

[6. EQUIPMENT AND FACILITIES FURNISHED BY OPERATOR 28](#_Toc92392527)

[7. AFFILIATES 32](#_Toc92392528)

[8. DAMAGES AND LOSSES TO JOINT PROPERTY 35](#_Toc92392529)

[9. LEGAL EXPENSE 35](#_Toc92392530)

[10. TAXES, PERMITS AND STATUTORY FEES 37](#_Toc92392531)

[11. INSURANCE 38](#_Toc92392532)

[12. COMMUNICATIONS 39](#_Toc92392533)

[13. HEALTH, SAFETY AND ENVIRONMENT 40](#_Toc92392534)

[14. OTHER EXPENDITURES 41](#_Toc92392535)

[III. OVERHEAD 41](#_Toc92392536)

[1. OVERHEAD—DRILLING AND PRODUCING OPERATIONS 43](#_Toc92392537)

[2. OVERHEAD—MAJOR CONSTRUCTION AND CATASTROPHE 48](#_Toc92392538)

[3. OVERHEAD – ENVIRONMENTAL PROJECT 50](#_Toc92392539)

[4. AMENDMENT OF OVERHEAD RATES 51](#_Toc92392540)

[IV. MATERIAL PURCHASES, TRANSFERS, AND DISPOSITIONS 51](#_Toc92392541)

[1. DIRECT PURCHASES 52](#_Toc92392542)

[2. TRANSFERS 52](#_Toc92392543)

[3. DISPOSITION OF SURPLUS 58](#_Toc92392544)

[4. SPECIAL PRICING PROVISIONS 60](#_Toc92392545)

[V. INVENTORIES OF CONTROLLABLE MATERIAL 60](#_Toc92392546)

[1. DIRECTED INVENTORIES 61](#_Toc92392547)

[2. NON-DIRECTED INVENTORIES 61](#_Toc92392548)

# FOREWORD

The COPAS 202x Accounting Procedure and this interpretation were developed as a successor to the 2005 model form, to reflect current industry needs and practices. It was developed with the following model form operating agreements in mind: AAPL 610-1989, 1989H, and 2015, AAPL 710-2002 and RMMLF Form 2-1994. The accounting procedure can also be adapted for use in other types of operations such as facility agreements. Regardless of which agreement form governs, and whether this accounting procedure will be used in a new agreement or to amend an existing agreement, users should exercise caution to ensure the agreement fits the operational, commercial and other issues pertaining to the property and situation, and make appropriate modifications.

The purpose of this publication is to explain, interpret, and elaborate on the provisions of the COPAS 202x Accounting Procedure and the intent of the drafters. It does not replace Model Form Interpretations that pertain to other COPAS model form accounting procedures. This publication also does not replace provisions of any accounting procedure that is part of any existing agreement.

The first part of this publication contains the complete model form without any notations. In the second part of this publication, the bold type restates the COPAS 202x Accounting Procedure language; the indented type that follows, not bolded, provides background information, context, and interpretation.

If the parties elect to change the accounting procedure, they should also review the Agreement. The Agreement typically governs if there is a conflict and may contain provisions relevant to the desired changes that also need to be modified to reflect the parties’ intent. Harmonizing the Agreement and the accounting procedure makes the’ intent clear.

Finally, the Accounting Procedure and this interpretation contain lists and examples that are preceded by the words such as “include”, “includes,” or “including.” These mean “include, but not limited to”, “includes, but not limited to”, “including, without limitation”, and similar language which does not limit the reference to the enumerated examples.

**COPAS 202x ACCOUNTING PROCEDURE**

# INSTRUCTIONS FOR COMPLETING

**THis MODEL FORM Might NOT CONTAIN ALL PROVISIONS REQUIRED BY PARTIES ENGAGED IN Joint OPERATIONS. IN ADDITION, THIS MODEL FORM CONTAINS PROVISIONS THAT MUST BE COMPLETED BY INSERTING APPROPRIATE DOLLAR AMOUNTS, percentages, NUMBERS OF PARTIES, AND EACH PARTY MUST DETERMINE APPROPRIATE INSERTS FOR ITS PARTICULAR SITUATION OR APPLICATION. USERS OF THIS MODEL FORM OR PORTIONS OR VARIATIONS THEREOF SHOULD SEEK THE ADVICE OF Legal, Accounting, and other business professionals TO ENSURE THAT THE AGREEMENT accurately REFLECTS THE parties’ INTENT AND IS PROPER UNDER THE APPLICABLE BUSINESS CIRCUMSTANCES. USE OF THE FORM, Council of petroleum accountants socieites, INC. (“COPAS”) interpretations or guidelines, OR A PORTION OR VARIATION of any of them THEREOF is AT THE SOLE DISCRETION, RISK, AND LIABILITY OF THE USER PARTIES. COPAS DISCLAIMS ANY AND ALL INTERESTS OR LIABILITY WHATSOEVER FOR LOSSes OR DAMAGES THAT MAY RESULT FROM USE OF THE model FORM, COPAS interpretations or Guidelines, OR PORTIONS ORVARIATIONS THEREOF.**

General – This Accounting Procedure was developed with the AAPL 610 (1989, 1989-H and 2015), AAPL 710-2002, and Rocky Mountain Mineral Law Foundation Form 2-1994 Model Form Operating Agreements in mind. Given the array of agreements this Accounting Procedure could accompany, and the various types of operations that it might be used for, users should exercise care and due diligence when using this Accounting Procedure to ensure it fits the circumstances and meets the requirements which such person or entity intends to address.

Heading – Fill in the exhibit letter or number, as well as the name and date of the agreement to which the Accounting Procedure is being attached. The date in the heading should be consistent with the date of the agreement to which it is attached. However, if this Accounting Procedure is an amendment to an existing agreement, use the amendment effective date.

Section I.1 – Some terms defined in this Accounting Procedure might also be defined in the operating or other agreement (“Agreement”) to which the Accounting Procedure is attached. Typically, the Agreement will govern if there is a conflict, and the second sentence of this Accounting Procedure form states the Agreement definitions will govern. Review the definitions in the Agreement and this Accounting Procedure, to identify overlap and reconcile any differences.

Section I.3 – The Accounting Procedure does not require anything to be filled in, but it is worth noting that many operating agreements also contain a cash advance provision, so users will want to reconcile the differences between them (or even strike one of them).

Section I.5.E – If the parties intend to include this optional provision, they must initial it to signal their intent. If they do not intend to include it, they may want to strike through it.

Section I.6.B – Fill in the blanks with the number of parties and percentage required to approve amendments to this Accounting Procedure.

Section II.6.A – Insert the interest rate that will apply to the undepreciated balance of the facility investment account.

Section II.7. (iv) – Fill in the dollar threshold to establish when approval is required for charging Affiliate goods and services.

Section II.14 – Fill in the blank to establish when approval is required for costs charged under this provision.

Section III.1 – Select Alternative 1 or 2, at the beginning of this Section, to determine which method of assessing overhead will apply.

Section III.1.A – Fill in the overhead rates in this Section if using the Fixed Rate Basis method of assessing overhead.

Section III.1.B – Fill in the overhead rates in this Section if using the Percentage Basis method of assessing overhead.

Section III.2 – Insert the Major Construction and Catastrophe overhead rates.

Section III.3 – Insert the Environmental Project overhead rates.

# ACCOUNTING PROCEDURE

**EXHIBIT “ ”**

**ACCOUNTING** **PROCEDURE**

**JOINT OPERATIONS**

Attached to and made part of \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**[PLACE HOLDER – AP will go in this section. Omitted for now to reduce file space / paper.]**

# INTEPRETATION

# I. GENERAL PROVISIONS

## 1. DEFINITIONS

**The following capitalized terms have the meaning ascribed to them in this Section I.1. However, if the term is expressly defined in the Agreement, the definition in the Agreement controls.**

The definitions in the Agreement to which this Accounting Procedure is attached as an exhibit (e.g., operating agreement or farmout agreement) will prevail if the Agreement also defines these terms. If the Parties do not intend for the Agreement definition to prevail, they should consult with their legal counsel for guidance on how to modify the Agreement or this Accounting Procedure to give effect to the desired definition.

**“AFE” means an Authority for Expenditure prepared by a party to the Agreement for the purpose of estimating the costs to be incurred in conducting an operation under the Agreement.**

The AFE is a good faith estimate of costs, typically prepared as part of the election process for an operation conducted under the Agreement. Significant variances between actual costs and the AFE may require notice or a vote under the Agreement. If an Operator prepares an AFE for its own use, the Agreement may still require the Operator to furnish an informational copy of the AFE to Non-Operators. The term “AFE” is sometimes defined in the Agreement, so Parties should review the Agreement to ensure the definitions conform.

**“Affiliate” means for a person, another person that controls, is controlled by, or is under common control with that person. For the purposes of this definition, “control” means the ownership by one person, directly or indirectly, of more than 50% of the voting securities of a corporation or, for other persons, the equivalent ownership interest (such as a partnership interest), and “person” means an individual, corporation, partnership, trust, estate, unincorporated organization, association, or other legal entity.**

Frequently, the Agreement contains a definition of Affiliate. Parties should review the Agreement to ensure the definitions conform. An Affiliate is only defined by the Agreement or Accounting Procedure for purposes of administering the Agreement and this accounting procedure, and is not determined by the IRS, GAAP, or any other legal definition of an affiliate.

**“Agreed Interest” means interest, compounded monthly, at the rate per annum equal to the prime rate published by *The Wall Street Journal*, or by the Federal Reserve if *The Wall Street Journal* is not published, on the first business day of the month in which payment is due, and afterwards on the first business day of each succeeding month, plus three percentage points. If the aforesaid rate is contrary to any applicable usury Law, the interest rate will be the maximum rate permitted by Law.**

Agreed Interest reimburses the party holding the debt for their cost of borrowing, and to encourage prompt payment. Agreed Interest starts the day following the payment due date and compounds on the first day of each succeeding month until the delinquent party makes payment, or the delinquency is otherwise resolved. If the bill is due on the 21st of the month, interest starts on the 22nd of the month if the bill is not paid on time, using the Agreed Interest rate in effect on the first day of the month when the bill is due. If the receivable is still outstanding the next month, the Agreed Interest rate on the first of the next month applies during that month. Thus, if the Agreed Interest rate changes over time, multiple rates are used to calculate total interest due.

**“Agreement” means the operating agreement, farmout agreement, or other contract between the Parties to which this Accounting Procedure is attached.**

**“Catastrophe” means a sudden calamitous event bringing damage, loss, or destruction to property or the environment, such as an oil spill, blowout, explosion, fire, storm, hurricane, or other disaster.**

A Catastrophe is often the result of a weather event or other natural disaster, but it could also stem from other causes such as equipment failure or sabotage. Regardless of the cause, a Catastrophe generally requires the direct intervention and supervision of management. Often, the Operator forms a team to deal with the media, general public, regulatory authorities, Non-Operators, and anyone alleging property damage or personal injury, and to formulate courses of action to deal with the emergency.

**“Controllable Material” means Material that, at the time of acquisition or disposition by the Joint Account, as applicable, is so classified by the Council of Petroleum Accountants Societies, Inc. (COPAS).**

COPAS MFI-38, *Materials Manual*, classifies certain Material as Controllable Material. Generally, Material that is not classified as controllable is non-controllable, however the Operator has discretion to classify other Materials as Controllable Material. Classification of Material as Controllable Material is significant from the standpoint of joint interest billing detail and physical inventories.

**“Environmental Project” means a project to investigate and remediate environmental conditions, or to prevent environmental claims, that is necessary and proper for the direct benefit of the Joint Operations. An Environmental Project does not include routine operations, such as exploration, appraisal, development, production, maintenance, repair, Major Construction projects, or Catastrophe projects.**

The following discussion is intended to clarify what constitutes an Environmental Project, and therefore when Environmental Project overhead may be applied. It does not address the chargeability of any particular project.

Environmental remediation deals with the removal of pollution, contaminants, damage, or obstructions from environmental media and structures such as soil, groundwater, sediment, or surface water. Not all environmental remediation projects constitute an Environmental Project for purposes of this accounting procedure. Environmental remediation activities directly related to a catastrophic event would be considered part of the Catastrophe project, rather than an Environmental Project. For example, cleaning up released hydrocarbons after a well control incident or weather event, to restore the property to the condition that existed prior to the Catastrophe, would qualify for Catastrophe overhead rather than Environmental Project overhead. Environmental remediation activities which are part of routine operations, such as cleaning up a well or facility site after commissioning or after abandoning a well are not an Environmental Project for purposes of this accounting procedure.

Environmental remediation not related to a Catastrophe, and which is not part of routine operations, constitutes an Environmental Project. An example of this is a project to remediate soil or groundwater pollution that resulted from long-term seepage. A remediation project can entail taking samples to determine the scope of the problem, lab analysis, feasibility studies, etc.

The Operator may perform other routine environmental activities associated with drilling or other downhole well operations, major construction, producing and abandonment operations would also be considered an integral part of those operations, rather than an Environmental Project. Examples of routine environmental activities include:

* site-specific surveys needed to obtain permits
* well site pollution prevention such as building containment systems
* treatment and disposal of flowback or produced water
* testing and monitoring air emissions
* project to upgrade or replace equipment to comply with new regulations or a settlement.

Additionally, the Operator may perform other environmental work that is not environmental remediation, but which constitutes an Environmental Project for purposes of this accounting procedure. These are activities that prevent or reduce risk, are required to comply with Laws or recommendations by government entities or to avoid penalties or fines, and that are not part of routine operations. Examples include:

* seismicity studies to ensure operations do not cause harm to surrounding structures or water wells
* studying and mitigating harm to other endangered or threatened species, including development plans, habitat preparation, moving wildlife, and handling conservation credits or other regulatory requirements
* hydrology studies to ensure water wells are not contaminated by operations, and to protect from future claims alleging damage.

Environmental work may be performed significantly prior to drilling or producing activity, because of abatement or mitigation of non-routine environmental issues and long-lead times required to get permits, and the activities may cover a broader area than just one well or facility site. As such, there may be no wells identified to charge the work to, and/or no operating agreement or other agreement identifying the Parties’ responsibilities when the work is performed. Environmental costs may be included in the AFE and allocated to wells or facilities when the wells are drilled, or facilities installed. Although the costs may eventually be allocated to the wells/facilities, they are considered to be costs of an Environmental Project.

Research and development projects are carried out to innovate and develop new or improved products or procedures. R&D projects are conducted to provide a competitive advantage, develop new business, or in response to pressure from the board, external stakeholders. They have the potential to benefit future operations, rather than for the direct benefit of specific properties. An example is an R&D project to develop ways to sequester CO2. These types of projects are usually outside the scope of the Agreement (unless the Parties approve it) and would not meet the criteria in the definition to be classified as an Environmental Project.

It is important to note that the accounting procedure only addresses how to account for an Environmental Project. It does not authorize the Operator to conduct the work, any more than the accounting procedure authorized a drilling or recompletion operation. The Operator’s authority to conduct operations, and limits on that authority are established in the Agreement. For example, in the case of remediation projects, the Operator will ballot the Parties, as the cost will most likely exceed the Operator’s single expenditure limit in the operating agreement.

The Operator may be required to conduct long-lead Environmental Projects well in advance of there being an operating agreement or elections to determine who will be participating in a well that benefits from the Environmental Projects. In those cases, the Environmental Project cost is allocated to the well or wells that benefit and included in the AFEs for the well, which the Non-Operators approve or reject.

**“Field Office” means a structure, or portion of a structure, whether a temporary or permanent installation, the primary function of which is to directly serve operation of the Joint Property and which serves as a staging area for** **directly chargeable employees and contractors who operate the Joint Property.**

Function, not location, determines what constitutes a Field Office.

**“First Level Supervision” means those individuals whose primary function in Joint Operations is the direct oversight of directly chargeable employees and contractors who operate the Joint Property. First Level Supervision functions may include:**

* **Responsibility for employees and contractors engaged in field operations activities such as production operations, maintenance, construction, well remedial work, equipment movement and drilling**
* **Responsibility for** **day-to-day direct oversight of rig operations**
* **Responsibility for day-to-day direct oversight of construction operations**
* **Coordination of job priorities and approval of work procedures**
* **Responsibility for optimal resource utilization (equipment, Materials, personnel)**
* **Responsibility for meeting production and operating expense targets**
* **Representation of the Parties in local matters involving community, vendors, regulatory agencies, and landowners, as an incidental part of the supervisor’s operating responsibilities**
* **Responsibility for all emergency responses with employees and contractors who operate the Joint Property**
* **Responsibility for ensuring employees and contractors operate the Joint Property in compliance with company policies and procedures**
* **Responsibility for employment decisions and performance appraisals for employees who operate the Joint Property**
* **Oversight of sub-groups for operations functions such as electrical, HSE, communications, instrumentation, measurement, which may have group or team leaders.**

The first sentence describes the main criterion in determining whether a person’s function qualifies as First Level Supervision. The primary function requirement refers only to the time billed to the Joint Account. For example, if the person supervises 12 people, five whose time is directly chargeable and seven whose time is not billable, that person may be a first level supervisor as to the five people. The portion of the supervisor’s time charged to the Joint Account should be based on a reasonable allocation such as head count.

The above list is intended as examples of First Level Supervision functions and is not all-inclusive. The performance of any one or more of these or similar functions does not indicate an individual is a First Level Supervisor. The conditions under which the First Level Supervision may be charged direct to the Joint Account are addressed in Section II.2 (*Labor*). Refer to COPAS MFI-21, *Overhead Principles,* for more information on first level supervision.

**“HSE” means health, safety, and environment.**

This term is an acronym, used for drafting convenience.

**“Joint Account” means the account showing the charges paid and credits received in the conduct of the Joint Operations that are to be shared by the Parties, but does not include the account pertaining to volumes or proceeds attributable to hydrocarbons and by-products produced under the Agreement.**

The Joint Account does not generally include credits for the sale of hydrocarbons or charges incurred for gathering, processing, marketing, or transportation of hydrocarbons that are considered post-production costs.

**“Joint Operations” means all operations necessary or proper for the exploration, appraisal, development, production, protection, maintenance, repair, abandonment, and restoration of the Joint Property.**

Joint Operations generally do not include activities related to gathering, processing, marketing, or transportation of hydrocarbons after they are transferred to a transporter, purchaser, or marketing agent.

**“Joint Property” means the real and personal property subject to the Agreement, regardless of location.**

Real property is the land, fixtures, and minerals in place. Personal property refers to the movable property, such as severed minerals and Material that is not a permanent fixture on the lands. Joint Property includes equipment that is owned by the Parties pursuant to this agreement. Joint Property does not include equipment and facilities owned entirely by the Operator, by the Operator and third parties, or by the Operator and some of the Parties to this agreement, but which is owned or operated under another agreement.

**“Laws” means any laws, rules, regulations, decrees, and orders of the United States of America or any state thereof and all other governmental bodies, agencies, and other authorities having jurisdiction over or affecting the provisions contained in or the transactions contemplated by the Agreement or the Parties and their activities and operations under the Agreement, whether such laws now exist or are hereafter amended, enacted, promulgated, or issued.**

**“Major Construction” means a project to construct and install, expand, or modify fixed assets beyond the wellhead, that are required for Joint Operations, or the dismantlement, abandonment, removal, and restoration of platforms, production equipment, and other operating facilities.**

The qualification for Major Construction projects depends on the type of activity. Drilling, completing, reworking, or equipping a well through the wellhead is not considered a Major Construction project.

**“Material” means personal property, equipment, supplies, or consumables acquired or held for use in Joint Operations.**

Material includes equipment such as casing, tanks, pumping units, valves, fittings, and supplies but also includes items such as water, diesel, and mud. Material is classified as Controllable or Non-Controllable Material.

Non-Controllable Material is a broad category which includes anything that is not classified as Controllable Material and includes consumables. Consumables are goods which become incorporated into other goods and lose their identity, or cannot be used, returned, or reasonably resold at the end of their use. Consumables are often replaced regularly because they wear out, are used up, or are completely consumed during use. Examples of consumables include rags, welding rods, paint, gloves, blasting sand, batteries, and most other supplies.

The term “acquired or held for use” recognizes that Material, such as common or frequent replacement parts, long-lead items, or critical spares, may be purchased specifically for use in Joint Operations while not being put in service immediately.

See COPAS MFI-38, *Materials Manual*, for more information.

**“Non-Operators” means the Parties to the Agreement other than the Operator.**

**“Offshore Facilities” means platforms, surface and subsea development and production systems, and other support systems such as oil and gas handling facilities, living quarters, offices, shops, cranes, electrical supply equipment and systems, fuel and water storage and piping, heliport, marine docking installations, communication facilities, navigation aids, and other similar facilities necessary in the conduct of offshore operations, all of which are located offshore.**

Offshore Facilities are required to handle hydrocarbon or water production, water disposal, water source, and injection operations, or they may provide accommodations for living quarters, offices, communications, Material handling, and other facilities required in offshore operations. Offshore Facilities may be located on or off the contract or unit area. Consider whether the Agreement defines “facilities” to determine if there is any conflict or overlap. Additionally, the provisions dealing with facility or project approval, take-in-kind provisions, and other provisions in the Agreement, or separate facility use agreements, may limit, or otherwise affect the chargeability of certain facilities.

**“Operator” means the Party designated pursuant to the Agreement to conduct the Joint Operations.**

**“Parties” means legal entities signatory to the Agreement or their successors and assigns. Parties are referred to individually as “Party.”**

**“Participating Interest” means the percentage of the costs and risks of conducting an operation under the Agreement that a Party agrees, or is otherwise obligated, to pay and bear.**

Participating Interest is sometimes referred to as a consenting party’s interest. It refers to the cost-bearing interest of a Party. Refer to the Agreement to see if it contains a definition and ensure the definitions are consistent.

**“Payroll Burden and Benefits” means payroll-related costs other than salary and wages, such as payroll taxes, employee benefits, workers’ compensation insurance, unemployment taxes, and time-off pay.**

This term does not include Personal Expenses or the administrative cost for handling payroll and benefits.

**“Personal Expenses” means costs for transportation, meals, lodging, temporary living accommodations, relocation, and other expenses reimbursed under the usual practice of the Operator or its Affiliate, as applicable.**

**“Remote Technology Center” means a facility, regardless of location, having dedicated technical and/or operations staffing, that directly monitors and/or controls Joint Operations on a real-time basis.**

Remote Technology Centers may be owned by the Operator, a third party, an Affiliate, or the Joint Account. The Remote Technology Centers may serve drilling, completion, and/or production operations, and those operations may be onshore or offshore. Refer to MFI-57, *Remote Technology Centers*, for more information.

**“Shore Base Facilities” means onshore support facilities that provide such services to the Joint Property as a receiving and transshipment point for Material; debarkation point for operations personnel and services; communication, scheduling, and dispatching center; and other associated functions serving Joint Operations.**

Refer to COPAS MFI-46, *Shorebase Facilities and Offshore Staging Areas,* for more information.

**“Technical Services” means engineering, geosciences, or other professional services (such as those performed by engineers, geologists, geophysicists, HSE specialists, technicians) who address, mitigate, or prevent specific operating conditions or problems for the benefit of Joint Operations. Technical Services also includes design and drafting. Technical Services does not include those functions specifically identified as overhead under the second paragraph of Section III (*Overhead*).**

Technical Services does not include functions such as financial services, oil or gas marketing, procurement, tax, regulatory, nor does it include legal or land services, which are covered under other provisions.

Expanded regulatory requirements, changing technologies, and expanded job functions may change the scope and role of technical labor. It is not necessary for a technical person to have attained the specialization at an accredited college or university, but rather, these skills may be acquired through a combination of life experiences and continuing education. The function should require skills, knowledge, and abilities that benefit the Joint Operation and are required to address a specific operational issue.

Refer to Section II.2.A for more information on how this term applies to chargeable functions.

## 2. STATEMENTS AND BILLINGS

**The Operator shall bill each Non-Operator on or before the last day of the month for its proportionate share of the Joint Account for the preceding month. Bills and statements must identify the AFE, lease or facility, and all charges and credits summarized by appropriate categories of investment and expense, and a summary, by major Material classifications, of all Controllable Material. Intangible drilling costs, audit adjustments, and unusual charges and credits shall be separately and clearly identified.**

**The Operator will make available to Non-Operators any statements and bills required under Section I.2 or Section I.3.A (*Advances and Payments*) by electronic means or by paper copy. The Operator shall provide the Non-Operators instructions and any necessary information to access and receive the statements and bills within the timeframes specified herein. An electronic statement or bill will be deemed as delivered 24 hours (exclusive of weekends and federal holidays) after the Operator notifies the Non-Operator that the statement or bill is available. Upon request from a Non-Operator, Operator shall provide the bills and statements to such Non-Operator in another media, if reasonably available to Operator.**

The primary purpose of the billing is to provide the Non-Operators with a summary of the previous month’s transactions reflecting the amount due to (or from) the Operator and to enable the Non-Operators to properly account for Joint Account transactions. The billing is not intended to provide detail necessary for audit purposes as contemplated by Section I.5.A (*Expenditure Audits*) of this Accounting Procedure. Refer to COPAS MFI-26, *Joint Interest Billing Summary Classifications* for more information. The following is an explanation of the detail that is required:

* Charges and credits should be classified in a manner that allows the Non-Operators to make proper distribution between capital expenditures (segregated by tangibles and intangibles) and operating expenses and to facilitate compliance with governmental requirements.
* Controllable Material may be detailed or summarized to reflect total charges and credits during the month. Major Material classifications are found in COPAS MFI-38, *Materials Manual*.
* Intangible drilling costs may be detailed or summarized by account totals, allowing Non-Operators to properly account for such costs.
* The bill should identify audit adjustments by individual audit number, exception number, and amount, or supplemental information should be provided to the Non-Operators, allowing Non-Operators to verify that exceptions granted were recorded to the Joint Account.
* Unusual charges and credits should be separately identified, or supplemental information should be provided to the Non-Operators allowing identification of unusual charges. Examples include items such as lease rentals, damages, well contributions, fines, and penalties.

The Parties may elect to exchange joint interest billings via electronic means, in which case the users’ manual or agreement should be used as a guide.

The Operator might use the joint interest billing system as a way to account for charges and credits that are not Joint Account charges and credits in context of this accounting procedure. Examples include:

* credits for the value of skim oil netted from a saltwater disposal charge
* charges from a transporter or purchaser to filter and dispose of frac sand downstream of the custody transfer point (for 100% of the wellhead volumes)
* charges to dispose of gas (negative gas prices)
* marketing fees.

Charges and credits not governed by this accounting procedure may be subject to other agreements and should be handled in accordance with the governing agreement.

## 3. ADVANCES AND PAYMENTS

1. **Except as otherwise provided for in the Agreement, the Operator may require one or more of the Non-Operators to advance their share of the estimated cash outlay for the succeeding month’s operations. Each such statement and invoice for the payment in advance of estimated expense will be submitted on or before the 20th day of the preceding month. Each Non-Operator shall pay to Operator its proportionate share of such estimate within 30 days after receipt of the advance request. The Operator shall adjust each monthly billing to reflect advances received from the Non-Operators for such month. If a refund is due, the Operator shall apply the refund to the subsequent month’s billing or advance, unless the Non-Operator sends the Operator a written request for a cash refund. The Operator shall remit the refund to the Non-Operator within 30 days of receipt of such written request.**

Cash advances are intended to keep the Operator from having to finance the Non-Operators’ share of costs of conducting Joint Operations. Consequently, the cash advance applies to all cash outlays – both capital costs and operating expenses.

Many of the model form operating agreements also contain a cash advance provision. The due date in the operating agreement might differ from the due date in the accounting procedure. Other terms may vary as well. Occasionally the Operator may modify the operating agreement to request a cash advance for the entire amount of a project prior to commencement, for administrative reasons or to reduce financial risk. Check the operating agreement and accounting procedure cash call provisions for consistency.

If the amount of the advance exceeds the actual cash outlay for the month, the Operator may apply the excess to the subsequent month’s costs or cash advance requirement. It may also apply the advance to any amounts on the current or subsequent month’s billing for capital costs or operating expenditures that were not advanced, if any. If any remaining advance exceeds the actual costs of the subsequent month’s billing (or for the project if the advance was for the full project cost) the Non-Operator may request a refund. The refund protects the Non-Operator’s cash flow if the advance paid is significantly higher than the actual costs for the month (or project) or where there are no ongoing expenditures against which to apply the overpayment, as might happen with an exploratory well.

1. **Except as provided below, each Non-Operator shall pay its proportionate share of each bill in full within 30 days of receipt. If the due date is on a weekend or on a federal holiday, the payment will be due the following business day.** **If payment is not made within such time, the Non-Operator shall pay interest at the Agreed Interest rate on the unpaid balance, if requested by Operator. Agreed Interest on late payments accrues the day after the due date until the date the Operator receives payment. In addition, the delinquent Party shall reimburse Operator for attorney’s fees, court costs, and other costs incurred by Operator in connection with the collection of unpaid amounts. Non-Operator may not reduce or delay payment as a result of inquiries or anticipated credits unless the Operator has agreed. Notwithstanding the foregoing, the Non-Operator may reduce payment to the extent such reduction is caused by being billed for:**

**(1) an incorrect working interest or Participating Interest that is higher than such Non-Operator’s actual working interest or Participating Interest, as applicable; or**

**(2) a project or AFE requiring approval of the Parties under the Agreement, that the Non-Operator has not approved or is not otherwise obligated to pay under the Agreement; or**

**(3) a property in which the Non-Operator no longer owns a working interest, except for costs which remain the responsibility of the Non-Operator according to the transfer of interest requirements in the Agreement; or**

**(4) charges outside the adjustment period, as provided in Section I.4 (*Adjustments*).**

**If the Non-Operator reduces payment pursuant to items (1) through (4), it must furnish Operator documentation or explanation prior to the payment due date. If any amount withheld pursuant to this provision is determined to be due and payable, and is paid after the due date, such delinquent amount is subject to the Agreed Interest, at the discretion of the Operator.**

Refer to the definition of Agreed Interest for information on applying interest.

Non-Operator may short pay the billing only if it is clearly in error as a result of one of the four causes listed, and the reduction is limited to the amounts that fall within those four categories. If any item on the billing is questionable, but does not meet any of these criteria, the Non-Operator should pay the bill as rendered and submit a written request for an adjustment or explanation of the item in question. Non-Operator may not reduce or delay payment because of inquiries or anticipated credits unless the Operator agrees in advance. The Operator should answer inquiries promptly, and if an adjustment is in order, issue a credit (or debit) to the Joint Account. Non-Operator may not short pay the invoice due to lack of profitability or failure to achieve financial, operational, or other objectives.

If a Party reduces an amount billed for one of the reasons listed, it should furnish explanation or documentation for the short pay, such as:

* prior audit responses
* correspondence with the Operator
* citing relevant Agreement language
* request for an AFE
* title opinions.

Regarding item (3), model form operating agreements contain notice requirements that must be met before the Operator is required to recognize a transfer of interest. Even after the required notice period has lapsed, the transferring party may still be liable for costs incurred after the effective date but attributable to operations it approved prior to making the assignment. Refer to Article VIII.D of an AAPL 610 Model Form Operating Agreement, Article 26.3 of the RMMLF Form 2-1994, and Article 26.1.2 of the AAPL 710-2002 Model Form Offshore Operating Agreement.

The lien and security interest provision or default provision of the Agreement may also allow the Operator (and other Parties who are carrying the delinquent costs) to recover attorney’s fees, court costs, and other costs incurred to collect unpaid amounts. The Agreement may allow the Operator to request other non-defaulting Parties help bear a portion of the defaulting Party’s cost while waiting to collect from the defaulting Party. In that case, the Operator will need to reimburse the other Parties who help bear the delinquent costs, if any funds are received from the defaulting Party.

## 4. ADJUSTMENTS

1. **Payment of a bill shall not prejudice the right of any Party to protest or question the correctness thereof; however, all bills and statements, including payout statements, rendered during any calendar year shall conclusively be presumed to be true and correct, with respect only to expenditures, after 24 months following the end of any such calendar year, unless within said period a Party takes specific detailed written exception thereto making a claim for adjustment. The Operator shall provide a written response to all written exceptions, whether or not contained in an audit report, within the time periods prescribed in Section I.5 (*Expenditure Audits*).**

The 24-month limit applies to expenditures subject to this accounting procedure; it does not apply to revenue or other costs included in the bill or statement.

A Party may question or challenge a bill by giving the Operator written notice. The written exception may be the result of a desk review of the bill, previous discussions with Operator, previous audits, unusual entries, etc. or it may be the result of the Non-Operator exercising its audit rights under Section I.5 (*Expenditure Audits*).

Written exceptions should provide an explanation of why the Non-Operator believes the charge is incorrect and include documentation to support the claim. It is critical that the Operator be able to understand how the Non-Operator determined the dollar amount of the exception. A vague exception that merely asks the Operator to prove the charges in an account are correct essentially asks the Operator to perform a self-audit and is not a proper exception. Likewise, Operators might reject exceptions based on sampling because that amounts to the Non-Operator asking the Operator to perform a self-audit. An improperly documented written exception might result in the Operator denying the claim, so the Non-Operator should be aware of and follow the Operator’s documentation requirements.

Refer to COPAS MFI-40, *24-Month Accounting Adjustment Period for Joint Account Adjustments*, for more information. Refer to the Agreement for provisions relating to sending notices.

1. **All adjustments initiated by the Operator, except those described in items (1) through (4) of this Section I.4.B, must be made no later than** **the 24-month period following the end of the calendar year in which the original charge appeared or should have appeared on the Joint Account statement or payout statement. Adjustments that may be made after such 24-month period are limited to those resulting from any of the following:**

**(1) a physical inventory of Controllable Material as provided for in Section V (*Inventories of Controllable Material*);**

**(2) an offsetting entry (whether in whole or in part) that is the direct result of a specific written exception or inquiry relating to another property or agreement;**

**(3) a retro-active adjustment resulting from an audit or assessment by a government entity; or**

**(4) a working interest ownership or Participating Interest adjustment.**

The phrase “initiated by the Operator” includes a review of accounts or records that is not the result of a detailed written exception as described in Paragraph A above or a government audit. An adjustment to a specific cost that is allowed outside the 24-month adjustment period does not allow either Party to review and adjust similar charges. Refer to COPAS MFI-40, *24-Month Accounting Adjustment Period for Joint Account Adjustments*, for more information and examples.

Adjustments resulting from physical inventories are allowed after the 24-month period because Operators historically have conducted inventories on a longer cycle – e.g., every five years.

An offsetting entry to the Joint Account that is a direct result of a specific written exception relating to another property or agreement is allowed after the 24-month adjustment period because the adjustment is not initiated by the Operator and the timing is generally beyond the Operator’s control. The written exception does not necessarily have to be in a formal audit report. The exception can also be the result of a desk audit, an inquiry, or an information request, so long as it is in writing and submitted timely. For example, an information request submitted during a joint interest audit of another property causes the Operator to make an adjustment to the Joint Account. The offsetting entry is allowed after the 24-month limit because the information request that generated the adjustment was in writing and timely submitted.

Usually, the offsetting entry is the result of an exception pertaining to another property – e.g., a miscoding to property A results in credit to property A and charge to a property B. The exception that triggers the adjustment is submitted by a party to the agreement governing property A (who could also be a party to the agreement covering property B or a third party). The offsetting entry adjustment could also happen when working interest owners in given property are subject to different agreements or terms and conduct separate audits. Even though there is one property, there could be multiple Joint Accounts, with offsetting entries, due to non-consent or carried interest arrangements (e.g., force pooling order, joint development agreement, or participation agreement).

Exceptions for changes or corrections in working interest or Participating Interest do not allow changes to what is billed, but rather changes to the proportion each Party must bear.

1. **Any allocation or reallocation of preliminary project costs or costs for shared equipment, facilities or services among wells or projects receiving benefit should appear on the Joint Account statement or payout statement when the well or project receives benefit. Examples include:**

* **Location staking**
* **Permitting fees**
* **Rights of way and easement payment**
* **Environmental assessments**
* **Shared pads**
* **Production facilities**
* **Drilling support facilities.**

Costs may be incurred prior to establishing the Joint Account. In these cases, service dates do not determine the 24-month adjustment period. The adjustment period cannot begin until the well or project is approved, and the participants determined – i.e., the Joint Account is established. The Non-Operator may need to look at other documentation to determine the date benefit is received.

Spud date is commonly used to determine the 24-month period to allocate pre-drill costs. That does not mean the Operator cannot charge costs sooner, once the AFE is approved. In the case of a well pad, a new well receives benefit when it begins to use the well pad. If the well is going to tie into an existing facility, it receives benefit when it ties into the facility.

Refer to AG-29, *Shared Well Pad Cost Allocations*, for more information.

## 5. EXPENDITURE AUDITS

**A. A Non-Operator, upon written notice to the Operator and all other Non-Operators, has the right to audit the Operator’s accounts and records relating to any bills rendered, unless otherwise provided in the Agreement. The audit must be conducted no later than 24-months following the end of such calendar year in which such bill was rendered. Conducting an audit will not extend the time for the taking of written exception to and the adjustment of accounts as provided for in Section I.4 (*Adjustments*).**

Unless otherwise provided for in the Agreement, the right of a Non-Operator to conduct an expenditure audit is not dependent on compliance with other provisions of the Agreement, such as the status of that Non-Operator’s accounts payable balance with the Operator. However, some Agreements allow the Operator to suspend the rights of a defaulting party, which could include audit rights. Refer to Article VII.D of the AAPL 610-1989 and later model forms JOAs for a sample of such a provision.

Refer to the Agreement for proper methods of providing notices. Refer to COPAS AG-19, *Expenditure Audit Protocols,* for more information on the expenditure audit process.

**Any Party that is subject to payout accounting under the Agreement has the right to audit the accounts and records of the Party responsible for preparing the payout statements, or of the Party furnishing information to the Party responsible for preparing payout statements. Audits of payout accounts may include the volumes of hydrocarbons produced and saved and proceeds received for such hydrocarbons insofar as they pertain to payout accounting required under the Agreement. Unless otherwise provided in the Agreement, audits of a payout account statement must be conducted no later than the 24-month period following the end of the calendar year in which the payout statement was rendered.**

This provision allows audits of proceeds that pertain to a payout account because a payout account records both costs and proceeds pertaining to a non-consent or other carried operation (e.g., farmout). Auditing both components is necessary to confirm the payout balance. This provision does not address audit rights for volumes or proceeds that are not subject to payout accounting. The Agreement may allow the Parties access to records pertaining to volumes and measurements.

The Operator usually prepares payout statements, but that is not always the case. Another Party may be responsible for issuing the payout statement if the Operator is a non-consenting Party and another Party carries out the operation. Additionally, if the Operator prepares the payout statements, other carrying Parties may need to supply the Operator with information on proceeds they receive from the non-consenting Party’s share of production. Consequently, a non-consenting Party might want to audit the records of all carrying Parties, not just the Operator.

It is the responsibility of the Operator, or Party preparing the payout statements, to send payout statements timely and regularly to non-consent Parties. The 24-month audit period for payout statements runs from the end of the calendar year in which the payout statement was rendered. If the Operator, or Party preparing the payout statements, fails to render payout statements timely and regularly, the audit scope will include all first-time costs included on the rendered statement, extending the audit period beyond 24 months. However, the fact that the rendered payout statements contain cumulative balances does not make the entire payout period subject to audit.

**The Non-Operators shall make every reasonable effort to conduct a joint audit in a manner that will result in a minimum of inconvenience to the Operator. The Operator will bear no portion of the Non-Operator’s audit cost. The audits may not be conducted more than once each year without prior approval of the Operator, except upon the resignation or removal of the Operator.**

Non-Operators who participate in the audit bear the cost of the audit personnel and their expenses. Costs incurred by the Operator to provide appropriate support staff and equipment are not chargeable to the Non-Operators participating in the audit. Such costs are reimbursed to the Operator through the provisions of Section III (Overhead).

**The Non-Operator leading the audit (“lead audit company”) shall make good faith efforts to issue the audit report within 90 days after completion of the audit testing and analysis; however, the 90-day period will not extend or shorten the 24-month requirement for taking specific detailed written exception as required in Section I.4.A (*Adjustments*) above. All claims shall be supported with sufficient documentation.**

If a Non-Operator submits a written exception after the 24-month period expires, the Operator may deny the exception. Claims submitted more than 90 days after completion of testing and analysis are still valid if there is still time remaining under the 24-month period.

**A timely filed written exception will, with respect to the claims made therein, preclude the Operator from asserting a statute of limitations defense against such claims, and the Operator waives its right to assert any statute of limitations defense against such claims for so long as any Non-Operator continues to comply with the deadlines for resolving exceptions provided in this Accounting Procedure. If the Non-Operators fail to comply with the deadline in Section I.5.C, the Operator's waiver of its rights to assert a statute of limitations defense against the claims brought by the Non-Operators will lapse, and such claims will then be subject to the applicable statute of limitations.**

The tolling of the statute of limitations pertains to the period during which a Party may file a claim against another Party for breach of contract. The period varies from one state to another, and users of the accounting procedure should refer to the contract in question and consult their legal counsel to determine the period for a specific property and questions regarding an alleged breach. If the statute of limitation is four years, and a Party files suit in year six, the defendant may raise the statute of limitations as a defense, unless the statute is tolled.

1. **The Operator shall provide a written response to all exceptions in an audit report within 180** **days after Operator receives such report. Denied exceptions should be accompanied by a substantive written response. If the Operator fails to provide a substantive written response to an exception within this 180-day period, upon request by Non-Operator the Operator will owe Agreed Interest on that exception or portion thereof, if ultimately granted, from the date Operator received the audit report until the date the Non-Operator receives payment.**

The deadline for the Operator to respond and the payment of interest is a mechanism to encourage timely responses and handling of audit claims. A substantive response consists of factual support and/or contract references which address the Non-Operators’ exception. A statement such as “The Operator is researching this exception and will reply at a later date,” or a denial without any explanation, does not constitute a substantive response.

Operator does not owe interest on granted exceptions unless requested by the Non-Operator under this provision.

1. **The lead audit company shall reply in writing to the Operator’s response to an audit report within 90 days of receipt, and the Operator shall respond in writing to the lead audit company’s follow-up reply within 90 days of receipt; provided, however, each Non-Operator has the right to represent itself if it disagrees with the lead audit company’s position or believes the lead audit company is not adequately fulfilling its duties. If the Operator fails to provide a substantive written response to an exception within this 90-day period, upon request by Non-Operator the Operator will owe Agreed Interest on that exception or portion thereof, if ultimately granted, from the date it received the audit report until the date the Non-Operator receives payment.**

The 90-day response time for the lead audit company’s rebuttal to the Operator’s response and the Operator’s response to this rebuttal, as well as the payment of interest, are means to ensure prompt resolution of audit exceptions. The responses and rebuttals should be of substantive content, furnishing additional support for the applicable Party’s position, clarification of prior positions that appear to have been misunderstood, or a request for a resolution conference to resolve the issues pursuant to Section I.5.D.

Operator does not owe interest on granted exceptions unless requested by the Non-Operator under this provision.

1. **If any Party fails to meet the deadlines in Sections I.5.B or I.5.C or if any audit issues are outstanding 15 months after Operator received the audit report, the Operator or any Non-Operator participating in the audit has the right to call a resolution meeting, as set forth in this Section I.5.D or it may invoke the dispute resolution procedures included in the Agreement, if applicable. The meeting will require one month’s written notice to the Operator and all Non-Operators participating in the audit. The meeting will be held at the Operator’s office or mutually agreed location, and shall be attended by representatives of the Parties with authority to resolve such outstanding issues. Any Party who fails to attend the resolution meeting shall be bound by any resolution reached at the meeting. The lead audit company shall make good faith efforts to coordinate the response and positions of the Non-Operator participants throughout the resolution process; however, each Non-Operator has the right to represent itself. Attendees shall make good faith efforts to resolve outstanding issues, and the Parties must present substantive information supporting their position. A resolution meeting may be held as often as agreed to by the Parties. Issues unresolved at one meeting may be discussed at subsequent meetings until each such issue is resolved.**

**If the Agreement contains no dispute resolution procedures and the audit issues cannot be resolved by negotiation, any Party to the dispute may request the matter be submitted to mediation. In such event, promptly following one Party's written request for mediation, the Parties to the dispute shall choose a mutually acceptable mediator and share the costs of mediation services equally. The Parties shall each have present at the mediation at least one individual who has the authority to settle the dispute. The Parties shall make reasonable efforts to ensure that the mediation commences within 60 days after receipt of the mediation request. Notwithstanding the above, any Party may file a lawsuit or complaint (1) if the Parties are unable, after reasonable efforts, to commence mediation within 60 days after receipt of the mediation request, (2) for statute of limitations reasons, or (3) to seek a preliminary injunction or other provisional judicial relief, if in its sole judgment an injunction or other provisional relief is necessary to avoid irreparable damage or to preserve the status quo.**

The 15-month period corresponds with the deadlines in Sections I.5.B and I.5.C, for the Operator’s initial reply, one follow-up response by both the lead audit company and the Operator, and an additional three-month period for the Parties to determine how to proceed. However, the Operator, or any Non-Operator that participated in the audit by providing audit staff and/or monetary assistance, may call a resolution meeting as soon as it becomes apparent the Parties have reached an impasse.

As an alternative to audit resolution meetings, or once audit resolution meetings have reached an impasse, the Parties may invoke the dispute resolution provisions of the Agreement, if applicable. The dispute resolution provisions in the Agreement often set out procedures for conducting and sharing the costs of mediation and/or arbitration.

1. **[*OPTIONAL PROVISION – FORFEITURE PENALTIES*]**

**THIS PROVISION APPLIES ONLY TO PARTIES HAVE EXPRESSLY INDICATED THEIR INTENT TO INCLUDE IT BY INITIALING HERE OR IN THE MARGIN: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

***If the Non-Operators fail to meet the deadline in Section I.5.C, any unresolved exceptions that were not addressed by the Non-Operators within one year following receipt of the last substantive response of the Operator are deemed to have been withdrawn by the Non-Operators. If the Operator fails to meet the deadlines in Section I.5.B or I.5.C, any unresolved exceptions that were not addressed by the Operator within one year following receipt of the audit report or receipt of the last substantive response of the Non-Operators, whichever is later, are deemed to have been granted by the Operator and adjustments shall be made, without interest, to the Joint Account.***

If the Operator fails to submit a timely response under this provision, it will be required to pay claims, regardless of their validity. Similarly, if the Non-Operators fail to timely respond, they may be deemed to withdraw valid claims, even if the statute of limitations on those claims has not expired. The Operator does not owe interest on claims granted under this provision because they are not necessarily valid exceptions.

## 6. APPROVAL BY PARTIES

1. **General Matters**

**When an approval or other agreement of the Parties or Non-Operators is expressly required under other Sections of this Accounting Procedure, the Operator shall notify all Non-Operators who are eligible to vote of the Operator’s proposal. Except** **for approvals required under Sections** **IV.2.A.(5) (*Transfers*) and IV.3 (*Disposition of Surplus*) or as provided in the Agreement, the agreement or approval of a majority in interest of the Non-Operators who are eligible to vote and not an Affiliate of the Operator shall be controlling on all Non-Operators.**

**If Material being transferred to the Joint Property is priced under Section IV.2.A(5) ­– agreed to pricing – approval of a majority in interest of the Parties who will be charged for such Material is required; provided, however, if Operator and its Affiliates own a majority in interest, approval requires vote of one other Party. If Material being transferred from the Joint Property is priced under Section IV.2.A(5) – agreed to pricing – or being disposed of under Section IV.3, approval of a majority in interest of Parties owning the material is required, provided, however, if Operator and its Affiliates own a majority in interest, but less than 90%, approval requires the vote of one other Party owning an interest in the Materials.**

**This Section I.6.A applies to specific situations of limited duration where a Party proposes to deviate from this Accounting Procedure. Approval of a deviation under this provision does not constitute an amendment.**

Votes under this provision are for limited exceptions in accounting for specific projects or activities, not for permanent changes or amendments to the Accounting Procedure. Examples include approval to charge extraordinary relocation costs, foreign national premiums, legal fees not allowed as a direct charge, and Material pricing exceptions.

The accounting procedure excludes the Operator’s and its Affiliates’ vote because this provision is typically used when the Operator wants to charge the Joint Account for a cost that is not normally chargeable. Thus, the Operator and its Affiliates have a conflict of interest, relative to the Non-Operators. Requiring a simple majority of unaffiliated Non-Operators helps to manage that conflict, without making the pass mark too high.

Approval requires an affirmative vote and there is no deadline to reply (except for Material dispositions). Failure to reply amounts to a “no” vote. Setting a deadline to reply and stipulating that failure to timely reply is deemed approval would undermine efforts to manage the conflict of interest. Also, setting a deadline to reply and stipulating that failure to timely reply is deemed a “no” vote, might require the Operator to re-ballot everyone if it received the requisite approval after the deadline.

The different voting requirements for Material pricing reflect operational realities. The Operator’s interest is more closely aligned with Non-Operators – to secure or dispose of Materials to meet operational needs. In the case of Material transfers under IV.2.A(5), if the Non-Operators fail to reply, the Operator can still price the Materials using one of the other pricing methods. In the case of Material dispositions under IV.3, all Parties who own the Material have a vested interest in timely disposal, and the Operator must often act quickly when a buyer is identified. Refer to Section IV.3 for additional provisions on the voting process to dispose of Material.

The Agreement may also contain voting provisions and it typically takes precedence if there is a conflict between it and any of its exhibits. Consult with legal counsel to determine if there is a conflict between any voting provision in the Agreement and this voting provision, and any modifications needed to give effect to the desired voting procedure. Also, be aware that some operating agreements provide that a Party declared to be in default is not entitled to vote.

Refer to COPAS AG-24, *Notifying Non-Operators of Accounting Procedure Deviations*.

1. **Amendments**

**If the Agreement contains no contrary provisions in regard thereto, this Accounting Procedure can be amended by an affirmative vote of Operator and \_\_\_\_\_\_\_\_\_\_ or more Non-Operators who are not an Affiliate of the Operator, having a combined working interest of at least \_\_\_\_\_\_\_\_\_%, which approval shall be binding on all Parties. If the Parties fail to specify the percentage vote required, an amendment will require unanimous approval.**

This provision specifies the voting threshold for approving any proposed amendment to this Accounting Procedure, such as overhead rate amendments pursuant to Section III.4 (*Overhead*) or permanent changes to other terms, such as dollar thresholds.

# II. DIRECT CHARGES

**The following costs are directly chargeable to the Joint Account:**

## 1. RENTALS AND ROYALTIES

**Rentals, royalties, rights of way, and easements** **paid by Operator on behalf of the Parties, for Joint Operations.**

Various types of lease rentals, royalties, rights of way, and easements (surface and subsurface) may be required to conduct Joint Operations, for well pads, production facilities, pipelines, horizontal wellbores, or other installations or activities. When these costs are incurred on behalf of the Parties – all co-owners or all consenting parties – they are a proper charge to the Joint Account. Royalties paid to use patented technology may be charged to the Joint Account.

Many Joint Operations involve divided interests, where Parties contribute separate leases, which have different terms. For example, one lease might require compensatory royalty payments, and another does not, or the leases might have different shut-in royalty terms. Another Party might contribute a mineral interest, which is royalty-free. Obligations that burden leasehold interests are the responsibility of the Party or Parties that contributed the interest and are not part of the Joint Account. Examples are lessor royalties, overriding royalties, production payments, shut-in royalties, compensatory royalties, and minimum royalties. Typically, each Party is responsible for paying or causing to be paid its own royalties. Even if the Operator agrees to pay burdens on behalf of Non-Operators, they are deducted from that owner’s revenue disbursements. Booking these payments to the Joint Account would result in the Parties sharing the cost proportionately, when they should be borne by the Party that contributed the lease. If all the Parties own an undivided interest throughout the contract or unit area, then they would have the same leasehold obligations, and the Operator might pay on everyone’s behalf. Even so, these payments are usually a deduction from proceeds disbursed, except delay rentals might be billed through the land system, rather than joint interest billing system.

The Agreement may contain provisions that address how rentals or royalties should be paid. Laws may also affect responsibility for these payments.

## 2. LABOR

1. **Salaries and wages, including Operator’s established incentive compensation programs that are based on pre-determined metrics and are an integral part of salary programs, other than burdens on production, for Operator’s employees:**

This Section addresses labor provided by Operator’s employees. When these same functions are provided by unaffiliated third parties or Operator’s Affiliates, they are charged under Sections II.5 and II.7, respectively. Chargeability is based on function, not location.

An example of burdens on production, which are excluded, is an overriding royalty granted to an employee or group of employees. These might be considered a subsequently created interest under the Agreement and borne by the Party whose lease or interest is burdened. Refer to MFI-37, *Incentive Compensation Costs*, for more information on incentive compensation programs.

**(1) directly engaged in operating the Joint Property;**

This refers to Operator’s employees directly responsible for the day-to-day operations, drilling or other downhole operations, Major Construction, Catastrophe projects, or Environmental Projects, who are not performing overhead functions. The employees do not necessarily have to be on the contract or unit area. Some operations may be conducted in other locations such as a well pad or facility located off the contract area, a facility that remotely controls operations, or a construction yard where equipment used for Joint Operations is being assembled or fabricated. Chargeable functions include monitoring or inspecting the well site, preventive maintenance, corrective maintenance and may be done remotely. Conversely, someone located on the contract or unit area is not necessarily chargeable, if performing overhead functions.

If chargeable employees serve multiple properties, the cost of their salaries and wages may be charged based on time worked or the Operator may use another equitable and consistent allocation method (such as well count in cases where each well served generally receives the same benefit). If the charges are based on time worked, they should be supported by time sheets, time studies or other documentation.

**(2) directly engaged in operating Shore Base Facilities, Offshore Facilities, or other facilities serving the Joint Property if such costs are not included in the rates charged under Section II.6** **(*Equipment and Facilities Furnished by Operator*) and are not a function covered under Section III (*Overhead*);**

Facilities furnished by the Operator may serve one property or multiple properties. If the facility serves multiple properties, an allocation of costs may be needed. However, chargeable labor costs which are incurred for a particular property may be charged directly to that property rather than including those costs in an allocation pool. An example would be an employee working in a Shore Base Facility loading casing for a specific drill well. This labor would be chargeable under this provision only if the labor costs are not included in the rate charged for the shore base or facility.

For more information on allocating costs for shore bases serving more than one property, refer to COPAS MFI-46, *Shorebase Facilities and Offshore Staging Areas*. For more information on charges for remote technology facilities, see COPAS MFI-57, *Remote Technology Centers*.

**(3) directly engaged in First Level Supervision of operations employees chargeable under II.2.A.(1) and (2);**

First Level Supervision is defined in Section I.1.

The charge for First Level Supervision can be based on time worked as supported by the Operator’s timesheets, time studies, or other documentation. To ease the administrative burden of maintaining detailed timesheets, an allocation may be used when the supervisor oversees numerous properties. When allocations are used, the method must be equitable and consistently applied. One of the more common allocation methods is well count. It may be necessary to keep detailed timesheets when the supervisor oversees a specific project so that this cost can be charged directly to the project and not be allocated to all properties in the First Level Supervisor’s allocation pool.

Refer to MFI-21, *Overhead Principles*.

**(4)** **directly engaged in providing Technical Services** **for:**

**(i) design and drafting for a Major Construction or Catastrophe project, or Environmental Project, or technical design for the drilling and completion of a new well; or**

**(ii)** **handling or addressing specific operating conditions or problems for:**

* **drilling, redrilling, deepening, plugging back, recompleting, or sidetracking operations, through the latter of completion, or through plugging and abandonment if the well is a dry hole**
* **workovers, remediation, repairs, or reworks**
* **isolating, decompleting, or securing a well to protect it from operations conducted on an offset well**
* **Major Construction projects**
* **Catastrophe projects**
* **Environmental Projects**
* **implementing new, or non-routine updates to, HSE Laws or standards required or recommended by governmental authorities having jurisdiction; or**
* **plugging and abandonment operations.**

Chargeability of Technical Services depends on function performed, rather than location because technology has rendered a location-based distinction largely irrelevant. This is similar to a 2005 Model Form Accounting Procedure that uses Alternative 3 for off-site Technical Services and option B for Major Construction and Catastrophe. Accordingly, chargeability depends on whether the person providing Technical Services is engaged in one of the functions listed above. The Operator needs to document the time spent on chargeable functions, and the nature of the work performed, to support the charges. If the nature of the work performed is not on the time sheet, the Operator should maintain supplemental documentation to support the charge. Examples of supplemental information include drilling reports, fishing reports, etc.

Charges end after the specific operating condition or problem is resolved.

Examples of billable time include:

* Drill Well On Paper (DWOP)
* Technical design work for drilling and completion
* Facility design and drafting
* Designing waterflood or other secondary or tertiary recovery projects
* Addressing specific operating conditions or problems
* Inspecting equipment

Examples of non-billable time include:

* AFE preparation, cost estimates or economic analysis
* Rig scheduling
* Budgeting
* Planning or follow-up
* Preparing plans of operations for working interest owners or agencies
* General monitoring of operations (when not handling, mitigating, or preventing specific operations conditions or problems)
* Post-drilling analysis that benefits future operations
* Non-productive time, including time between chargeable activities, waiting on information, or management review
* Studies or analysis that Operator is not willing to share with the Non-Operators who are consenting parties and not in default
* Work that does not directly benefit Joint Operations, such as field-wide reservoir studies of a non-unitized area, regional geological studies, preliminary analysis of potential well locations
* Design work or planning to conduct operations on existing wells, that is not part of a Major Construction or Catastrophe project, or Environmental Project
* Administrative functions.

Planning activities that do not fit the criteria, such as planning a rig schedule or post-drilling analysis to benefit future projects do not qualify as billable time. Designing a well or completion plan for a new well is chargeable. Revising the well plan during drilling or completion operations to adapt to unexpected conditions is addressing a specific condition or problem and is chargeable to that well. Applying that knowledge to update existing well plans for subsequent wells is planning and not chargeable. Work to minimize specific problems that have come up in the past is planning and is not chargeable.

Time spent by a technical person engaged in a drilling or completion operation onsite or in a remote technology center is chargeable, even if the well does not encounter problems, as the operating condition – drilling and completion – qualifies.

The 7th bullet under (ii) refers to implementing new, or non-routine updates to, HSE Laws or standards required or recommended by governmental authorities having jurisdiction. Once the new HSE Law or standard has been implemented, Technical Services for routine compliance are not chargeable, unless they meet the other criteria, such as handling a specific problem that encountered.

If a person who normally provides Technical Services is engaged in activities that do not fall under the description of billable Technical Services, that time is governed by other provisions of this Accounting Procedure that relate to the type of work being performed. For example, routine monitoring of production operations, or performing management functions, are covered by overhead. A technical person performing First Level Supervision of field employees would be chargeable under II.2.A(3) when acting in that capacity.

Costs billed under this provision do not include clerical or non-technical personnel who support the Technical Services or supervisors and managers of the Technical Services staff unless approved by the Parties.

If the technical person travels to the contract or unit area, Joint Property, or construction yard, and his or her time is billable under this provision, then reasonable travel time is also chargeable.

Technical services provided by unaffiliated third parties or Affiliates are covered by Sections II.5 and II.7, respectively. These same functions that determine chargeability of Operator’s employees also apply to them, except as provided in the Agreement.

**(5) directly engaged in performing the following functions for Joint Operations:**

* **Negotiating with landowners to acquire surface and subsurface rights to build, install, and access wells and other operations infrastructure; but excluding negotiations to acquire leasehold or mineral rights**
* **Meeting with landowners or regulatory personnel, and survey crews to select sites for conducting Joint Operations and related infrastructure needed to carry out operations**
* **Overseeing surveying and staking of locations, and line locating**
* **Acquiring water rights**
* **Assessing damages in the field and negotiating settlements with landowners**
* **Conducting inspections in the field to verify compliance with surface use restrictions.**

The person performing these functions will often meet with the landowner or landowner’s representative at the location to determine where to locate well pads, facilities, etc. In addition to the well pad or facility pad, there could be other infrastructure necessary carry out operations, such as roads, communication towers, gathering lines, or electrical distribution lines.

In many cases, oil and gas leases or surface use agreements contain restrictions on surface use. For example, they may contain specifications on cattle guards, gates, road cuts and maintenance, pond size and depth. This requires vigilance on the part of the Operator to verify compliance, which helps to maintain good relations with the landowners, ensure continued access, and minimize potential damages.

Negotiating with landowners to acquire surface and subsurface rights does not mean acquiring oil and gas leases or mineral rights. Rather, it refers to acquiring easements and rights of way, which are needed to conduct Joint Operations.

If the Joint Operation requires extensive land work (e.g., work in an environmentally sensitive area), the Parties are encouraged to reach an agreement on whether overhead fees appropriately reimburse the Operator for the costs or if the definition should be modified to include additional functions as direct charges.

**Charges for the Operator’s employees identified in Section II.2.A will be based on the employee’s actual salaries and wages, or in lieu thereof, a day rate representing the Operator’s average salaries and wages of the employee’s specific job category.**

For ease of administration, and to protect an individual worker’s privacy, it is acceptable to use a day rate to charge the employee’s salaries and wages. In computing this day rate, or other time equivalent rate (hourly rate or monthly rate), several factors need to be considered:

* The rate should be based on a group of employees performing similar job functions.
* The rate should be based on a group of employees within a relatively small range of pay scales to minimize the difference between actual cost and the amounts charged, to the extent reasonably possible.
* Within a certain pay range there will be a difference between the range’s minimum and maximum amounts. If this difference is significant, due to geographical locations, different pay scales, etc., it might be appropriate to create separate groups and develop multiple rates to calculate a rate that more closely matches actual.

**Charges under this Section II.2.A for employees who are foreign nationals may not exceed comparable compensation paid to an equivalent U.S. employee pursuant to this Section II.2, unless approved by the Parties pursuant to Section I.6.A (*General Matters*).**

The cost of having expats is disproportionate to the cost of using an in-country person, because of the premiums, benefits, and tax considerations. Use of an expat is often a development opportunity that primarily benefits the Operator, given the cost differential. The incremental costs should be borne by the Operator unless it gets approval of the Parties.

**B. Operator’s cost of holiday, vacation, sickness, and disability benefits, and other customary allowances paid to employees whose salaries and wages are chargeable to the Joint Account under Section II.2.A, excluding severance payments or other termination allowances. Such costs under this Section II.2.B may be charged on a “when and as-paid basis” or by “percentage assessment” on the amount of salaries and wages chargeable to the Joint Account under Section II.2.A. If percentage assessment is used, the rate shall be based on the Operator’s cost experience.**

If a person’s time is chargeable under Section II.2.A, the cost of his or her holiday, vacation, sickness, disability benefits, jury duty, and excused absences is also chargeable. Unless an employee is regularly assigned to a particular property for the entire year, it is very difficult to make an equitable charge using the “when-and-as-paid” basis. The “percentage assessment” generally provides a more equitable distribution of these costs to all the properties served throughout the year. The Operator should periodically review the “percentage assessment” and adjust the rate to provide a fair and equitable distribution of actual costs to the properties served.

Severance payments and other termination allowances are not chargeable to the Joint Account because they often result from reorganizations, mergers, overstaffing or poor performance, and do not provide direct benefit to the Joint Property. Also, it can be difficult to match the cost to the properties served over the time the person provided service to the company.

**C. Expenditures or contributions made pursuant to assessments imposed by governmental authority that are applicable to costs chargeable to the Joint Account under Sections II.2.A and B.**

Costs billed under this provision include FICA (Federal Insurance Contributions Act), federal unemployment taxes, and state unemployment taxes. Some of these taxes apply only to a certain amount of the employee’s earnings, and not the entire annual pay. One such tax is FICA, which has two components:

* Social Security’s Old-Age, Survivors, and Disability Insurance (OASDI)
* Medicare’s Hospital Insurance (HI)

The OASDI is assessed on only a certain amount of an employee’s earnings. Therefore, if charging these costs on a percentage assessment, rather than actual cost as incurred, these limits must be considered. For example, assume the total FICA tax is 7.65%, comprised of a 1.45% HI rate applied to all earnings and a 6.2% OASDI rate applied to the first $120,000 of earnings. For employees whose annual salary exceeds $120,000, the effective tax rate is less than 7.65%. This should be considered when calculating the percentage to be applied to the salaries and wages which will result in a percentage that is less than 7.65%. Using this calculated percentage assessment rather than charging a lower amount in the final months of the year allows the cost to be applied evenly throughout the year, ensuring all properties served by that person during the year bear an equitable portion of the costs.

**D. Personal Expenses of employees whose salaries and wages are chargeable to the Joint Account under Section II.2.A when the expenses are incurred in connection with directly chargeable activities; provided however, relocation costs that result from reorganization or merger of a Party, or that are for the primary benefit of the Operator, shall not be chargeable to the Joint Account. Extraordinary relocation costs, such as those incurred as a result of transfers from remote locations, such as Alaska or overseas, shall not be charged to the Joint Account unless approved by the Parties pursuant to Section I.6.A (*General Matters*).**

Personal Expenses (defined in Section I.1) of chargeable employees are generally chargeable when they benefit the Joint Operations. Some Personal Expenses are not directly chargeable to the Joint Account, even though the employer reimburses them, because they do not provide direct benefit to the Joint Operations. Examples of non-chargeable expenses include professional memberships, dues, periodicals, recruiting expenses, and corporate and social functions.

Personal Expenses should match the property or properties that benefitted. As such, the allocation generally should be consistent with the salary and wages of the person who incurs them.

Relocation expenses are chargeable only when they are for the benefit of the Joint Operations, rather than for the benefit of the Operator. Relocation expenses may include items such as real estate fees, closing costs, compensation for loss on sale of home, miscellaneous expense allowances, and tax assistance payments. Chargeable relocation costs should be allocated equitably and consistently with salaries and wages as provided for in Sections II.2.A(1) and (2).

**E. Costs incurred for operational, technical, HSE, government-mandated,** **or government-recommended training for employees whose salaries and wages are chargeable under Section II.2.A.**  **This training charge includes the salary or wages and Payroll Burden and Benefits of the person being trained, training course costs, and Personal Expenses incurred for the training. The training cost will be charged to the properties directly benefiting from the training. Charges to the Joint Account for training course costs may not exceed prevailing commercial rates, where such rates are available.**

Costs incurred in training include course registration, materials, and instructors.

Government-mandated and government-recommended training refers to any government entity having jurisdiction over operations, or training required by judicial decree as a result of a settlement or verdict. This includes training related to compliance with government-mandated or recommended practices and standards.

Training costs for courses that are not operational, technical, HSE, government-mandated, or government-recommended are considered to be covered by the overhead provision of Section III (*Overhead*).

The type of training, not its location, determines chargeability. Salaries, wages, burdens, benefits, and Personal Expenses of a chargeable employee continue to be charged to the property when the employee is attending such training, regardless of where the training takes place.

The allocation of chargeable training costs typically follows the salaries and wages of the person being trained. However, if the training benefits fewer than all the properties served by an individual, such as gas lift training, the cost should be charged/allocated only to the property or properties that will directly benefit from the training.

Refer to MFI-35, *Employee and Contractor Training Cost*, for more information*.*

**F. Operator’s current cost of established plans for employee benefits, including group life insurance, health care plans, retirement/401K contributions, stock purchase, savings plans, bonus, tuition assistance, applicable to the Operator’s labor costs chargeable to the Joint Account under Sections II.2.A and B, based on the Operator’s actual cost not to exceed the employee benefits limitation percentage most recently published by COPAS.**  **If COPAS ceases or fails to publish an employee benefits limitation percentage, the upper limit on employee benefits will be based on a replacement index and methodology that reflects substantially the same data.**

Employee benefits charged under this provision are for established plans that are available across the board to all employees. The term “bonus” does not refer to incentive compensation payments, which are considered at-risk pay.

Benefits are charged as a percentage of the salary or wages. The percentage is limited to the lesser of the percentage calculated based on Operator’s actual cost or the COPAS upper limit. As of this publication date, COPAS publishes an employee benefits limitation percentage annually which is based on data from the Bureau of Labor Statistics.

Refer to COPAS MFI-27, *Employee Benefits and Percentage Limitation*, for more information.

**G. Award payments to employees whose salaries and wages are chargeable under Section II.2.A, to the extent such awards (i) pertain to services directly benefitting Joint Operations, (ii) are an established award program that is not part of incentive pay compensation, and (iii) are based on pre-determined metrics.**

Awards to recognize individual or team accomplishments related to Joint Operations are directly chargeable to the Joint Account. Refer to COPAS MFI-49, *Employee and Contractor Awards,* for more information.

## 3. MATERIAL

**Material purchased or furnished by the Operator for use in Joint Operations, as may be required for immediate use or is reasonably practical and consistent with efficient and economical operations. The Operator shall make good faith efforts to avoid the accumulation of surplus stocks.**

The Operator may decide to stock spare parts or equipment for reasons such as frequent replacement, long-lead time to replace, or that would have a significant impact on operations if not readily available. These spares are not considered to be surplus.

Detailed provisions regarding materials pricing, transfers, and disposition are covered in Section IV of this accounting procedure. The Agreement may contain additional provisions related to acquisition and disposition of materials, including approval requirements.

Refer to MFI-38, *Materials Manual*, for more information.

## 4. TRANSPORTATION

**Transportation of the Operator’s, Operator’s Affiliate’s, or contractor’s personnel and Material necessary for Joint Operations, subject to Section IV.2.B (Freight).**

This paragraph allows direct charges to the Joint Account for transportation of personnel and materials. See Section IV for additional provisions detailing how materials transportation costs should be charged.

Refer to COPAS MFI-45, *Offshore Marine and Aircraft Costs,* for information concerning allocation of marine and aircraft transportation used in offshore operations.

## 5. SERVICES

The cost of third-party services, equipment, and utilities used in Joint Operations, except as follows:

* goods and services provided by Operator’s Affiliates, which are covered by Section II.7 (*Affiliates*);
* services covered by Section II.9 (*Legal Expense*); and
* functions specifically identified in Section III (*Overhead*) as covered by overhead.

Notwithstanding the foregoing, chargeable costs include incidental administrative and other costs incurred by the third-party vendor that are an integral part of providing chargeable services.

Awards paid to contractors shall be chargeable to the Joint Account if they (i) pertain to services directly benefitting Joint Operations, (ii) are an established award program, and (iii) are based on pre-determined metrics. The cost of operational, technical, HSE, government-mandated, or government-recommended training shall be chargeable to the Joint Account, for third parties who are chargeable under this Section II.5.

Generally, the function, and not the provider, that determines whether a service is directly chargeable to the Joint Account. Functions that would not be chargeable if performed by the Operator are not chargeable when performed by a third party. However, there can be exceptions in the Agreement. For example, Section IV.A of the AAPL 610-1989, 1989H and 2015 model forms allow a direct charge for “Costs incurred by Operator, including fees paid to outside attorneys which are associated with hearings before governmental agencies, and which costs are necessary and proper for the activities contemplated under this agreement…”

Services, equipment, and utilities may include leased communication systems.

In conjunction with a chargeable service, a third-party provider typically incurs and charges for its own incidental costs that would normally be classified as overhead if performed by Operator (such as report preparation, copying, and invoicing). Some vendors build the cost into their fee structure for a job, and others itemize the cost on an invoice. These incidental costs are acceptable if they are part of the overall cost of a chargeable third-party service, customary for that company, and within reason. However, if the Operator has outsourced an overhead function to a third party, the function does not become chargeable to the Joint Account just because it is performed by a third party.

Labor for repairs, additions, inspections, supervision of fabrication, and modifications performed on tangible personal property owned by the Joint Account are chargeable at cost under this provision. Travel and other expenses reimbursed to a contractor or consultant are part of the cost of service and billable to the Joint Account under this provision if the contractor or consultant incurred the costs in connection with chargeable activities.

Awards to recognize individual or team accomplishments provided by third parties are chargeable to the Joint Account if the award relates to services provided for Joint Operations. Refer to MFI-49, *Employee and Contractor Awards*, for more information*.*

## 6. EQUIPMENT AND FACILITIES FURNISHED BY OPERATOR

**The Operator shall charge the Joint Account for use of equipment and facilities furnished by Operator, including production facilities, Shore Base Facilities, Offshore Facilities, Field Offices, and Remote Technology Centers. The cost of Field Offices shall be chargeable only to the extent the Field Offices provide direct service to individuals who are chargeable pursuant to Section II.2.A (*Labor*), Section II.5 (*Services*), or II.7 (*Affiliates*), as applicable.**

**In the absence of a separately negotiated agreement, equipment and facilities furnished by the Operator will be charged as follows:**

1. **Charges for use of such equipment and facilities will be made at rates commensurate with the cost of ownership and operation. Such rates may include labor, maintenance, repairs, other operating expense, insurance, taxes, depreciation using straight line depreciation method, and interest on gross investment, less accumulated depreciation, not to exceed \_\_ % per annum; provided, however, depreciation shall not be charged when the equipment and facilities investment has been fully depreciated. The rate may include an element of the estimated cost for abandonment, reclamation, and dismantlement. Such rates shall not exceed the commercial rates currently prevailing in the area of the Joint Operations.**
2. **In lieu of charges in Section II.6.A, the Operator may elect to use commercial rates prevailing in the area of the Joint Operations, less 20%. If equipment and facilities are charged under this Section II.6.B, the Operator shall adequately document and support commercial rates and shall periodically review and update the rate and the supporting documentation.** **For automotive equipment, the Operator may elect to use rates published by COPAS. If COPAS ceases or fails to publish such rates, Operator may charge vehicle rates based on a method comparable to that most recently used by COPAS.**

This provision is used to charge equipment and facilities owned by the Operator and used in Joint Operations. It is also used to charge leased equipment where the Operator assumes the risk of ownership responsibilities, operates the equipment, and incurs other costs in connection with the equipment, such as installation costs, maintenance, or labor. The equipment or facility may serve more than one property, simultaneously or over time.

The term “equipment and facilities” is used in the broad sense to include equipment that may be mobile or semi-mobile and installations that may be semi-permanent or permanent in nature. Examples of such equipment and facilities and some possible bases for charging for or allocating the costs are listed below. This is not a complete list of facilities and equipment that are directly chargeable to the Joint Account. Equipment and facilities are chargeable if necessary and proper to conduct operations, and if there is nothing in the Agreement that would prohibit the charging of such costs.

Following are common methods of charging for equipment and facilities, but other equitable bases may be used. For some facilities, there may be two or more tiers of allocations, that use different allocation bases.

| Equipment/Facility | Possible Charge or Allocation Basis |
| --- | --- |
|  |  |
| 1. Mobile Equipment |  |
| Aircraft (manned) | See MFI-45 |
| Unmanned aircraft (drone) | Hours/well count |
| Automotive unit | Hour or mileage |
| Tractor, bulldozer, crane, forklift | Hour/day |
| Test separator or compressor | Hour/day |
| Paraffin scraping unit | Hour/day |
| Cement mixer | Hour/day |
| Solar generator | Hour/day |
| Boat | See MFI-45 |
| House trailer | Day/month |
|  |  |
| 1. Semi-Mobile Equipment |  |
| Drilling or workover rig, pulling unit | Day rate/footage/turn-key |
| Barge | Day |
|  |  |
| 1. Semi-Permanent Equipment |  |
| Skid-mounted production handling facility | Day/volume |
|  |  |
| 1. Permanent Installation |  |
| Compressor station | Volume or well count |
| Saltwater disposal system | Volume or well count |
| Fresh water wells or water supply system | Volume |
| Roads | Miles/well count |
| Platform | Volume, well count, square footage |
| Production handling facility | Volume, well count |
| Field office | Square footage/ headcount/well count |
| Canals | Miles/well count |
| Dock | Wells |
| Oil storage & loading facility | Volume/well count |
| Gathering system | Volume/well count |
| LACT system | Volume/well count |
| Laboratory services (excluding R&D) | Hours/unit |
| Remote technology center | See MFI-57 |
| Shorebase facility | See MFI-46 |
| Communication equipment | Wells or personnel served |
| Computer production control | Wells connected, hours/days |
| Sand facility | Weight/volume |
|  |  |
| 1. Miscellaneous |  |
| Drill pipe or frac string | Footage/day |

Cost Basis and Commercial Rates:

When Operator-owned equipment and facilities serve the Joint Operations, the Operator may elect to charge the Joint Account on the basis of costs of ownership and operation. Recoverable costs include labor, maintenance, repair, depreciation of investment, insurance, interest on the undepreciated investment, and applicable taxes. The Operator may incur substantial costs for abandonment and reclamation that should be shared by non-owning users of the equipment and facilities during their useful life, so the rate may include an element of the estimated expense of dismantlement, abandonment and reclamation, less estimated salvage value. Reclamation costs do not include replacement or refurbishment of equipment and facilities. Reasonable documentation supporting the rate must be made available to the Non-Operators upon request.

If the facility rate includes insurance premiums – e.g., property damage insurance – and the facility sustains a loss, the amount of the loss covered by insurance may not be passed on to facility users. Only uninsured losses may be included in the facility costs passed on to users.

If there is no commercial rate in the area of the Joint Operations for substantially similar equipment or facilities, the Operator should use a cost-based rate. For example, if an Operator builds a water pipeline to save on the costs of trucking water to a remote location, the Operator should not use a commercial trucking rate for its water pipeline rate because it is not the same service.

Paragraph A allows the Operator to charge interest on the gross investment less accumulated depreciation. The interest is considered the cost of money and lost opportunity cost, not a profit.

The Operator has the sole discretion whether to charge under paragraph A or paragraph B, assuming a commercial rate is ascertainable. If there are no commercial providers in the area of Joint Operations, the Operator must use paragraph A, except automotive equipment may be charged using another method option under B. Once the Operator has selected an option for charging a given facility, that method should remain the basis for charges throughout the period that the facility is used for Joint Operations. However, factors such as a change in the Operator’s accounting systems and methodologies, a change of Operator, or availability of a commercial rate etc. may justify a change in the option used to charge a given facility.

Equipment and facilities may be used by both personnel chargeable to the Joint Account and by non-chargeable personnel – for example, a Field Office or communications equipment. The portion of the equipment or facility that serves non-chargeable personnel is not chargeable to the Joint Account.

Rate Considerations:

The Joint Operation may only need to use equipment for a short time or needs only a portion of a facility’s capacity. The Operator, in effect, rents the equipment or facility to the Joint Operation so that it only pays for the time or capacity used.

The period of time equipment or a facility should be charged to the Joint Account compared to the time the equipment or facility is actually used is sometimes difficult to ascertain. Generally, in the case of categories 1) Mobile Equipment, 2) Semi-Mobile Equipment, 3) Semi-Permanent Installations, and 5) Miscellaneous Equipment, charges should be made for the time the equipment or facility is at the disposal and use of the Joint Operation or is required to be available on a standby basis to adequately serve the Joint Operation. The Operator is expected to be prudent and should not move equipment or a facility into the service of a Joint Property before its use is required nor permit the equipment or facility to remain on or in the service of the Joint Property when it is not necessary. However, Non-Operators should expect reasonable standby charges for operational and logistical reasons – e.g., so there is no down time waiting on equipment, to ensure movement does not interfere with operations, or to minimize transportation charges. In the case of category 4) Permanent Installations, charges should generally be based on the actual time or capacity used. This would be appropriate for permanent compressor stations, saltwater disposal wells, freshwater wells, and supply systems, gathering systems, and LACT systems. In other instances, charges for equipment or facilities in this category (such as roads, canals, docks, and oil storage and loading facilities) should be based on their availability for use if the service is of a continuing or permanent nature and by special agreement if the service is of a temporary nature.

Transportation of Equipment/Facility:

The Joint Account should bear the cost of transporting the equipment or facility to and from the site where operations are conducted, and the cost of setting up and dismantling the equipment or facility at the site where operations are conducted. An exception is when transferring the equipment or facility to another service location. In that case, the receiving property should pay for the transportation to the new service location.

Automobiles:

The Operator may charge its actual cost of ownership (or leasing cost if applicable) and operation, or the rates as described in paragraph B. The rates under paragraph B include operating costs therefore care must be taken not to charge actual operating costs when using rates.

Field Offices:

Costs of Field Offices staffed by personnel whose salaries and wages are directly charged to the Joint Account under Sections II.2.A (*Labor*), are directly chargeable to the properties served by those personnel. For offices that house both field operating functions and functions covered by overhead, only the portion attributable to personnel whose time is chargeable under Sections II.2.A (*Labor*) may be allocated and charged to the properties served. If the Field Office is jointly owned, costs may be charged to the owners under other provisions of Section II (*Direct Charges*) – e.g., Materials, Services. The costs would be accumulated and charged to other properties served by the Field Office, if any, as equipment and facilities furnished by Operator under the other properties’ respective accounting procedures.

Common methods for allocating Field Office costs include:

* Allocation based on headcount (full-time equivalent). Calculate the cost of providing an office and allocate the cost based on the number of employees that use the office. The charge to the Joint Account would be calculated by applying the rate to the number of personnel who use the office and are directly chargeable.
* Allocation based on square footage – calculate a cost per square foot and charge the Joint Account based on the square footage of the office space used by directly chargeable personnel.
* Allocation that mirrors the allocation of labor charges.

When calculating the cost of providing a Field Office, the costs should include only those costs associated with providing the services needed by the person to perform his or her duties for Joint Operations, and not the support costs of being an employee. Examples of costs to include are:

* Depreciation, if the building is owned, or rent
* Utilities (gas, electric, water)
* Communication services (telephone, fax, copier)
* Computer hardware and software

Operating Agreements

The Agreement may also contain requirements regarding equipment provided by the Operator, including commercial rate limits and/or prior approval. For example, see the following model form operating agreement provisions: AAPL 610-1989, 1989H, and 2015—Article V.D.1; RMMLF Form 2-1994—Article 15.5; AAPL 710-2002—Article 5.7.

Additional Resources

MFI-44, *Field Computer and Communications Systems*

MFI-45, *Offshore Marine and Aircraft Allocations*

MFI-46, *Shorebase Facilities and Offshore Staging Areas*

MFI-55, *Vehicle Rates*

MFI-56, *Rig-Related Costs*

MFI-57, *Remote Technology Centers*

## 7. AFFILIATES

**All work performed, or materials supplied, by an Affiliate of Operator shall be performed or supplied at competitive rates and terms, and in accordance with customs and standards prevailing in the industry unless otherwise agreed to by the Parties under Section I.6.A (*General Matters*).**

**Charges to the Joint Account for goods and services provided by an Affiliate in a Competitive Transaction may be made without approval of the Parties, unless required under the Agreement. Each of the following is considered a Competitive Transaction:**

1. **for an Affiliate that routinely conducts business with unaffiliated customers, the rates and terms charged the Joint Account are representative of rates and terms the Affiliate charges non-affiliated customers;**
2. **Affiliate labor charged on the same basis as if provided by Operator under Section II.2 (*Labor*);**
3. **Affiliate equipment and facilities charged on the same basis as equipment and facilities provided by Operator under Section II.6 (*Equipment and Facilities Furnished by Operator*);**
4. **Affiliate equipment, facilities or Materials charged at rates and terms that are competitive with unaffiliated third parties, in accordance with customs and standards prevailing in the area of Joint Operations;**
5. **charges to the Joint Account for the Affiliate’s goods and services used in Joint Operations that are less than or equal to $ .**

**The threshold in (v) applies separately to each Affiliate and it applies separately to each:**

* **project or operation requiring an AFE or other authorization from Non-Operators under the Agreement; or**
* **calendar year, for Joint Operations not requiring an AFE or other authorization under the Agreement.**

**If the Parties fail to designate a dollar amount in (v), the amount deemed adopted by the Parties is the amount established as the Operator’s expenditure limitation in the Agreement. If the Agreement does not contain an Operator’s expenditure limitation, the amount deemed adopted by the Parties is $ 0.**

**Charges to the Joint Account for goods and services provided by an Affiliate that are not considered a Competitive Transaction require approval of the Parties under Section I.6.A (*****General Matters*).**

**Nothing in this Section II.7 authorizes charges to the Joint Account for services covered by Section II. 9 (*Legal Expense*) or functions covered by Section III (*Overhead*).**

**The Operator may not charge the Joint Account for expediting, purchasing fees or other mark-up for Affiliate goods and services.**

ther, but does not establish the appropriateness of the charge

The Competitive Transaction criteria are similar to those found in MFI-18, *Operator Affiliates and Related Entities*, and some of the prior COPAS accounting procedures. If an Affiliate routinely conducts business with unaffiliated third parties, it will likely be common knowledge in the public domain, or the Operator must provide reasonable documentation to support that is the case. For example, the affiliate may have a website, or actively markets its goods and services. The Affiliate’s status as such is determined over time, not based on a single point in time.

The Operator is expected to provide reasonable support that charges are appropriately classified as a Competitive Transaction. If any one of the criteria in items (i) – (v) apply, it is considered a Competitive Transaction.

It might not be practical to show that the Affiliate’s rates and terms are the same charged to its other customers, or the Operator may be unable provide support the Affiliate’s charges if the entity is no longer an Affiliate when the audit is conducted or resolved. The charges are still acceptable if Operator can show the rates charged at the time were competitive with commercial rates in the area.

Regarding charges under (ii) and (iii), the Operator is expected to allow an audit and reasonably demonstrate the Affiliate goods or services are charged on same basis as goods or services provided by the Operator under Sections II.2 or II.6. Labor rates are comprised of salary or wages and other components in Section II.2, but do not include support costs or overhead.

Item (iv) reflects concepts found in many model form operating agreements – that Affiliate goods and services be provided at competitive rates and in accordance with customs and standards prevailing in the industry. Generally, the Non-Operators should be no worse off than if the Operator hired a third party to provide the equipment, facilities, or Material. The Operator is expected to provide reasonable proof that the Affiliate rates and terms are competitive. Examples of supporting documentation include invoices from other providers in the area, quotes or bid sheets.

Labor is excluded from (iv) to prevent the Joint Account being charged fully loaded labor rates that include overhead costs. Affiliate labor rates that include overhead costs – as sometimes occurs with Affiliates that provide field labor or Technical Services – would not be a Competitive Transaction and would require approval.

An Affiliate charge that does not meet one of the Competitive Transaction criteria requires approval of the Parties. The Operator may want to obtain approval prior to charging the Joint Account. Obtaining approval after the fact can be more difficult, creating exposure for the Operator.

Documentation of commercial rates and terms in the area can include quotes, bid sheets, or invoices from unaffiliated third-party providers. It is preferable to get more than one quote, bid or invoice, however, that may not always be practical. The availability of and process for obtaining third-party supporting documentation may vary from one area to another. If the rates are within the range of rates offered by unaffiliated third parties for the area of Joint Operations, they are acceptable; it does not have to be an average of a pre-determined number of sources. Comparing an Affiliate’s rates and terms to that of a third party is not limited to price – there may be other consideration of value, such as stand-by time.

Unlike some international operations, the Operator is not allowed to add fees for purchasing, expediting or traffic coordination fees to an Affiliate’s charges. If the Internal Revenue Code or other guidelines require an adjustment to the price charged to Operator for an Affiliate’s goods and services, that is a financial and tax accounting matter, and does not affect the Joint Account.

## 8. DAMAGES AND LOSSES TO JOINT PROPERTY

**Costs or expenses, other than those covered by Section III (*Overhead*), necessary to repair, replace or abandon Joint Property resulting from damages or losses incurred, except to the extent such damages or losses result from a Party’s or Parties’ gross negligence or willful misconduct, in which case such Party or Parties shall be solely liable.**

Most Agreements provide that costs incurred for repair or replacement of Joint Property due to damage or loss shall be borne by the Joint Account unless the damages or losses resulted from gross negligence or willful misconduct of a Party. If any equipment is destroyed or damaged, the Operator should provide Non-Operators documentation to enable them to properly account for their costs and, upon request, provide additional data necessary to file claims with their insurers.

If there is a dispute as to which Party or Parties are responsible for bearing the costs of any damage or losses, the Operator may charge the Joint Account for the repair or replacement costs associated with any damages or losses incurred until there has been a final determination or agreement as to the responsible Party or Parties. If the Operator is deemed responsible, credits should be issued to the Joint Account upon that determination. If another party is determined to be responsible, credit will be issued to the Joint Account upon receipt of funds from the responsible party.

## 9. LEGAL EXPENSE

1. **Costs incurred by Operator in procuring abstracts, fees paid to attorneys and landmen for title examinations (including preliminary, supplemental, shut-in royalty opinions, division order title opinions), and title curative work are chargeable except as limited by the Agreement. If the Agreement is silent regarding chargeability, these costs are directly chargeable to the Joint Account.**

Chargeability of conducting title work and curative work is often determined by provisions in the Agreement. Article IV.A of the AAPL 610-1989, 1989H and 2015 Model Form Operating Agreements:

* allow a direct charge for procuring abstracts, fees paid outside attorneys for title examination (including preliminary, supplemental, shut-in royalty opinions and, division order title opinions), and other direct costs relating to title work for Joint Operations. This may include costs for brokers to prepare abstracts;
* do not allow a direct charge for Operator’s staff attorneys or other personnel who perform these functions.
* provide that each Party is responsible for securing its own curative matter and pooling amendments or agreements needed in connection with its own interest.

Sometimes the Agreement is modified to allow or disallow direct charges for to the Joint Account for some of these costs. For example, the form may be modified so that Operator performs the curative work on behalf of the Parties, and charges the cost to the Joint account, or it is modified to allow direct charges for Operator’s legal and land staff who perform title examination.

If Agreement is silent regarding chargeability, or refers to the accounting procedure to determine chargeability, the costs to procure title materials and title opinion are directly chargeable to the Joint Account, regardless of Operator’s staff or a third party performs the function. For example, the RMMLF Form 2-1994 Unit Operating Agreement, provides for costs incurred by the Operator to acquire materials need to perform title examination are chargeable to the Party who failed to provide title information to the Operator, but the form does not explicitly state whether title examination costs are chargeable.

If attaching the accounting procedure to an Agreement that does not address title or curative costs, the Parties will want to consider whether to modify the Agreement or this accounting procedure to ensure these costs are treated as intended.

1. **Costs incurred by Operator, including fees paid to outside attorneys, which are associated with hearings before governmental agencies for securing of spacing or pooling orders or any other orders necessary and proper to conduct Joint Operations are chargeable except as limited by the Agreement. If the Agreement is silent regarding chargeability, these costs are directly chargeable to Parties on whose behalf Operator is acting.**

This provision parallels language in Article IV.A of the AAPL 610-1989, 1989H and 2015 Model Form Operating Agreements, which:

* allow a direct charge for “costs incurred by Operator, including fees paid to outside attorneys, which are associated with hearings before governmental agencies, and which costs are necessary and proper for the activities contemplated under this agreement”; and
* do not allow a direct charge for services rendered by Operator’s staff attorneys or other personnel to perform this function.

These costs are not limited to outside attorney fees. For example, charges could include regulatory, land or technical work required in connection with hearings or recording fees to file instruments such as pooling designations or unit agreements in the county records, or agencies such as the Bureau of Land Management. If any Party challenges the Operator’s position on regulatory matters, Operator’s costs should be borne by Parties it represents in defense of that position, and not those protesting it. It would be inappropriate for a Non-Operator to pay for its own costs to protest Operator’s position, as well as the Operator’s costs incurred defending against that protest.

1. **Attorney’s fees, court costs, and other legal costs incurred to collect amounts due under this agreement may be charged in accordance with the Agreement and Section I.3.B (*Advances and Payments*). Recording fees to file of record liens and security interests granted under the Agreement are chargeable, except as limited by the Agreement.**

Some Agreements also allow the Operator to recover legal fees, court costs, and other collection costs. This remedy is also available to Non-Operators if the Operator is a defaulting party. Refer to Article VII.D.5 of the AAPL 610-1989, 1989H, and 2015 Model Form Operating Agreements, and Article 28.4 of the RMMLF Form 2-1994 Unit Operating Agreement. See also Articles 8.6.1 and 8.6.1.2 of the AAPL 710-2002 Model Form Offshore Operating Agreement.

1. **The costs of handling, settling, or otherwise discharging litigation, claims, and liens incurred in or resulting from Joint Operations, or necessary to protect or recover the Joint Property,** **and which are not covered by paragraphs A, B, and C, are chargeable to the extent permitted under the Agreement. Costs of the Operator’s or Affiliate’s legal staff or outside attorney fees and expenses, are not chargeable unless approved by the Parties pursuant to Section I.6.A (*General Matters*) or otherwise provided for in the Agreement.**

Other costs chargeable under this provision may include investigating, court costs, cost to procure evidence, and amounts paid in settlement or satisfaction of any litigation or claim resulting from operations under the Agreement.

Special attention should be directed to the terms of the Agreement because the accounting procedure needs to be read and applied in tandem with the Agreement. Chargeable costs are subject to any claims and lawsuit provisions of the Agreement and can vary widely. Refer to:

* AAPL 610-1989, 1989H and 2015 Model Form Operating Agreements – Article X
* AAPL 710-2002 Model Form Offshore Operating Agreement – Article 19
* RMMLF Form 2-1994 Unit Operating Agreement – Articles 17.1.D, 28.1

If the Agreement does not expressly allow charges for Operator’s or Affiliates employees performing these functions, the Operator may not include charges for personnel covered by overhead, unless agreed to by the Parties.

The claims and lawsuits provision in the Agreement may not allow legal fees to be charged without prior approval. For example, Article X of the AAPL 610 Model Form Operating Agreement (Claims and Lawsuits) refers to the cost of settlement, i.e., damage payments, not necessarily legal fees. The dollar thresholds commonly found in Article X only grant settlement authority for relatively minor issues that do not require extensive legal work (and are often handled in-house). While Article X refers to “all costs and expenses” of discharging the claim, that does not mean that management, accounting, legal, administration and other costs normally classified as overhead are chargeable. Article X is read and interpreted in conjunction with Article V.D.2 of the AAPL 610 1989, 1989H and 2015 Model Form Operating Agreements (and similar provision in other forms) that provides that costs and expenses are borne in accordance with the Accounting Procedure. The Parties might have conflicting interests in claims and lawsuits or want to obtain their own representation. Each Party pays for its own costs to oversee and manage the claim.

## 10. TAXES, PERMITS AND STATUTORY FEES

**All taxes, import duties, licenses, bonds, and permitting fees of every kind and nature, assessed or levied upon or in connection with Joint Operations, Joint Property, or the production therefrom, and which have been paid by the Operator for the benefit of the Parties, including penalties and interest, except to the extent the penalties and interest result from the Operator’s gross negligence or willful misconduct.**

**If a Law requires the Operator to provide a service and prescribes a fee payable to the Operator for such service, such fee will be a direct charge to the Joint Account or to the affected Party or Parties, as applicable.**

**If ad valorem taxes paid by the Operator are based in whole or in part upon separate valuations of each Party’s working interest, then notwithstanding any contrary provisions, the charges to the Parties will be made in accordance with the tax value generated by each Party’s working interest.**

**Costs of tax consultants or advisors, the Operator’s employees, or Operator’s Affiliate employees in matters regarding ad valorem or other tax matters, are not permitted as direct charges unless approved by the Parties pursuant to Section I.6.A (*General Matters*).**

**Charges or credits to the Joint Account resulting from sales or use tax audits, including extrapolated amounts and penalties and interest, are permitted, provided the Non-Operator has the right, upon request, to review the tax auditors’ reports and the calculation of the extrapolated amount for the various properties which served as the basis for tax charges or credits and to determine that the correct amount of taxes was allocated to the Joint Account. If the Non-Operator is not permitted to review such documentation, the sales or use tax may not be directly charged unless the Operator can conclusively document the amount owed by the Joint Account.**

The first paragraph deals with taxes on Joint Operations, Joint Property, and production. It does not allow charges for income taxes. However, it does allow direct charges for sales tax paid on the overhead fees may be billed to Non-Operators under this agreement.

An example of a chargeable permitting fee is a fee paid to an agency for a filing on behalf of the Joint Operations, such as a drilling permit or a FERC filing fee. However, if each Party is responsible for its own filings for the property, each Party would bear its own filing fee, and the fee would not be chargeable. Preparing filings or permits is an overhead function.

An example of a cost chargeable under the second paragraph is the fee prescribed by Oklahoma Senate Bill 168. This bill allows the Operator to charge the Joint Account a fee to reimburse the Operator for the burden of royalty distributions and record keeping.

Normally, the cost of administering and managing the tax function is considered covered by overhead, even if the Operator outsources some or all of this function. However, if there is a tax partnership agreement, it may provide a fee for managing the tax partnership.

Refer to COPAS AG-20, *Extrapolated Sales and Use Tax Audit Assessments*, for more information.

## 11. INSURANCE

**Net premiums paid for insurance required to be carried for Joint Operations for the protection of the Parties. If Joint Operations are conducted at locations where the Operator acts as self-insurer in regard to its workers’ compensation and employer’s liability insurance obligation, the Operator shall charge the Joint Account manual rates for the risk assumed in its self-insurance program subject to applicable state and federal workers’ compensation Laws. The manual rates will be the rates published by COPAS, or as provided by an actuary if COPAS ceases or fails to publish manual rates. The manual rates of the adjacent state will be used for employees performing work offshore, adjusted by the U.S. Longshoreman and Harbor Workers (USL&H) or Jones Act surcharge, if applicable.**

**Operator shall credit the Joint Account with settlements received from insurance it carried for the benefit of the Parties. Each Party’s share of the settlement will be based on its Participating Interest share of the operation giving rise to the settlement; provided, however, if such settlement is derived from insurance purchased by the Operator for fewer than all Parties, such settlement will be credited to those Parties for whom the insurance was purchased, in the proportion of their respective contributions toward the insurance coverage.**

The accounting procedure allows the Operator to charge the joint account for insurance the Operator is required to carry for the Parties. The amount charged to the Joint Account is the net premium paid by Operator after any refunds or discounts received by the Operator.

The type and amount of insurance required to be carried by the Operator is addressed in the Agreement and/or an insurance exhibit. Generally, agreements require the Operator to carry workers’ compensation and employer’s liability insurance, which covers a company’s liability to its employees for job-related injuries.

Although the employer is required to carry workers’ compensation and employer’s liability insurance, some states allow the employer to self-insure rather than purchase an insurance policy on the market. If the Operator self-insures for such liability, it charges manual rates to compensate it for the risk it assumed in its self-insurance program.

COPAS obtains manual rates for workers compensation and employer’s liability insurance for certain job classifications, as a convenience to the industry, and publishes updated rates each year. The manual rates pertain only to the workers’ compensation and employer’s liability, not to other types of insurance. Refer to COPAS MFI-31, *Self-Insurance for Workers' Compensation and Employer's Liability Insurance,* for more information.

Examples of other types of insurance that might be required under the agreement or insurance exhibit include general liability, property damage, and well control insurance. Some agreements or insurance exhibits give a Non-Operator the option to be covered by Operator’s insurance or to provide its own insurance. In that case, the cost of this optional insurance is charged only to the Parties who do not elect to provide their own insurance. This option for a Non-Operator to provide insurance is not available for workers’ compensation and employer’s liability insurance, which only the Operator can provide.

If there is a claim covered by workers compensation, the Joint Account would not bear the cost, as the Non-Operators have paid for premiums or manual rates for this protection, and there are no deductibles or insurance limits for workers compensation claims.

For other types of claims, if there is a loss, the Operator may charge the Joint Account for the deductibles and loss over the insurance coverage limit, as to insurance coverage provided by the Operator. Any settlement received from an insurance carrier should be credited to the Parties that paid for the insurance coverage. Costs incurred by Operator may be charged to the Joint Account while the settlement is pending.

The AAPL 610 and the RMMLF Model Form Operating Agreements provide that if the Operator is required to carry automotive liability insurance, it may not be charged the Joint Account. Presumably, the reason for this is because operators once used Petroleum Motor Transportation Association (PMTA) rates, (as of this publication date, Kelley Blue Book and Edmunds rates), to charge for automotive costs. These published rates include an element of insurance costs, so if the Operator were to charge for automotive insurance, that would be considered a duplicate charge for automotive insurance. Refer to COPAS MFI-55, *Vehicle Rates*, for more information.

## 12. COMMUNICATIONS

**Costs of acquiring, leasing, installing, operating, repairing, maintaining dismantling, and abandoning communication facilities or systems directly supporting Joint Operations. Such costs include hardware, software, labor, field buildings that house the communication system, and communication links.**

Historically, charges for communication systems were limited to equipment and associated expenses on the Joint Property and between the Joint Property and the Operator’s offices directly responsible for field operations. It is not practical to isolate and determine the costs in that manner due to the pervasiveness and interconnectivity of technology.

Systems components serving only the Joint Property might be jointly owned with all costs borne by the Joint Account. Systems components serving multiple properties with various ownerships may be Operator-owned or leased, with charges made to properties served on an equitable basis such as established rates, direct usage, and allocation, in accordance with Section II.6 (*Equipment and Facilities Furnished by Operator*), or in accordance with Section II.7 (*Affiliates*).

Refer to COPAS MFI-44, *Field Computer and Communication Systems* and MFI-57, *Remote Technology Centers*, for more information.

## 13. HEALTH, SAFETY AND ENVIRONMENT

**Costs incurred for:**

1. **well containment, pollution containment and pollution removal equipment** **that is capable of serving Joint Operations, whether used or on standby; or**
2. **actual costs of control, cleanup and resulting responsibilities of spills, or discharges from permitted outfalls, as deemed appropriate by Operator for prudent operations; or**
3. **HSE assessments, surveys, or testing.**

The Operator may be required by Laws to have pollution containment and removal equipment available on standby. It may also decide to have additional equipment or resources available, even if not required by Laws. Ordinarily, this equipment is not Operator-owned, but rather made available to the Operator through its membership in associations such as Clean Gulf Associates. Assessments or fees incurred by the Operator for pollution containment and response organizations are directly chargeable, provided the charge to the Joint Account is based on:

* an equitable allocation of costs between the Operator’s upstream, midstream, and downstream operations, if applicable;
* membership in the association provides direct benefit to the Joint Property, whether actually used or available on standby;
* the allocation among properties reflects the operational dynamics giving rise to the charge, such as drilling activity, volumes, well count, or acreage.

The actual costs of containing a spill and the resulting cleanup and remediation responsibilities, as well as discharges from permitted outfalls as required by applicable Laws or deemed appropriate by Operator are directly chargeable. Generally, the participants in the operation giving rise to the incident are responsible for the spill and containment costs. However, the responsibility of each Party for clean-up costs, penalties and fines may be different if an environmental incident resulted from gross negligence or willful misconduct of a Party, or the Parties agreed to shift liability through indemnification provisions in an agreement.

Refer to MFI-54, *Well Containment Service Providers*, for more information.

## 14. OTHER EXPENDITURES

**Any other expenditure not covered or dealt with in the foregoing provisions of this Section II (*Direct Charges*), or in Section III (*Overhead*) and which is of direct benefit to Joint Operations and is incurred by the Operator in the necessary and proper conduct of the Joint Operations; provided however, the charge requires approval of the Parties, pursuant to Section I.6.A (*General Matters*), if it exceeds $ \_\_\_\_\_\_\_. If the Parties fail to designate an amount, the amount deemed adopted by the Parties is the amount established as the Operator’s expenditure limit in the Agreement. If the Agreement does not contain an Operator’s expenditure limit, the amount will be deemed to be $100,000.**

This paragraph gives the Operator flexibility to account for unanticipated costs arising from changes in operations, regulations, or technology. Costs addressed elsewhere in Section II or in Section III would not qualify as an “Other Expenditure.”

The Operator should not break down costs into smaller transactions to circumvent the threshold.

The Agreement may have voting provisions that override the Accounting Procedure voting provisions.

# III. OVERHEAD

**The Operator is entitled to charge overhead fees to the Joint Account, in accordance with this Section, as reimbursement for costs incurred by it that are not directly chargeable to the Joint Account. The overhead fees are reimbursement for the functions listed in the next paragraph, and any other expenditures not classified as directly chargeable under Section II (*Direct Charges*).**

**Functions included in the overhead rates regardless of whether performed by the Operator, Operator’s Affiliates or third parties and regardless of location, include the following:**

* **warehousing, other than for warehouses that are jointly owned under this Agreement**
* **costs of conducting inventory that are not chargeable under Section V (*Inventories of Controllable Material*)**
* **procurement**
* **administration**
* **accounting and auditing**
* **pipeline nominations and scheduling**
* **human resources**
* **management**
* **supervision not directly chargeable under Section II.2 (*Labor*)**
* **legal services not directly chargeable under Section II.9 (*Legal Expense*)**
* **handling tax matters, other than those costs identified as directly chargeable under Section II.10 (*Taxes, Permits and Statutory Fees*)**
* **permitting and regulatory work not directly chargeable under the Agreement or Section II.9, such as: preparation and monitoring of permits or certifications; preparing regulatory reports; reviewing, interpreting, or submitting comments on or lobbying with respect to Laws or proposed Laws**
* **land and division order services that are not chargeable under the Agreement, or Sections II.2 (*Labor*) II.9 (*Legal Expense*)**
* **Technical Services not chargeable under Section II.2.A(4).**

**Overhead charges are considered reimbursement for all costs and expenses associated with functions not directly chargeable, including the salaries or wages plus applicable Payroll Burden and Benefits, and Personal Expenses of individuals performing such functions, as well as their office and other support costs.**

The overhead provision allows charges for costs of functions not billable under Section II, such as administrative costs, and supervision/management. The above list is not an all-inclusive list.

The Parties negotiate an overhead fee to reimburse Operator for these functions, in lieu of direct charges to the Joint Account for these functions that support the Joint Operations. The overhead fee is not considered to be a dollar-for-dollar reimbursement for the overhead functions. Reorganizing or outsourcing these functions to a third party or an Affiliate does not then make them chargeable to the Joint Account. The overhead fee represents reimbursement for those services regardless of who performs them, so the Parties are encouraged to reach a clear understanding of which functions are to be covered by the overhead fee. Refer to COPAS AG-23, *Overhead Rate Negotiation and Calculation,* for more information.

Auditing is an overhead function, as it pertains to accounting records. This includes hosting audits by Non-Operators, internal audits and vendor audits. Auditing in this context does not refer to HSE or operational inspections, even though such they are sometimes referred to as “audits.” These inspections are part of lease operations and chargeable under Section II.

Permitting and regulatory work in context of this provision refers to the function of preparing and filing reports with various regulatory agencies. It does not include costs of Operator’s or contract personnel who inspect wells or facilities or attend onsite inspections by governmental agencies.

This overhead rate includes reimbursement for supervision and management not allowed as a direct charge under Section II – i.e., above First Level Supervision.

Warehouse operation and maintenance expenses represent the cost of storing and handling Material for which it is neither practical nor feasible to purchase directly from outside sources at the required time of need, or the storage of surplus. This Material can be stored at the Operator’s warehouse, an Affiliate’s warehouse, or a third party’s warehouse or yard. The warehouse operation and maintenance expenses include costs such as salaries and related Payroll Burdens and Benefits of warehouse personnel receiving and disbursing stock items; depreciation on Material storage facilities; loading, unloading, and transportation to stocking point; maintenance and care of stock and storage facilities; and any other cost incurred directly for the purpose of warehousing Material, regardless if the service is provided by the Operator, its Affiliate, or a third party such as a vendor.

If the warehouse is jointly owned by the Parties under this Agreement, the costs to store Joint Account Material in that warehouse are directly chargeable under the various provisions under Section II, such as Labor (II.2), Materials (II.3), Transportation (II.4), etc.

Marketing fees are not a chargeable function under Section II (*Direct Charges*) of the accounting procedure. However, the above list of overhead functions intentionally omits marketing fees.  The main reason for that omission is because each Party has a duty to take in-kind under model form operating agreements, so marketing can be viewed as being outside scope of the operating agreement. Additionally, there may be other agreement provisions or other agreements that allow marketing fees to be passed along.

Refer to COPAS MFI-21, *Overhead Principles*, for more information.

## 1. OVERHEAD—DRILLING AND PRODUCING OPERATIONS

**As reimbursement for costs incurred but not chargeable under Section II (*Direct Charges*) and not covered by other provisions of this Section III, the Operator shall charge overhead using:**

* **(Alternative 1) Fixed Rate Basis, Section III.1.A.**
* **(Alternative 2) Percentage Basis, Section III.1.B.**

**A. Overhead—Fixed Rate Basis**

**(1) The Operator shall charge the Joint Account at the following rates per well per month:**

**Drilling Well Rate per month $ (prorated for less than a full month)**

**Producing Well Rate per month $**

Rates are initially established during the negotiation of the Agreement, and should be commensurate with the Operator’s cost to provide the overhead functions covered by the rate. The fixed rates, the Agreement effective date, the published COPAS overhead adjustment factors, and the well status are the only elements necessary for the Operator to determine the monthly overhead charge to the Joint Account.

**(2) Application of Overhead—Drilling Well Rate shall be charged as follows:**

**(a)** **Charges for onshore drilling wells begin on the date of initial penetration of the ground by any rig or unit to commence drilling the wellbore, (“spud date”) and terminate on the latter of the date the drilling or completion equipment used on the well is released. Charges for offshore and inland waters drilling wells begins on the date the first drilling or completion equipment arrives on location and terminates the latter of (i) the date the last drilling or completion equipment moves off location or, (ii) the date the equipment is released. No charge shall be made during suspension of drilling or completion operations for 15 or more consecutive calendar days.**

The drilling well rate is expressed as a per–well, per month rate but is applied based on drilling days during a month. To calculate the overhead charge for a partial month, divide the number of days in a month into the drilling well rate, then multiply the daily rate by the number of days that qualify for drilling overhead.

The well qualifies for drilling overhead when the well is sustaining some type of drilling or completion operations with the use of a rig, completion unit or other type of completion equipment. Drilling overhead charges cease when the last drilling or completion equipment is released. Use of equipment used in production testing, cleanup operations, testing for state and federal regulations, etc. does not qualify for drilling overhead.

Refer to COPAS MFI-48, *Application and Calculation of Drilling Overhead*, for more information*.*

**(b) Charges for any well undergoing downhole work, including abandonment, for a period of five or more consecutive workdays shall be made at the Drilling Well Rate. Such charges shall be applied for the period from date operations, with rig or other units used in operations, commence through date of rig or other unit release, except that no charges shall be made during suspension of operations for 15 or more consecutive calendar days.**

Downhole operations such as workover, recompletion, isolation, de-completion, or abandonment operation requiring five or more consecutive workdays (not necessarily consecutive calendar days) using a rig or other units, qualifies for drilling overhead. This applies to temporary or permanent abandonment. These operations attract the drilling well rate because the same types of overhead costs are incurred by the Operator as for drilling operations. For purposes of assessing overhead, operations are deemed to commence when the well is entered.

Refer to COPAS MFI-48, *Application and Calculation of Drilling Overhead*, for more information.

**(3) Application of Overhead—Producing Well Rate shall be charged as follows:**

**(a) An active well that is produced, injected into for recovery or disposal, or used to supply water for Joint Operations for any portion of the month qualifies for a one-well charge for the entire month, except as provided in III.1.A.(3)(b).**

The presence of production or injections volumes is commonly used to determine whether the well is active, for purposes of assessing overhead. Wells that produce oil, gas, or water, and wells that are injected into for pressure maintenance, enhanced recovery or disposal are considered active and qualify for overhead. A well that has open valves but does not have any production or injection volumes, as might happen due to pressure, is not considered an active well but may qualify for producing overhead under Section III.A.(3)(c) or Section III.A.(3)(d).

A well that produces or is injected into during any portion of a month is considered active and qualifies for the producing well rate for the entire month, even if it also qualifies for drilling overhead that same month. A producing well requires the same administrative efforts to account to regulatory bodies, working interest owners, or other parties regardless of the number of days it produces during the month.

Monitoring wells do not qualify for producing well overhead because they do not produce oil, gas, or water, and are not injected into. However, they do qualify for drilling overhead when they are drilled, and when being plugged. They might qualify for overhead under Section III.2(b) if they undergo downhole operations for five or more consecutive workdays.

**(b) With respect to a multi-completed well, each completion that is considered a separate well by the governing regulatory authority counts as a separate well for overhead purposes.**

This provision could apply to multi-lateral wells, vertical wells completed in multiple horizons, or to injection wells that have separate injection streams maintained for multiple horizons and which are reported separately. The rationale for separate overhead charges is because the accounting and other overhead functions are more complex. Costs and production must be analyzed more closely to determine which completion benefitted and the proper allocation if both completions benefit. Regulatory reporting and other aspects of managing multiple completions also require additional work.

**(c) A one‑well charge will be made for the month in which plugging and abandonment operations are completed on any well, unless the Drilling Well Rate applies, as provided in Sections III.1.A.(2)(a) or (b). This one-well charge applies even if the well qualified for producing overhead in that same month.**

If plugging operations span two or more calendar months, producing overhead is charged only for the month in which the operation is complete. If a well qualifies as an active well pursuant to Section III.1.A.(3)(a) and is subsequently plugged during the same month, a one-month charge is billable to the Joint Account for the active well and a second one-month charge is billable for the plugging operations that last less than five consecutive workdays. The reason for the second charge is to compensate the Operator for additional overhead costs it incurs for the plugging operation.

If the plugging operation qualifies for drilling overhead under Section III.1.A.(2)(a) or (b), this one-month charge does not apply. For example, if a well undergoes a casing repair that fails, and the Parties proceed to plug the well during the same rig deployment, the drilling rate applies to all the operations conducted during that rig deployment, including the plugging operation, if the operations lasted five or more consecutive calendar days.

**(d)** **A well that is capable of producing but shut-in for the entire month because of (i) an overproduced allowable, (ii) inability of a purchaser, processor, or transporter to take production, or (iii) legal restrictions on flaring qualifies for a one-well charge.**

The well must be capable of producing to qualify for overhead under this provision. Therefore, a well that is drilled but uncompleted (DUC) does not qualify.

The Operator might have to shut-in a well through no fault of its own. One situation is shutting in due to production allowable quotas set by a regulatory agency. While production allowable quotas are not currently an issue, that remains in the form, same as prior model form accounting procedures, in case future regulations force operators to shut in.

The Operator might also be forced to shut in wells when the offtake pipeline is full or damaged, or the gas processing plant is shut in. Historically, an onshore oil well could still produce under these conditions, by trucking the oil and water, and flaring gas not used in operations, or an offshore well could produce oil while flaring gas. However, environmental regulations might prevent the Operator from continuing to produce an oil well. In these situations, the Operator continues to incur overhead to keep the leases from expiring, while attempting to overcome the constraints and restore production.

Like prior model form accounting procedures, this form allows overhead charges for shut-in gas wells that meet the criteria. In addition, it allows overhead charges for shut-in oil wells that meet the criteria because operations are being conducted in areas lacking infrastructure or because of Laws or agreements that prohibit flaring.

A well that is shut-in for reasons that do not meet the criteria above, does not qualify for overhead. Examples include:

* preventing formation damage from offsetting well completion operations
* insufficient pressure to get into the pipeline
* the transporter will not take production because contaminants are out of spec
* repairs needed to an Operator-owned or -controlled gathering or transportation line.

**(4) The well rates will be adjusted on April 1 each year following the effective date of the Agreement; provided, however, if this Accounting Procedure is attached to or otherwise governing the payout accounting under a farmout agreement, the rates shall be adjusted on the first day of April each year following the effective date of such farmout agreement.** **The adjusted rates will be the initial or amended rates agreed to by the Parties, increased or decreased by the cumulative adjustment factor published by COPAS from the effective date of such rates to April 1 of the current year. If COPAS ceases or fails to publish the overhead adjustment factor, the adjustment will be based on the same methodology or a replacement index that reflects substantially the same data.**

Refer to MFI-47, *Overhead Rate Adjustments*, for more information.

**B. Overhead—Percentage Basis**

**(1) Operator shall charge the Joint Account at the following rates:**

**(a) Development Rate % of the cost of development of the Joint Property.**

**(b) Operating Rate % of the cost of operating the Joint Property.**

The Percentage Basis is designed to recover more of the Operator’s overhead costs at the time the Operator incurs such costs. Application of percentage overhead rates results in higher overhead charges when higher drilling or operating costs are incurred, and recovers additional overhead costs during inflationary periods. Despite its name, the development rate applies to exploratory, appraisal and development wells.

**(2) Application of Overhead—Percentage Basis shall be as follows:**

**(a) Subject to III.1.B.(2)(c), the Development Rate applies to the directly chargeable costs in connection with:**

* **drilling, redrilling, sidetracking, plugging back, recompleting or deepening of a well;**
* **a well undergoing downhole work for a period of five or more consecutive work days;**
* **abandonment and restoration of a well not completed as a producer;**
* **construction or installation of fixed assets, the expansion of fixed assets and any project clearly discernible as a fixed asset, other than a project that qualifies for overhead under Sections III.2 (*Overhead—Major Construction and Catastrophe*) or III.3 (*Overhead—Environmental Project*); and**
* **activities in preparation for any of the above operations.**

Some construction projects do not qualify for Major Construction overhead under Section III.2, because they do not meet the dollar threshold or because of the project type, e.g., the installation of pumping units or other artificial lift equipment. The development rate applies to these projects.

**(b) The Operating Rate applies to all other directly chargeable costs in connection with Joint Operations, except those subject to Section III.1.B.(2)(c), Section III.2 (*Overhead – Major Construction and Catastrophe*), or Section III.3 (*Overhead – Environmental Projects*).**

**(c) The Development Rate and Operating Rate do not apply to the following:**

* **legal fees covered by Section II.9 (*Legal Expense*)**
* **Material salvage credits**
* **costs covered by Section II.1 (*Rentals and Royalties*)**
* **the value of injected substances purchased for secondary or tertiary recovery**
* **property taxes, ad valorem taxes and other taxes and assessments levied, assessed, and paid upon the mineral interest in and to the Joint Property**
* **payments to or receipts from third parties in settlement of claims**
* **production handling fees, infrastructure access fees, or operating and maintenance fees paid for production handling facilities not owned by the Joint Account**
* **deferred production payments paid by Operator on behalf of the Parties**
* **premiums for insurance acquired for the Joint Account, other than workers’ compensation and employer’s liability insurance**
* **costs in excess of $5,000,000 cumulative per well operation, paid to one or more marine well containment vendors to have equipment available on a stand-by basis in case of an incident**
* **guarantee deposits**
* **fines and penalties.**

The percentage overhead rates do not apply to these costs because the resulting overhead charges would be disproportionate to the Operator’s overhead costs incurred in connection with these activities.

Salvage credits refer to credits received for Material previously used in Joint Operations and charged to the Joint Account. Salvage credits are excluded because including them would effectively result in crediting overhead previously earned when the Material was originally charged. Credits for unused Material, whether returned to a supplier or transferred to another property or a warehouse, are not considered salvage credits.

The marine well exclusion applies to the cost paid to have marine containment equipment on standby, but only as to costs exceeding $5,000,000. The overhead rate applies only to the first $5,000,000, whether billed on one or more invoices. The exclusion does not apply to costs paid to the marine well containment provider to respond to an incident. Some operators may have more than one marine well containment vendor on standby, even though regulations may require them to have only one. Overhead would be assessed on the combined total of $5,000,000, rather than $5,000,000 per vendor. This exclusion applies to well containment standby costs specific to a well. The exclusion does not pertain to costs paid to an organization such as Marine Preservation or Clean Gulf Associates that benefit multiple properties. Refer to MFI-54, *Well Containment Service Providers*, for more information.

## 2. OVERHEAD—MAJOR CONSTRUCTION AND CATASTROPHE

**The Operator** **may charge an overhead fee to reimburse it for costs incurred in connection with a Major Construction project that costs more than the Operator’s expenditure limit under the Agreement, or for any Catastrophe regardless of the amount. If the Agreement does not contain an expenditure limit, Major Construction Overhead will be assessed for any single Major Construction project costing more than $100,000 gross.** **The overhead rates for Major Construction and Catastrophe projects are:**

1. **\_\_\_\_% of the first $100,000; plus**
2. **\_\_\_\_% of the next $900,000; plus**
3. **\_\_\_\_% of costs in excess of $1,000,000.**

Typically, the accounting procedure is attached to an operating agreement that contains an expenditure limit negotiated by the Parties. Refer to: Article VI.D.3 of the AAPL 610-1989, 1989H and 2015 Model Form Operating Agreements; Article 17.1.B of the RMMLF Form 2-1994 Unit Operating Agreement; Article 8.2 of the AAPL 710-2002 Model Form Offshore Operating Agreement. A Major Construction project qualifies for overhead if the total project costs exceed that expenditure limit. If this accounting procedure is attached to an Agreement that does not contain an expenditure limit a project qualifies for Major Construction overhead if the project costs exceed $100,000 gross. Examples of Agreements that might not have an expenditure limit would be a farmout with an override that escalates at payout or a net profits agreement.

Fixed asset projects costing less than the threshold are ineligible for Major Construction overhead. The overhead costs associated with those projects are considered reimbursed by the overhead rates in Section III.1.A (Fixed Rate Basis) or III.1.B (Percentage Basis), as applicable.

To determine if a project qualifies for Major Construction overhead, consider the total project cost to all parties. The size and scope of a project drives project costs, and in turn, the associated overhead costs incurred by Operator. Therefore, total gross project costs, before allocation and netting, determines whether the project warrants Major Construction overhead. Total gross cost means all costs exclusive of overhead charged to the project, reduced by the credits for refunds or returns, and includes all project costs even if those costs will be allocated to multiple wells under multiple Agreements.

**The rates apply to the total gross cost charged under Section II (*Direct Charges*), for each Major Construction or Catastrophe project. To calculate Major Construction Overhead, the components of a single Major Construction project must be aggregated, and the cost of drilling and downhole well operations and cost of purchasing and installing pumping units and downhole artificial lift equipment are excluded.**

A Major Construction (or Catastrophe) project may involve multiple properties subject to different Agreements. In that case the direct costs will be allocated to the properties. The overhead tranches are applied on an Agreement-by-Agreement basis, not a well or total project basis. For example, assume the Operator constructs a facility with total direct costs of $2,000,000, serving five wells, and each well is served equally. Four wells are under one Agreement and the fifth well has a separate Agreement. Of the $1,600,000 allocated to the first four wells, the first $100,000 will be charged overhead at the negotiated rate under (1) above, the next $900,000 will be charged overhead at the negotiated rate under (2) above, and the final $600,000 will be charged overhead at the negotiated rate under (3) above. The single well under a separate Agreement is allocated $400,000. If the Accounting Procedure covering that well has the same tranches, it will be charged overhead at the negotiated rate under (1) above on the first $100,000, and at the negotiated rate under (2) for the remaining $300,000.

Costs of purchasing and installing pumping units and downhole artificial lift equipment do not qualify for Major Construction overhead because they are routine installations that do not cause the Operator to incur significant incremental overhead costs. Also, installing gas lift involves downhole well work that might qualify for drilling overhead under III.1.A (Fixed Rate Basis), or it will have overhead under III.1.B, as applicable.

**For Catastrophes, the overhead rates apply to the total gross costs chargeable under Section II (*Direct Charges*), incurred in responding to and restoring the Joint Property and environment to the equivalent condition that existed prior to the Catastrophe****. The rates apply separately to each Catastrophe. For the purposes of calculating Catastrophe overhead, the cost of drilling relief wells, substitute wells, or conducting other well operations directly resulting from the Catastrophe are included.**

**Notwithstanding anything to the contrary in the foregoing, Major Construction and Catastrophe overhead rates do not apply to the following:**

* **legal fees covered by Section II.9 (*Legal Expense*)**
* **Material salvage credits**
* **payments to and receipts from third parties in settlement of claims**
* **premiums for insurance acquired for the Joint Account, other than workers’ compensation and employer’s liability insurance**
* **guarantee deposits**
* **fines and penalties.**

Chargeable costs to handle a Catastrophe could include costs incurred off the Joint Property – e.g., cleaning up a spill on adjacent lands – or costs to repair third-party property that was damaged as a result of the event. If a Catastrophe involves multiple properties subject to different Agreements, the direct costs might be allocated to the properties involved, depending on the nature of the event, and which properties are responsible for the cost. The overhead rates and tranches are applied on an Agreement-by-Agreement basis, not a well or total project basis.

When calculating Catastrophe overhead, Catastrophe costs should not be commingled with costs that qualify for another type of overhead. Catastrophe overhead only applies to the costs required to respond to the Catastrophe and to restore the Joint Property to an equivalent condition that existed prior to the event; the cost of any improvements must be treated separately because they do not qualify for Catastrophe Overhead. Also, the cost of handling the Catastrophe may need to be separately captured for insurance, legal, tax or other purposes.

The accountant may want to consult with Land, Legal or other business advisors to determine how to separate the costs which are part of the Catastrophe response from those that constitute a separate project (because they go beyond restoring the property to the condition that existed prior to the event). The Agreement typically gives the Operator authority to conduct operations and incur costs necessary to protect life, property, and the environment. Once the immediate emergency is handled, the agreement will guide the next steps and approval required, such as restoring to the same condition that existed prior the catastrophe, rebuilding with different specs, abandoning, or a combination of those. A separate AFE and separate approvals may be required for the improvement portion of the project.

The overhead rates do not apply to salvage or insurance recovery, if any, because that would result in Operator refunding overhead previously earned.

**Expenditures that qualify for Major Construction or Catastrophe Overhead do not qualify for overhead under any other overhead provisions.**

Major Construction overhead does not apply to the cost of drilling, completing, recompleting, reworking, or equipping a well through the wellhead, regardless of the dollar amount, because overhead costs associated with these types of operations are reimbursed under Section III.1. However, Major Construction overhead applies to fixed asset projects beyond the wellhead that meet the threshold. Other overhead rates may apply to other, ongoing operations that occur at the same time, but any given expenditure can only give rise to one category of overhead.

Refer to MFI-52, *Catastrophe-Related Costs*, for more information on this subject.

## 3. OVERHEAD – ENVIRONMENTAL PROJECT

**Operator shall either negotiate an overhead rate or charge the Joint Account the following rates, as reimbursement for overhead costs incurred by it in support of an Environmental Project** **that costs more than the Operator’s expenditure limit under the Agreement. If the Agreement does not contain an expenditure limit, Environmental Project overhead will be assessed for any single Environmental Project costing more than $100,000 gross.**

**The overhead rates for an Environmental Project are:**

1. **\_\_\_\_ % of the first $ 100,000; plus**
2. **\_\_\_\_ % of the next $ 900,000; plus**
3. **\_\_\_\_ % of costs exceeding $ 1,000,000.**

**Environmental Project overhead rates do not apply to the following:**

* **legal fees covered by Section II.9 (Legal Expense)**
* **Material salvage credits**
* **payments to and receipts from third parties in settlement of claims**
* **premiums for insurance acquired for the Joint Account, other than workers’ compensation and employer’s liability insurance**
* **guarantee deposits**
* **fines and penalties.**

This provision provides reimbursement for Environmental Project support costs not directly chargeable to the Joint Account under Section II. Examples of those support costs include regulatory work, legal costs not approved as direct charge, project management, accounting, administrative, reporting, land work, handling claims, and general management.

An Environmental Project may include costs incurred on the lease, adjacent properties, storage sites, labs, or in an office. If the project affects more than one property, the Operator is expected to make allocation information available to Non-Operators upon request.

If an Environmental Project involves multiple properties subject to different Agreements, the overhead rates and tranches are applied on a contract-by-contract basis, not based on the total Environmental Project costs. For example, if an Environmental Project involves two properties under separate Agreements and they benefit equally, allocate the project cost to each property, and then apply the rates and tranches under each property’s respective agreement to calculate overhead.

Consider whether the nature of the project naturally entails multiple properties – i.e., whether the amount allocated to a property is part of a single integrated project. For example, a water, seismicity, or sage grouse study naturally covers a large area that will benefit multiple properties. The overall project cost determines if the threshold has been met. If activities are specific to individual properties but bundled in one AFE for ease of managing the project, the cost specific to the property determines whether the threshold has been met. For example, if there is a new regulation that requires the operator to replace compressor gaskets for 300 compressors, the cost to each property is a separate project and should be used in determining if the threshold has been met.

When calculating Environmental Project overhead, do not include costs that qualify for another type of overhead. Refer to the definition of Environmental Project for more information.

The percentage overhead rates do not apply to costs excluded above because the resulting overhead charges would be disproportionate to the Operator’s overhead costs incurred in connection with these activities. Salvage credits refer to credits for Material previously charged to the Joint Account and used in Joint Operations. Salvage credits are excluded because including them would effectively result in crediting overhead previously earned when the Material was originally charged. Credits for unused Material, whether returned to a supplier or transferred to property or a warehouse, are not considered salvage credits.

## 4. AMENDMENT OF OVERHEAD RATES

**The overhead rates provided for in this Section III may be amended if, in practice, they are found to be insufficient or excessive, in accordance with Section I.6.B (*Amendments*).**

Factors such as corporate restructuring, change of Operator, regulatory changes, or technology changes may result in changes to the Operator’s cost of providing overhead services.

# IV. MATERIAL PURCHASES, TRANSFERS, AND DISPOSITIONS

**The Operator is responsible for Joint Account Material and shall make proper and timely charges and credits for direct purchases, transfers, and dispositions. The Operator shall provide all Material for use in the conduct of Joint Operations; however, Material may be supplied by the Non-Operators, at the Operator’s option. Material furnished by any Party shall be furnished without any express, implied, or statutory warranties. The Operator shall maintain documentation to support charges and credits for Materials.**

The timely purchase, transfer and disposition of Material depends on factors such as lead time, specialized designs, operational considerations (frequency of repair, replacement), and market conditions.

Refer to COPAS MFI-38, *Materials Manual*, for more information.

## 1. DIRECT PURCHASES

**Direct purchases shall be charged to the Joint Account at the price paid by the Operator after deduction of all discounts taken. The Operator shall make good faith efforts to take discounts offered by suppliers, but will not be liable for failure to take discounts except to the extent such failure was the result of the Operator’s gross negligence or willful misconduct. A direct purchase is deemed to occur when an agreement is made between an Operator and a third party to acquire Material specifically for Joint Operations. Material provided by the Operator under vendor stocking programs, where the initial use is for Joint Operations and ownership of the Material does not pass from the manufacturer, distributor, or agent until usage, is considered a direct purchase. If Material is found to be defective or is returned to the manufacturer, distributor, or agent for any other reason, credit shall be passed to the Joint Account within 60 days after the Operator has received adjustment from the manufacturer, distributor, or agent.**

For direct purchases, the amount the Operator paid for material and the amount billed to the Joint Account will be the same. Returns follow the same principle; the amount received by the Operator for a material return is the same as the amount shared with the Joint Account.

Refer to COPAS MFI-23, *Discounts*, for more information.

## 2. TRANSFERS

**A transfer is determined to occur when the Operator (i) furnishes Material from a storage facility or from another operated property, (ii) has assumed liability for the storage costs and changes in value, and (iii) has ownership of the transferred Material. Similarly, the removal of Material from the Joint Operations site to a storage facility or to another operated property is also considered a transfer; provided, however, Material that is moved from the Joint Operations site to a storage location for safe-keeping pending disposition may remain charged to the Joint Account and is not considered a transfer. Material shall be disposed of in accordance with Section IV.3 (*Disposition of Surplus*) and the Agreement.**

A physical movement of Material does not necessarily constitute a transfer under this provision. A physical transfer for convenience, maintenance, or safekeeping which does not meet criteria (i), (ii), and (iii) does not constitute a transfer for the purposes of this provision.

**A. PRICING**

**The pricing of Material transferred should generally reflect the market value on the date of transfer. When higher than specification grade or size Material is used in Joint Operations, the Operator shall charge the Joint Account at the equivalent price for well design specification Material, unless such higher specification grade or sized Material is approved by the Parties pursuant to Section I.6.A (*General Matters*). Transfers of Material will be priced using one of the following pricing methods for new Material; provided, however, the Operator shall use consistent pricing methods, and not alternate between methods for the purpose of choosing the method most favorable to the Operator for a specific transfer:**

1. **prices published in COPAS’ Computerized Equipment Pricing System (CEPS), including the transportation cost from manufacturer to rail point as defined in Section IV.2.B (Freight);**
2. **a price paid by the Operator in the 12-month period prior to the transfer for like Material in the vicinity of the Joint Operations site;**
3. **a price quote from a vendor that reflects a current realistic acquisition cost;**
4. **the weighted average price paid by Operator for such Material purchased in the vicinity of the Joint Operations site; or**
5. **a price agreed to, pursuant to Section I.6.A (*General Matters*).**

The reference to charging according to well design specifications means the grade of Materials needed for the operation, which could differ from the Material listed in the AFE. The Operator may get data as it conducts an operation or from an offset well that could change the design after the AFE was issued. The intent of this provision to keep Operator from charging the Joint Account for Materials that are above specifications to use surplus materials.

Pricing should reflect the market value of the Material on the transfer date, which is when the criteria in Section IV.2.(i), (ii), and (iii) are met. This does not mean the date the transfer is valued by the Operator’s accounting department or the date of physical movement from the joint property to a yard if criteria in Section IV.2.(i), (ii), and (iii) are not met.

Any of the pricing methods listed above are acceptable forms of pricing Material transferred to and from the Joint Property rather than being directly purchased for the Joint Property. However, the Operator should not pick and choose the method that is favorable to each specific transfer. It is acceptable for the Operator to use one or more of the pricing methods, and it is not possible to use the same pricing method for every type of commodity as the data are not always available. For example, casing which has an API connection, and a standard weight and grade may be priced utilizing CEPS while casing with a premium connection and a proprietary grade may be more appropriately priced utilizing a recent purchase price. Regardless of method used, Operator must be able to support its pricing method.

The Operator must maintain auditable documentation to support the pricing and to provide Non-Operators upon request.

An invoice from a non-affiliated vendor would be appropriate documentation to support the price under the second option. It is appropriate to use the most recent price paid by the Operator, rather than selecting the highest or the lowest price paid during the period.

To support pricing based on quotes, the Operator should provide all pertinent information to the Non-Operators, such as name of the vendor, vendor’s representative providing the quote, date of the quote, and other relevant information to substantiate the pricing.

To support weighted average pricing option, the Operator should provide to Non-Operators an account of the weighted average price calculation. Such account should include history of purchases and transfers including quantities, values, and dates by invoice and/or by transfer. There can be significant variations in historical weighted averages due to market changes or if the material does not move often. Although the weighted average calculation may be technically correct, if it is not a reasonable reflection of current market conditions and a realistic transfer value, the Operator should use an alternative pricing method. A Non-Operator may take exception to weighted average pricing if it includes anomalies that result in pricing significantly outside of the market value.

**B. FREIGHT**

**The Operator shall charge the Joint Account for freight costs as follows:**

**(1) for oil country tubular goods (OCTG) and line pipe,**

* + **actual freight costs paid by the Operator to a third party to move the OCTG or line pipe from the manufacturer to the shore base, warehouse or fabrication yard or other operations site; or**
  + **freight rates provided by CEPS, which includes loading and unloading costs, for moving the OCTG or line pipe, as applicable, from the manufacturer to the rail point nearest the Joint Operations site; or**
  + **for freight provided by Operator or its Affiliate, the freight costs determined in accordance with Section II.6 (*Equipment and Facilities Furnished by Operator*) or Section II.7 (*Affiliates*), as applicable.**

**(2) for Material other than OCTG and line pipe,**

* + **actual freight costs paid by the Operator to a third party to move the Material; or**
  + **for freight provided by Operator or its Affiliate, the freight costs determined in accordance with Section II.6 (*Equipment and Facilities Furnished by Operator*) or Section II.7 (*Affiliates*), as applicable.**

1. **Other Freight Provisions**
   * **Regardless of whether using CEPS or manually calculating transportation costs, transportation costs from the rail point or staging area nearest to the Joint Operations site to the Joint Operations site are in addition to the foregoing, and directly chargeable to the Joint Account**
   * **Notwithstanding the foregoing, if the actual freight charges associated with redeployment of Operator’s surplus (i) from another property to the Joint Operations site or (ii) between the warehouse and the Joint Operations site exceeds the excluded amount most recently published by COPAS, the charge to the Joint Account may not exceed the cost of moving such surplus between the nearest stocking point and the Joint Operations site. Accessorial charges such as loading and unloading costs, split pick-up costs, detention, call-out charges and permit fees are excluded when determining whether the actual freight costs exceed the excluded amount published by COPAS.** **If COPAS ceases or fails to publish an excluded amount, the excluded amount will be the amount last published by COPAS, adjusted annually by the same factor used to adjust overhead rates under Section III.1.A.(4).**

**Transportation of Material between the Joint Operations site and another property, or from the Operator’s warehouse or other storage point to the Joint Operations site, shall be charged to the receiving property. Transportation of Material from the Joint Operations site to a warehouse or other storage point shall be charged to the sending Joint Account.**

Although not always, there are often two components of freight costs. The components are often called “legs.” One leg is from the manufacturer, mill, or distributor to a centralized or local staging area. Under CEPS pricing, this leg is from the manufacturer, mill, or distributor to a theoretical staging area, sometimes referred to as “rail point.” The second leg is from the staging area or rail point to the Joint Property. Both legs are chargeable to the Joint Account. The first leg of freight is an integral part of the cost of the Material.

The Operator might transfer Material a long distance – e.g., from Permian Basin to North Dakota – to use surplus.  The transfer could result in freight charges that are much higher than the freight that would have been charged had the Material been sourced from a supply store near the receiving location.  Therefore, instead of charging actual freight costs to the receiving location, the last paragraph of (3) requires freight charges be equalized if the actual freight costs exceed the excluded amount published by COPAS.  For example, if the actual freight cost is $2500, and the excluded amount published by COPAS is $2000, the freight charged to the receiving property is limited to an amount that it would have paid if the Material had been sourced from the nearest supply store to the receiving property.  If the actual freight is less than the excluded amount, the Operator may charge actual freight, even if there is a closer supply point.

**C. TAXES**

**Sales and use taxes shall be added to the Material transfer price using either the method contained in CEPS or the applicable tax rate in effect for the Joint Property at the time and place of transfer. In either case, the Joint Account will be charged or credited at the rate that would have applied had the Material been a direct purchase.**

Refer to COPAS MFI-38, *Materials Manual*, for more information.

**D. CONDITION**

**(1) Condition A – New and unused Material in sound and serviceable condition will be valued at 100% of the price determined in Section IV.2.A (*Pricing*), plus freight and taxes as provided in** Sections **IV.2.B (*Freight*) and IV.2.C (*Taxes*). All refurbishing costs required to repair damages will be borne by the divesting property.**

This provision applies to valuation of new and unused Material transferred to or from the Joint Account. Even if the Material was not used, it may have changed in value if a long time has elapsed, or markets are volatile. Repricing it ensures the Joint Account shares in any gain or loss, rather than the Operator enjoying all the gain or bearing the entire loss. Unused Material can sometimes need repairs due to damage incurred in handling, or deterioration from weather.

**(2) Condition B – Used Material in sound and serviceable condition and suitable for reuse without reconditioning will be valued by multiplying the price determined in Section IV.2.A (*Pricing*) by 75%, plus freight and taxes as provided in Sections IV.2.B (*Freight*), and IV.2.C (*Taxes*). Notwithstanding the foregoing, Material that was charged to the Joint Account as used Material and placed in service for Joint Operations, will be credited at the price determined in Section IV.2.A (*Pricing*) multiplied by 65%, plus freight and taxes as provided in Sections IV.2.B (*Freight*) and IV.2.C (*Taxes*).**

**Except as provided in Section IV.2.D.(3), all reconditioning costs required to return the Material to Condition B or to repair damages will be borne by the divesting property.**

This provision applies to transfers of Condition B Material to or from the Joint Account. Even if the Material was not used, it may have changed in value if a long time has elapsed, or markets are volatile. Repricing it ensures the Joint Account shares in any gain or loss, rather than the Operator enjoying all the gain or bearing the entire loss.

**(3) Condition C – Material that is not in sound and serviceable condition and not suitable for its original function until after reconditioning will be valued by multiplying the price determined in Sections IV.2.A (*Pricing*) by 50%, plus freight and taxes as provided in Sections IV.2.B (*Freight*) and IV.2.C (*Taxes*).**

**The cost of reconditioning may be charged to the receiving property to the extent Condition C value, plus cost of reconditioning, does not exceed Condition B value.**

Reconditioning restores Material so that it is suitable for its original function. The Operator has the choice of charging the reconditioning cost to the receiving property and transferring the Material at Condition C value. However, the amount charged to the receiving property for the Material plus the reconditioning cost may not exceed Condition B value. Alternatively, the Operator may charge the reconditioning cost to the divesting property, in which case the Material is transferred at Condition B value.

1. **Condition D – Material that is obsolete or no longer suitable for its original purpose but useable for some other purpose shall be charged or credited at a price commensurate with its intended use.**

As an example, casing, tubing, or drill pipe used as line pipe would be classified as Condition D and priced as low-pressure line pipe.

**(5) Condition E – Junk shall be priced at prevailing scrap value prices.**

Prevailing scrap price could be a price paid by third party for the scrap, or an index price if Operator wants to credit the Joint Account before actual disposal.

**E. OTHER PRICING PROVISIONS**

**(1) Preparation Costs**

**Subject to Section II (*Direct Charges*) and Section III (*Overhead*) of this Accounting Procedure, costs incurred by the Operator in making Material serviceable including inspection, third-party surveillance services, and other services will be charged to the Joint Account at prices which reflect the Operator’s actual costs of the services. New coating or wrapping are considered a component of the Material and priced in accordance with Sections IV.1 (*Direct Purchases*) or IV.2.A (*Pricing*), as applicable. No charges or credits may be made for used coating or wrapping. Preparation costs incurred will not be credited for Material transferred from the Joint Account unless those services permanently alter the Material and provide full value to any future receiving property.**

“Costs incurred" are actual costs as determined under Section II, less any discounts received in preparing Material for use by the Joint Account and may include costs incurred for the Material while in the Operator’s inventory. Documentation must be provided upon request to support charges or credits to the Joint Account including the method of allocating such charges or credits.

Common preparation services include coating and wrapping, inspection and surveillance costs. Examples of third-party surveillance costs include visual, drift and blue light inspections.

Coating and wrapping are included in the original price because the pipe is commingled, and it is difficult to match invoices with specific joints of pipe. Coating and wrapping costs may be included in the transfer price if the pipe was not used or re-coated prior to transfer. If the specs for the receiving well require coated and wrapped pipe, the Operator normally recoats the pipe because there is no way to tell if the original coating and wrapping is still good after the pipe has been used. If the well specs do not require coating and wrapping, the used coating and wrapping has no value to the receiving well.

Applying "dope” to pipe ends or performing inspections do not permanently alter the pipe and must be repeated. These costs are not included in the transfer price.

**(2) Loading and Unloading Costs**

**Actual costs incurred in loading and unloading related to the movement of the Material to the Joint Property in accordance with Section II; provided however, Operator may charge the rates published by COPAS for loading or unloading tubular goods when Operator uses its own equipment and employees.** **If COPAS ceases or fails to publish rates for loading and unloading tubular goods, the rate will be the rate last published by COPAS, adjusted annually by the same factor used to adjust overhead rates under Section III.1.A.(4).**

Loading and unloading, much like freight, may be incurred in different segments of the Material movement. Refer to the explanation above, regarding IV.2.B, Freight. Both portions of loading and unloading are chargeable to the Joint Account.

“Actual costs” refers to direct costs chargeable under Section II; it does not include the cost of overhead functions.

## 3. DISPOSITION OF SURPLUS

**Surplus Material is that Material, whether new or used, that is no longer required for Joint Operations. The Operator may purchase, but is not required to purchase, the interest of the Non-Operators in surplus Material.**

Surplus Material does not include spare material kept on hand for normal repair and maintenance operations or critical spares. Critical spares are items owned by the joint account and generally kept for long periods of time because replacements are not readily available, and lack of the item would have a major impact on operations. There is no specific listing of what constitutes critical spares. Critical spares vary due to the location and types of operations being conducted.

**A disposition is the relinquishment of ownership of the Material from the Joint Account to either a third party, a Non-Operator, or to the Operator. The Operator should make good faith efforts to dispose of surplus Material within 12 months.**

The Operator should dispose of surplus material in a timely fashion; however, it may not have any use for the material in other operations and may be unable to dispose of it due to market conditions. There is no penalty if the surplus is not disposed of within 12 months.

**Disposal of surplus Materials shall be made in accordance with the terms of the Agreement. If the Agreement contains no provisions governing disposal of surplus Material, this provision will apply.**

**Operator may dispose of Material without notice or approval of the Parties if disposed of under one of the following methods:**

1. **Material that was charged to the Joint Account through a direct purchase is returned to the vendor;**
2. **Condition A, B, or C Material is purchased by Operator or its Affiliate based on the pricing methods set forth in Section IV.2 (Transfers);**
3. **Condition D or E Material is sold to a third party that is not an Affiliate of Operator, under procedures normally utilized by Operator;**
4. **Sale other than those under (i) or (iii), to a third party that is not an Affiliate of Operator, and the market value is less than or equal to the expenditure limit in the Agreement, or $100,000 if the Agreement does not have an expenditure limit; or**
5. **Material in any condition that is sold at or above market value.**

The provision establishes when the Operator needs approval to dispose of surplus material, striking a balance between the Operator’s and Non-Operators’ needs. The authority granted the Operator allows it to act expeditiously and decisively when it identifies a buyer. The limit on that authority helps to minimize risk to Non-Operators and make sure they get a fair price.

Item (iv) refers to the single expenditure limit commonly found in operating agreements, e.g., Article VI.D of the AAPL 610-1989, 1989H and 2015 Model Form Operating Agreements. An example of an agreement that might not have an expenditure limit is a farmout agreement or net profits interest agreement.

Item (v) refers to market value. Generally, a sale under an arm’s-length transaction (i.e., to an unaffiliated party), is considered an acceptable market value. However, bid sheets or invoices can help to support the transaction. Examples documents an Operator may use to support that the price received represents more than market value include:

* Bids (pumping units)
* Buy-back agreements (casing and wellheads)
* Salvage credits given by a company to offset P&A costs it charges Operator

For purposes of administering (v), for casing and tubing one should consider the entire transaction, rather than the price of individual joints. For example, the sale of pup joints will not get as high a price as full joints. General market conditions – such as oil prices, rig activity, steel tariffs – can also influence the value of equipment.

Regardless of whether the Operator had authority to dispose of material, a Non-Operator may take exception to a disposition if it believes the Operator did not properly account for it. At the same time, if the Operator failed to get approval when it should have, that does not necessarily mean the Non-Operator has been harmed.

**All other dispositions require approval of Parties owning the Material (“Owners”) pursuant to Section I.6.A (*General Matters*). If approval is required, Operator shall give written notice to the Owners of the proposed disposition, with sufficient price, material specifications, and condition to make an informed decision. The Owners have 48 hours, exclusive of Saturdays, Sundays and federal holidays, after receipt of notice to respond. Failure to respond within the specified time is deemed approval of the proposed disposition.**

The Agreement may have a provision for general voting matters, specifying the response period, and default vote if a Party does not respond on time. The Agreement usually prevails over the accounting procedure.

Having a deadline and deemed approval for failure to respond facilitates timely disposition of surplus when the Operator finds a willing buyer.

**Operator shall credit the Joint Account for net proceeds received from the buyer. Costs incurred by Operator in disposing of the Materials that are not considered overhead under Section III, will be borne by the Owners. Operator shall make good faith efforts to credit the Joint Account for proceeds from the disposal of surplus Material within 60 days after (i) sale to Operator or its Affiliate, or (ii) payment is received from an unaffiliated third party for the Material, as applicable.**

Examples of costs incurred in disposing of materials include transportation to haul the Material, or labor to remove the equipment.

The reason for the 60-day period to credit the Joint Account is because Materials are often sold in bulk, making it time-consuming to book the entries to all the affected accounts.

## 4. SPECIAL PRICING PROVISIONS

**A. SHOP-MADE ITEMS**

**Items fabricated by the Operator’s employees, or by contract laborers under the direction of the Operator, shall be priced using the value of the Material used to construct the item plus the cost of labor to fabricate the item. Material from the Operator’s scrap or junk account will be valued at either 25% of the current price as determined in Section IV.2.A (*Pricing*) or scrap value, whichever is higher. In no event shall the amount charged exceed the value of the item commensurate with its use.**

If comparable items are commercially available and functionally equivalent, the Operator should charge the lesser of market price or material value plus fabrication cost. Examples of shop-made items are fences or cattle guards constructed from pipe or sucker rods.

**B. MILL REJECTS**

**Mill rejects purchased as limited-service casing or tubing will be priced at the price paid, if a direct purchase for the Joint Account, or at current market value commensurate with its use in the case of a transfer in accordance with Section IV.2 (*Transfers*).**

An example of this is P-110 tubing that has use for J-55 application. The tubing would be valued as J-55.

# V. INVENTORIES OF CONTROLLABLE MATERIAL

**The Operator shall maintain records of Controllable Material charged to the Joint Account, with sufficient detail to perform physical inventories.**

Operator is not required to maintain detailed records to conduct physical inventories of non-controllable material.

**Adjustments to the Joint Account by the Operator resulting from a physical inventory of Controllable Material shall be made within 12 months following the taking of the inventory or receipt of Non-Operator inventory report, or within the time prescribed for adjustments under Section I.4 (*Adjustments*), whichever is later. Charges and credits for overages or shortages will be valued for the Joint Account in accordance with Section IV.2 (*Transfers*) using Condition B prices in effect on the date of physical inventory unless the Operator or inventorying Parties can provide sufficient evidence another Material condition applies.**

As of this publication date, standards on the classification of Material as either Controllable or non-controllable are found in COPAS MFI-38, *Materials Manual*. The deadline ensures a timely conclusion to any inventory. The Parties may want to extend it in some circumstances, such as a large inventory scope. The Operator or inventorying Parties must provide records, upon request, to support the price and condition for any adjustment.

## 1. DIRECTED INVENTORIES

**Operator shall perform physical inventories upon written request of a majority in working interests of the Non-Operators (hereinafter, “directed inventory”); provided, however, Non-Operators cannot require Operator to perform directed inventories more frequently than once every five years. Operator shall commence directed inventories within 180 days after receiving written notice that a majority in interest of the Non-Operators has requested the inventory. All Parties shall be governed by the results of any directed inventory.**

**Expenses of directed inventories will be borne by the Joint Account; provided, however, costs associated with any post-report follow-up work in settling the inventory will be absorbed by the Party incurring such costs. Expenses of directed inventories may include the following:**

1. **A per diem rate, representative of actual salaries, wages and Payroll Burden and Benefits of the persons performing the inventory, or a rate agreed to by the Parties pursuant to Section I.6.A (*General Matters*). The per diem rate will also be applied to a reasonable number of days for pre-inventory work and report preparation.**
2. **Reasonable Personal Expenses for the inventory team.**

If a Non-Operator directs the Operator to conduct an inventory, all costs from the initiation of the inventory up to the time when the completed report is sent to the working interest owners are directly chargeable to the Joint Account. Once the report is issued, costs such as verifying or negotiating values and making the accounting entries are borne by the Party incurring the costs.

## 2. NON-DIRECTED INVENTORIES

**A. OPERATOR INVENTORIES**

**The Operator may conduct physical inventories not required by Non-Operators or a government entity, at its discretion. The expenses of conducting such Operator-initiated inventories may not be charged to the Joint Account.**

**B. NON-OPERATOR INVENTORIES**

**Subject to the terms of the Agreement, a Non-Operator may conduct a physical inventory at reasonable times at its sole cost and risk after giving the Operator at least 90 days’ prior written notice. The Non-Operator shall furnish the Operator its written report within 90 days of completing the inventory field work.**

The Agreement may have restrictions on the Non-Operator’s access to the Joint Property, such as non-consent situations and default remedies.

If the Non-Operator finds any discrepancies, it should submit its findings to the Operator in a timely manner. The Operator should respond to the Non-Operator findings by making appropriate charges or credits to the Joint Account or providing adequate documentation to reconcile the discrepancies.

**C. SPECIAL INVENTORIES**

**The expense of conducting inventories other than those described in Sections V.1 (*Directed Inventories*), V.2.A (*Operator Inventories*), or V.2.B (*Non-Operator Inventories*), shall be borne by the Party requesting such inventory; provided, however, inventories required due to a change of Operator or that are required by a government authority shall be charged to the Joint Account in the same manner as described in Section V.1 (*Directed Inventories*).**

The cost of conducting an inventory as a result of a Non-Operator selling its interest will be borne by the requesting Party or Parties.

The last phrase applies if government authority requires the Operator to conduct a new physical inventory. It does not apply to cost incurred by Operator to provide schematics or inventory records to a governmental authority that requests it.