

ONRR Year in Review Fiscal Year 2012 in Review

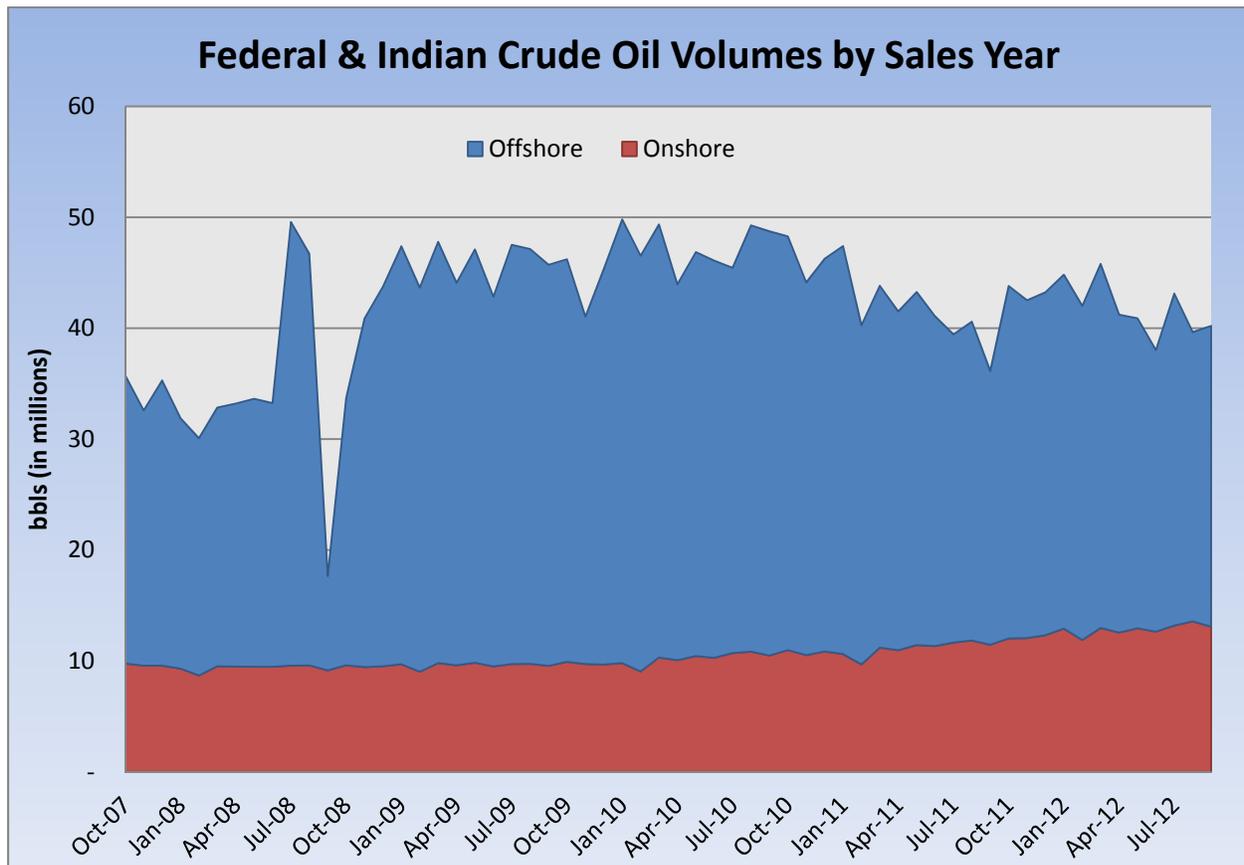
Overview:

Fiscal Year (FY) 2012, October 2011 through September 2012, saw a relatively stable year for the domestic oil and gas commodities markets. Factors that normally drive commodity instability such as economic changes, supply and demand fluctuations, volatility in the financial markets, and localized weather events were generally not present during FY 2012.

Crude oil prices saw their precipitous climb from the lows in 2009 begin to find some consistency. The average New York Mercantile Exchange (NYMEX) West Texas Intermediate (WTI) price for FY 2012 was \$95.67 which was only 3 percent higher than FY 2011's average of \$92.90. This slight increase reflected some stabilization in the markets as price increases of 35 percent and 20 percent were seen in FY 2010 and FY 2011, respectively. In FY 2012, NYMEX prices ranged from a low of \$82.41 to a high of \$106.20. In FY 2012, offshore crude continued to trade at significant premiums reaching as high as \$23.80 above the WTI price as a result of limited takeaway capacity at the Cushing, Oklahoma storage facility. However, offshore crude traded comparatively to Dated Brent with Light Louisiana Sweet (LLS) prices trading on average around \$2 below the international benchmark. Federal offshore oil volumes continued to decline, though of the 7 percent decline in FY 2012 was less than previous years. Federal and Indian onshore oil volumes continued to rise in FY 2012 as massive production increases in North Dakota's Williston Basin and New Mexico's Permian Basin spurred a 15 percent increase in onshore production. Overall, Federal and Indian oil volumes subject to royalty payments were down 1 percent. This slight decrease marked a curtailment in declines from 8 percent the previous fiscal year as a large increase in onshore production was able to lessen the overall impact of declining offshore production.

Natural gas prices declined significantly in FY 2012 with the average NYMEX price at Henry Hub at \$2.86 per MMBtu, a decrease of 30 percent from the FY 2011 average of \$4.10 per MMBtu. The price decline seen at the end of FY 2011 continued into FY 2012 until hitting a 10 year low in April. A very mild winter along with a continued increase in supply from onshore shale formations and associated gas production from onshore oily shale plays were the main factors that drove the decrease in prices. Federal and Indian gas volumes subject to royalty payments declined by about 6 percent in FY 2012 as onshore volumes held relatively steady and the Gulf of Mexico (GOM) continued its long-term decline.

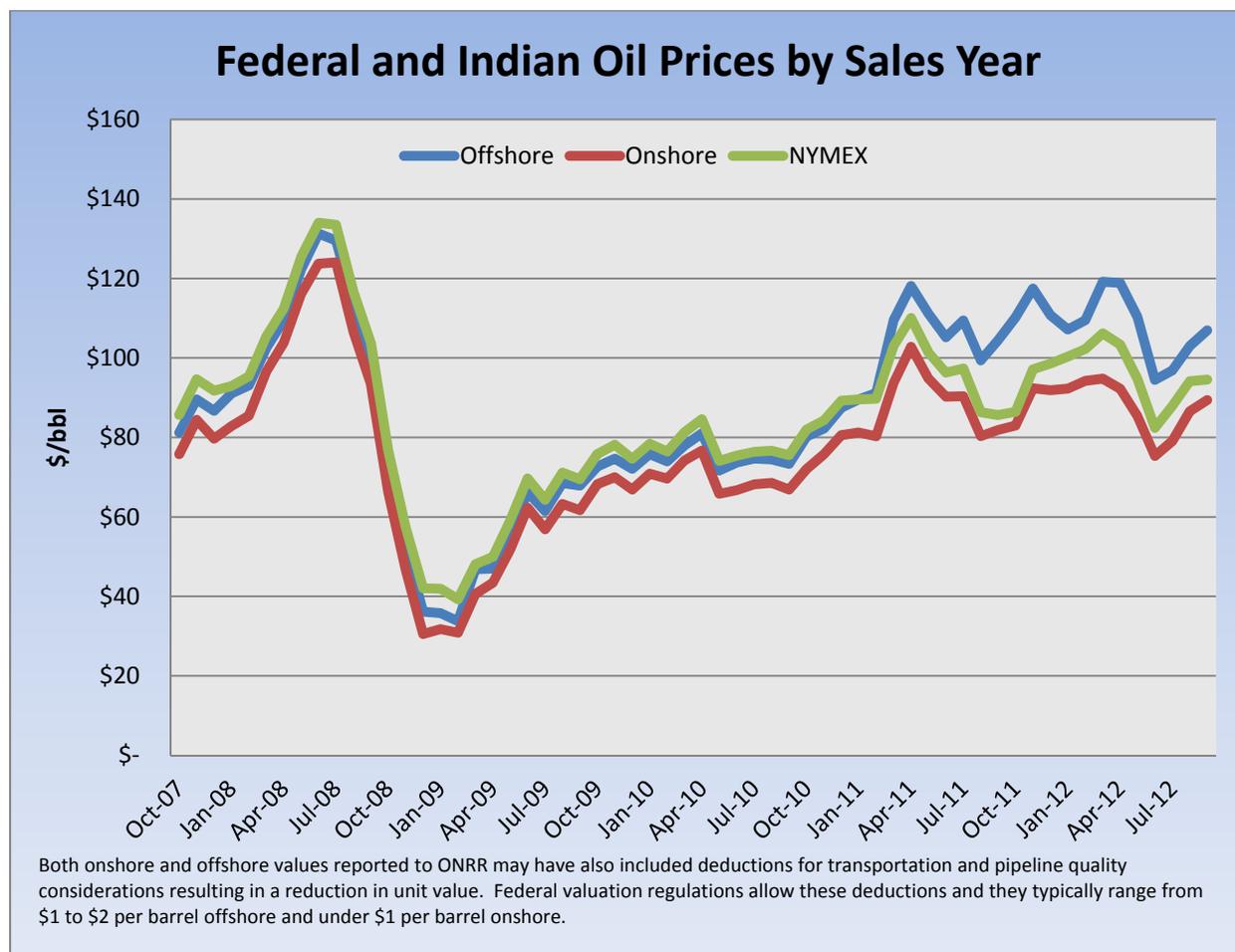
Federal and Indian Oil Volume Observations:



Federal and Indian onshore crude oil production increased by 15 percent in FY 2012 compared to FY 2011. Despite declining production from fields in Wyoming and Montana, North Dakota's Bakken Field continued to provide impressive amounts of production. North Dakota followed up a 50 percent FY 2011 production increase with a 66 percent increase in FY 2012. In total, the volumes subject to Federal and Indian royalties in North Dakota totaled 31 million barrels. In addition, production subject to Federal and Indian royalties in New Mexico increased by 20 percent driven by growth in the Permian basin. These production gains were the result of advances in completion technology and efficiency that allowed producers to extract oil from both new and existing shale formations.

Offshore crude oil volumes continued their production declines. From FY 2011 to FY 2012, production fell by 7 percent. Over the previous three fiscal years, GOM oil production has fallen 19 percent. These declines are indicative of declining available reserves as well as delays in new projects coming online. There were no significant supply disruptions in FY 2012; however, Hurricane Isaac and Tropical Storm Debby did require production shut-ins and rig evacuations in the GOM.

Prices Reported to ONRR for Federal and Indian Crude Oil Observations:

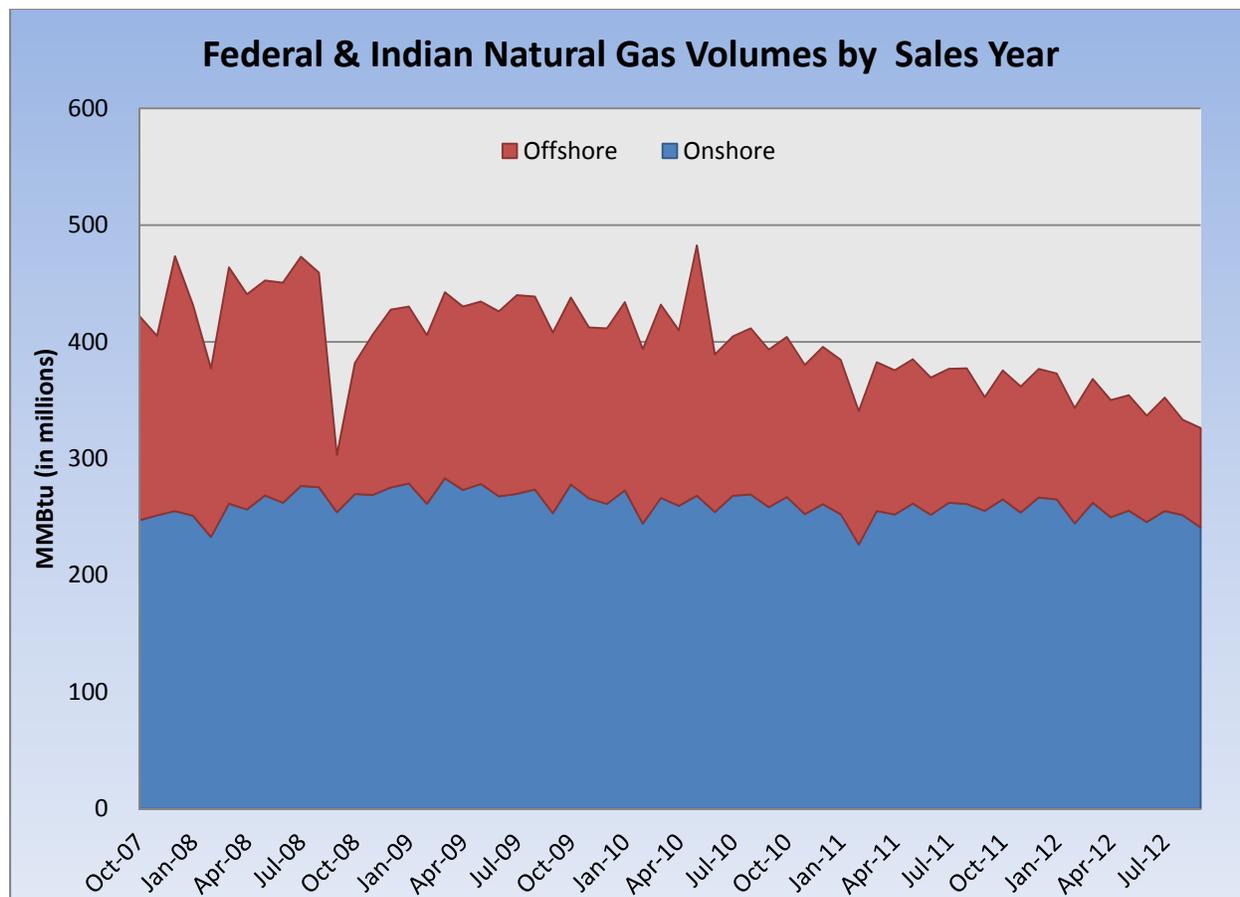


Oil prices in FY 2012 managed to avoid any extreme fluctuations and remained fairly consistent within a \$25 range. Prices peaked in February 2012 and saw their lowest points in June 2012. Overall, the NYMEX saw a \$2.77 per barrel increase on average from FY 2011. Offshore crude continued its premium to NYMEX in FY 2012. Where FY 2011 premiums averaged \$6 per barrel, FY 2012 premiums doubled that figure at \$13 per barrel. As was the case in FY 2011, takeaway constraints in the U.S. Mid-Continent at Cushing, Oklahoma depressed NYMEX WTI prices in comparison to offshore crude prices. While WTI remained stranded, GOM crude types competed directly with foreign crude imports and were priced similarly to those crudes.

Onshore discounts to the NYMEX WTI in FY 2012 remained almost identical to discounts seen in FY 2011 with an increase of just 6 cents per barrel. Bakken crude suffered the same takeaway issues as WTI as its production increased significantly. As North Dakota is a young energy market, limited pipeline and emerging railway takeaway capacity made it difficult for infrastructure to keep up with

production. At the same time, the May 2012 Seaway Pipeline reversal kick began to alleviate the Cushing stockpiles and thus, the downward pressure on WTI prices.

Federal and Indian Natural Gas Volume Observations:



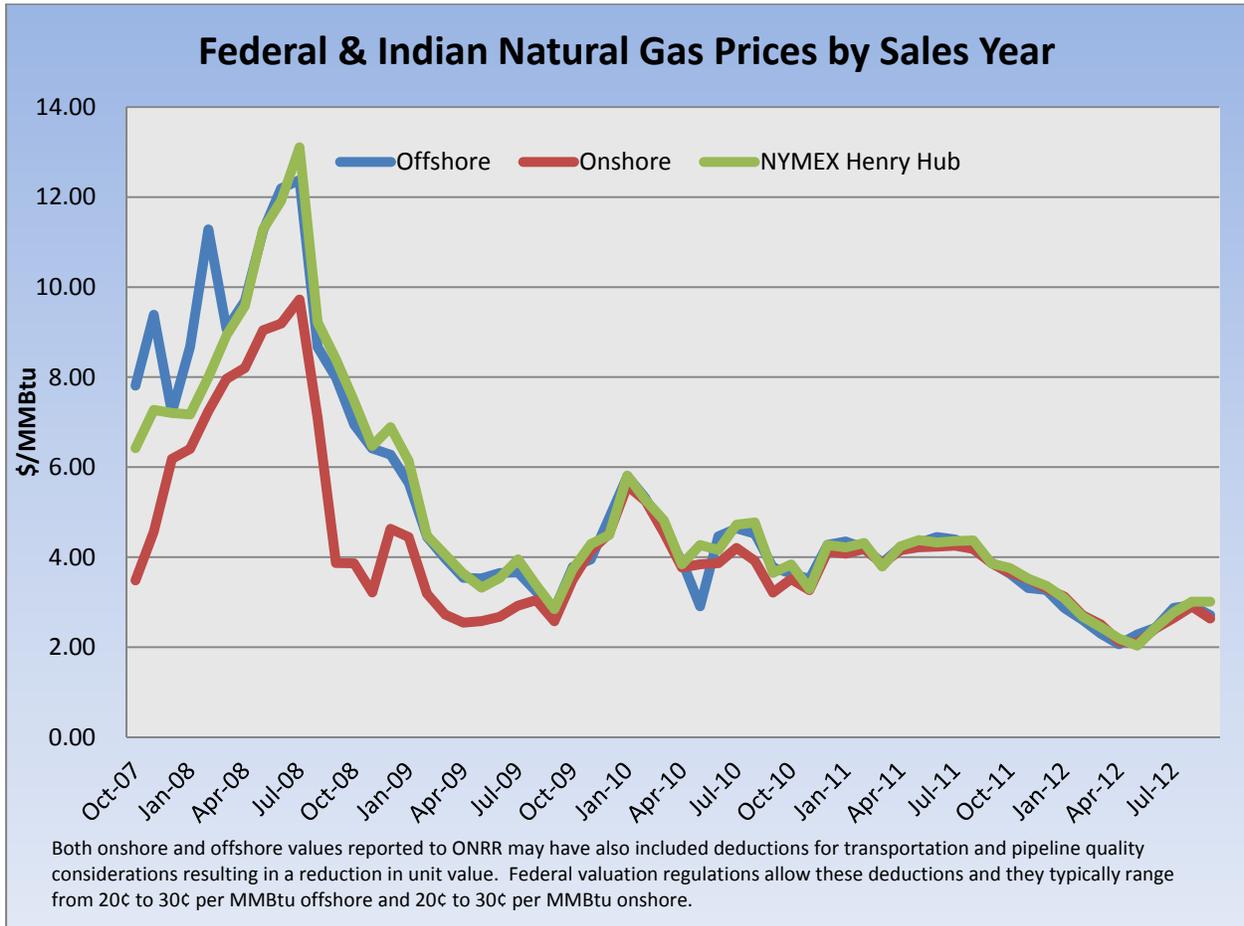
Federal and Indian gas production subject to royalty payments continued to steadily decline in FY 2012 with volumes down an average of about 6 percent from FY 2011. Storm activity during FY 2012 was light. However Hurricane Isaac and Tropical Storm Debby did require production shut-ins and rig evacuations in the GOM.

FY 2012 GOM gas volumes declined by over 18 percent from FY 2011. Combined with the declines seen in FY 2011, GOM production has declined over 30 percent in the previous two fiscal years and 42 percent since FY 2008. The same factors influencing the GOM oil decline contributed to the gas decline, although the continued weakness in natural gas prices also played a role.

Onshore gas production remained steady in FY 2012 despite a continued boom in shale resources. Weak natural gas prices relative to liquids continued into FY 2012 driving producers to target liquids-rich oily plays. Most of these liquids-rich plays are in areas with little or no Federal

production. Lower demand also buoyed supplies in storage as much of the country experienced a very mild winter in FY 2012.

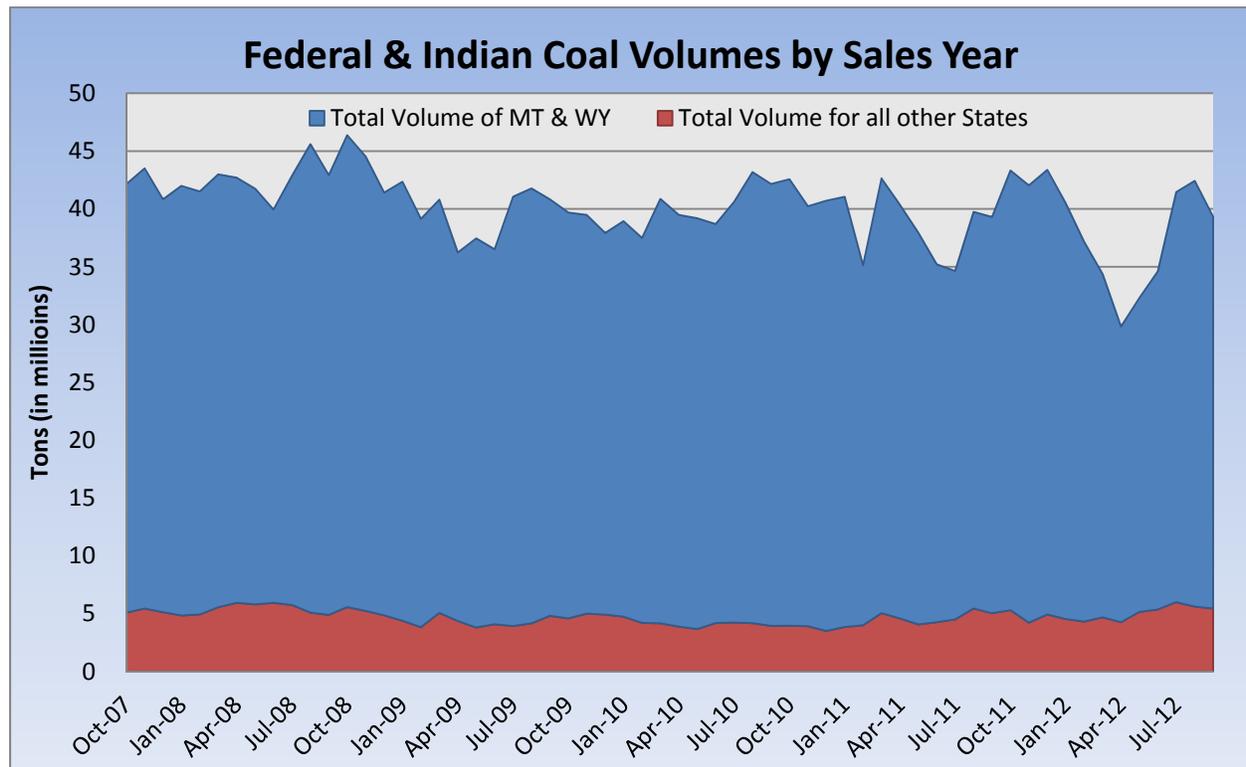
Prices Reported to ONRR for Federal and Indian Natural Gas by Production Year
Observations:



Natural gas prices slid in FY 2012, with the average NYMEX value declining 30 percent from FY 2011 reflecting strength in supply from unconventional shale resources in the Mid-Continent and Northeast and an unseasonably warm winter. The FY 2012 heating degree days were up 18 percent from FY 2011 leading to decreased demand for natural gas which further drove down prices.

Offshore and onshore prices reported to ONRR have closely followed the average NYMEX Henry Hub value with some slight variance due to differences in local price indices and allowances for transportation and processing costs. Increased production from shale gas production plays has led to a continuing convergence of the onshore and offshore gas prices. Gas produced in the GOM has been displaced from historic outlets in the consuming Northeast causing a decrease in GOM prices which has led to the FY2012 GOM price being slightly lower than the average onshore royalty price for the first time since we've compiled this report.

Federal and Indian Coal Volume Observations:



Federal and Indian coal production for FY 2012 fell by 1.9%. This drop in Federal and Indian production can largely be attributed to a decrease in PRB mine production. PRB production fell nearly 4% (16.4 million tons) in FY 2012. All other Federal and Indian coal production increased by 14.6%. Overall, Federal and Indian coal production fell by 8.79 million tons.

An increase in the natural gas price from FY 2011 to FY 2012 was not enough to stop the overall decrease in U.S. coal production. A higher natural gas price in FY 2012 was beneficial to PRB coal producers operating with slim profit margins. During a coal industry roundtable held in December 2012 in Gillette, Wyoming, PRB mine representatives from Arch Coal, Peabody Energy, and Cloud Peak Resources agreed that for PRB coal to stay competitive in the U.S. energy market, the natural gas price must be above \$3.00/MMBtu.

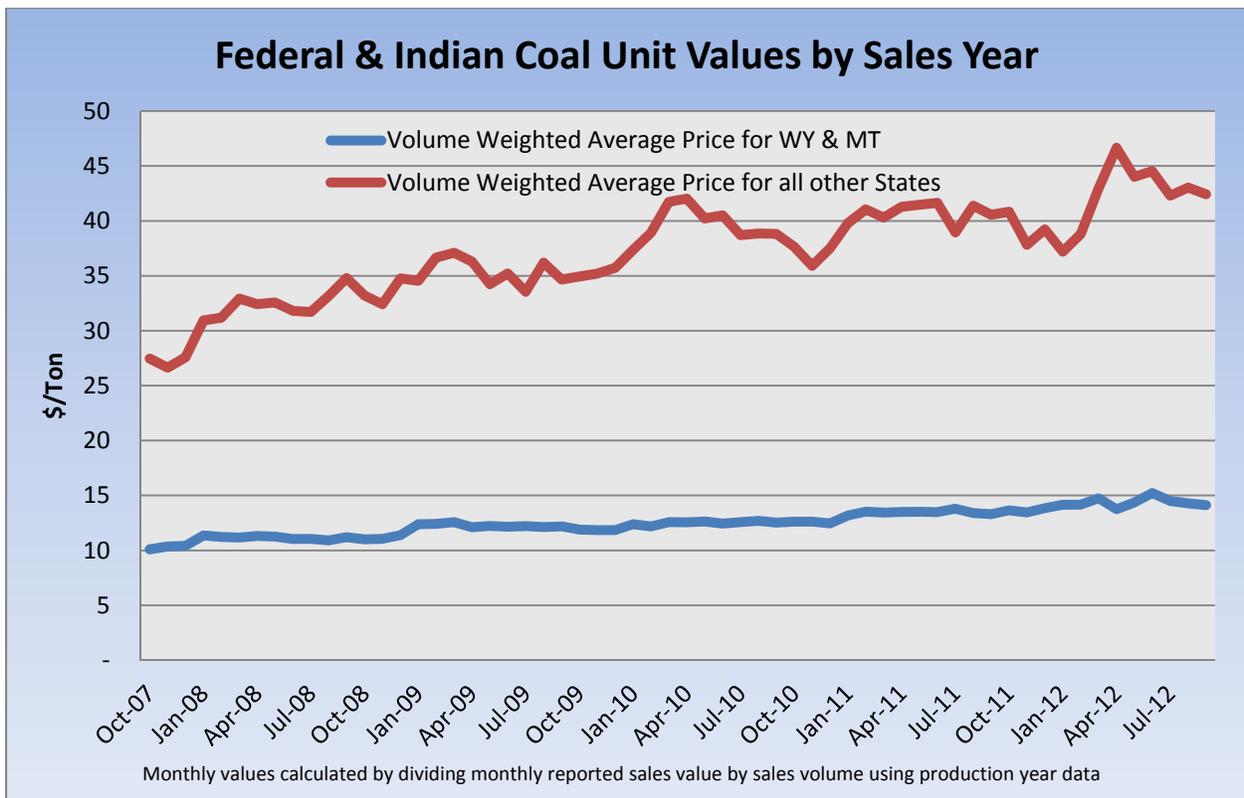
PRB coal mines sales were helped by increasing export sales of steam coal to Asia. EIA data indicated that U.S. coal producers exported a total of 125,420,000 short tons of coal in FY 2012. This is an increase of 25% from FY 2011. The EIA has projected a decrease in exports for 2013. The EIA explained that the cause of the decrease will be slower economic growth in China and increasing competition in the Asian Coal export market from Indonesia and Australia.

PRB coal producers are attempting to expand port access along the northwestern coast of the U.S. in order to increase their export capacity. Currently there are proposed coal export terminal projects

in Coos Bay, Oregon, and two in the Port of St. Helens, Washington. Arch Coal company representative Greg Schaefer described their coal export terminal during an industry roundtable held in December 2012 in Gillette, Wyoming. Arch Coal's terminal is located in Washington State. The existing terminal will need to be retrofitted into a coal export terminal. The proposed terminal will be constructed in two stages. The terminal will have the capacity to export 25 million tons of coal a year after stage one of the retrofit is complete. Once stage two is complete the terminal will have the capability of shipping 44 million tons of coal a year. Arch Coal's coal export terminal will also have the ability to store and blend coal. The proposed coal export terminals in Washington and Oregon are still in the permitting stage of development.

During FY 2012, the Environmental Protection Agency (EPA) moved closer to finalizing a greenhouse gas rule that will directly impact the U.S. coal industry. EPA's proposed rule would lower its New Source Performance Standards (NSPS) for new fossil fuel-fired generators to 1,000 lbs. CO₂/MWh. Coal fired power plants constructed using current technology cannot meet the 1,000 lbs. CO₂/MWh standard.

Prices Reported to ONRR for Federal and Indian Coal by Production Year Observations:



In FY 2012, the price for coal increased in the Powder River Basin (PRB) and in most other coal producing areas of the United States. Utah and Colorado coal prices stayed flat due to a continued lack of demand for western bituminous coal. Argus Coal Daily reported in July that the New Elk mine, located in Colorado, was forced to suspended production due to market conditions.

The percent of electricity the U.S. gets from its coal fired power plants continues to decrease despite the slowing expansion of natural gas electric power in FY 2012. According to Energy Information Agency (EIA) data, Coal fired power plants produced 15% fewer kilowatt-hours in FY 2012 compared to FY 2011. The data also indicated that the loss of coal fired electricity was balanced out by an increase in natural gas and renewable energy electricity sources.