

Fiscal Year 2013 in Review

Overview:

Fiscal Year (FY) 2013, October 2012 through September 2013, saw a relatively stable year for the domestic oil and gas commodities markets. Typical factors that drive commodity volatility such as economic changes, supply and demand fluctuations, unpredictability in the financial markets, and localized weather events were generally not present during FY 2013.

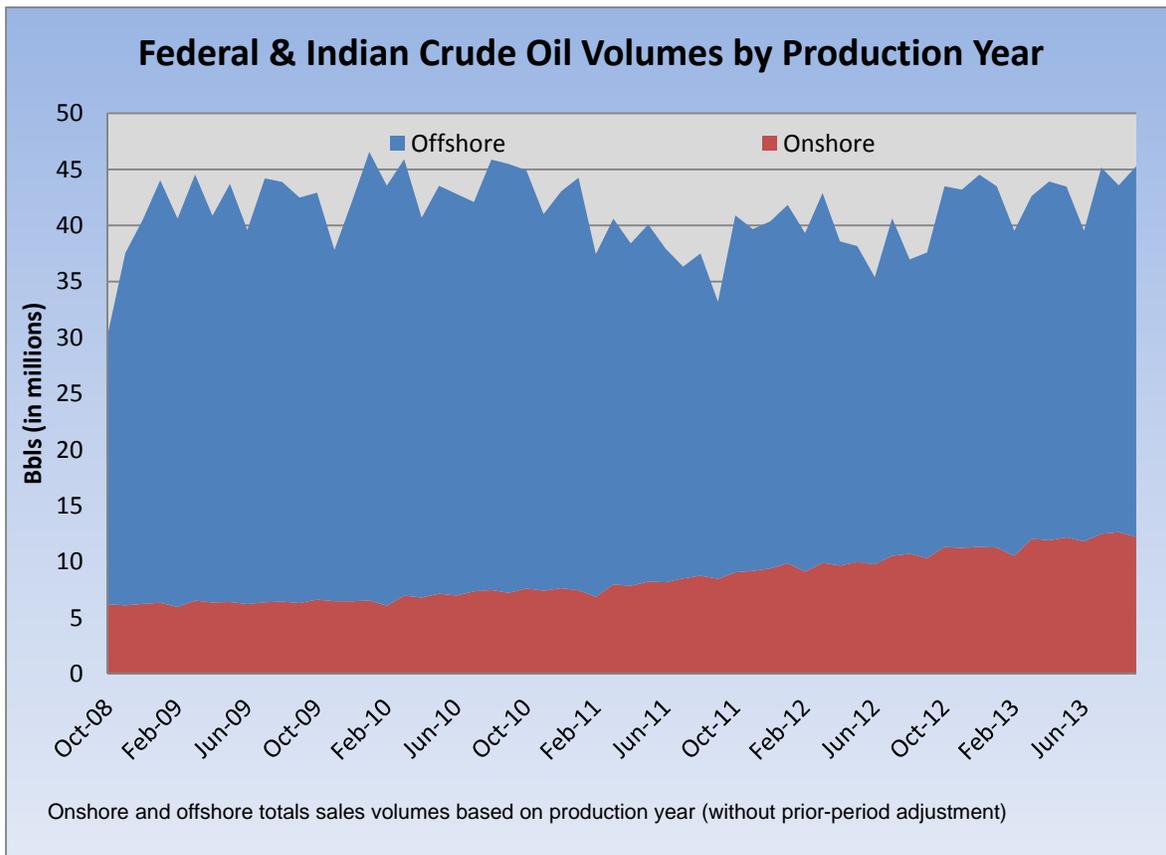
Regional crude oil prices in FY 2013 began to converge and trade more in line with each other. The average New York Mercantile Exchange (NYMEX) West Texas Intermediate (WTI) price remained consistent from its FY 2012 average, decreasing by just \$.02 per barrel. In contrast, the average offshore crude prices decreased by nearly \$3.00 per barrel and by September 2013 were trading within \$1.00 of NYMEX. In previous years, NYMEX and offshore prices had diverged significantly due to increased crude production arriving at Cushing, Oklahoma with inadequate pipeline capacity to Gulf of Mexico markets depressing the NYMEX price. FY 2013 saw an increase in Cushing takeaway capacity, a series of pipeline projects through Texas to bring crude directly to the Gulf of Mexico, and the continued proliferation of crude by rail from North Dakota. These factors created a decreased supply of crude at Cushing bringing offshore crude prices towards parity with NYMEX prices.

Federal onshore and offshore crude production both bounced back in FY 2013. Onshore production rose 15%, primarily from double digit increases in royalty bearing production from North Dakota (28%) and New Mexico (18%). These two states now compose 54% of onshore Federal and Indian production. Offshore production nearly recouped FY 2012's 7% decline by way of a production increase from the Gulf of Mexico. In FY 2013, Gulf of Mexico production increased by 6% predominately driven by several former royalty relief leases becoming royalty bearing and production from new leases.

Natural gas prices rebounded from the historic 10 year low seen in FY 2012 with the average NYMEX price at Henry Hub at \$3.60 per MMBtu, an increase of 26 percent from the FY 2012 average of \$2.86 per MMBtu. Among many factors, increasing gas demand for residential/commercial heating and industrial use drove this increase. Tempering this increase was a continued increase in supply from the Marcellus and Utica onshore natural gas shale plays, along with associated gas production from onshore oil shale plays such as the Eagle Ford and Niobrara.

Federal and Indian natural gas volumes subject to royalty payments declined by almost 9 percent in FY 2013 as onshore volumes decreased slightly while the Gulf of Mexico (GOM) continued its long-term decline.

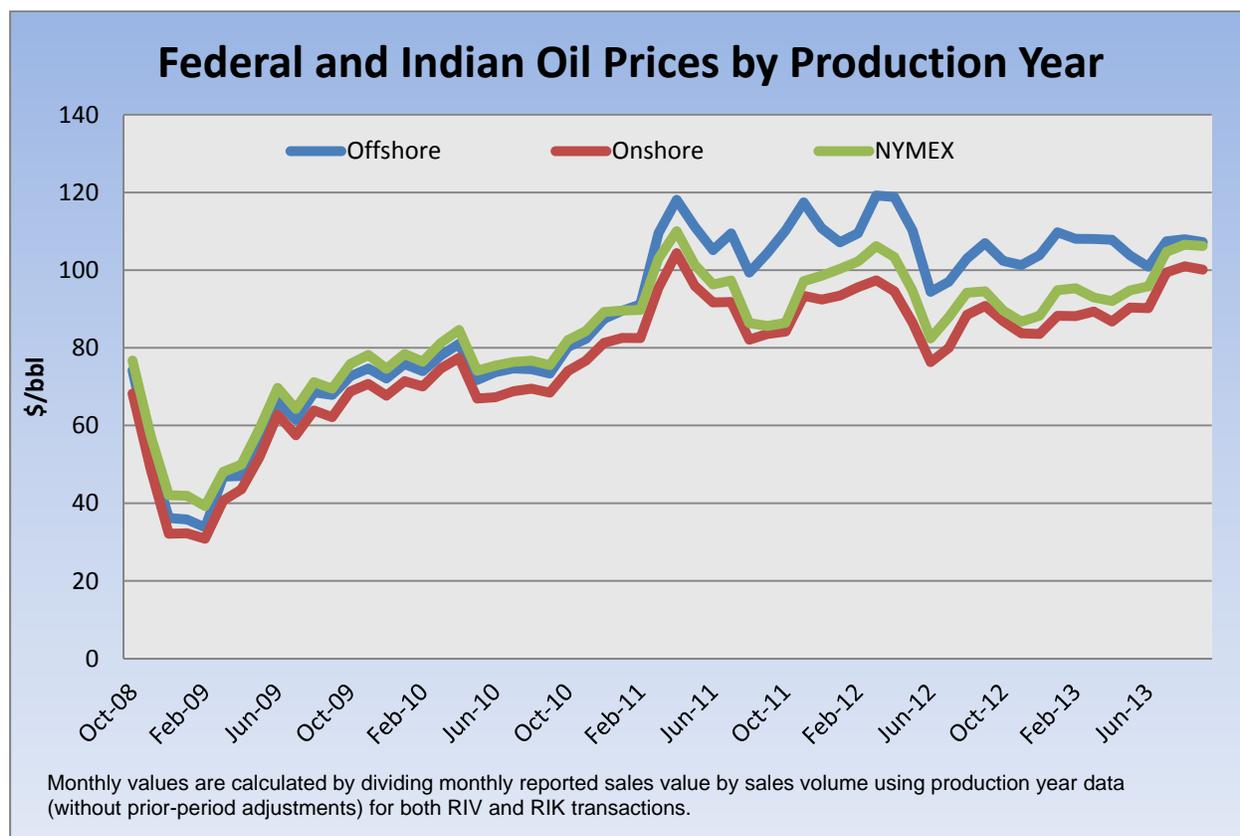
Federal and Indian Oil Volume Observations:



Federal onshore and Indian crude oil production continued to climb, increasing from an average of 12.96 million barrels per month in FY 2012 to 14.94 million barrels per month in FY 2013. Five states that make up 94% of onshore crude production, California, New Mexico, North Dakota, Utah, and Wyoming all posted increases compared to FY 2012. Leading the way was North Dakota (28% increase primarily from the Bakken) and New Mexico (18% increase primarily from the Permian Basin). Combined, North Dakota and New Mexico accounted for 54% of the year's Federal onshore and Indian production.

Offshore crude oil volumes also rebounded in FY 2013, increasing by almost 2 million barrels, or 6%. The main reasons for the increase in production were a combination of leases that were previously royalty relief leases becoming royalty bearing and several new leases starting production including BP's Atlantis project.

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

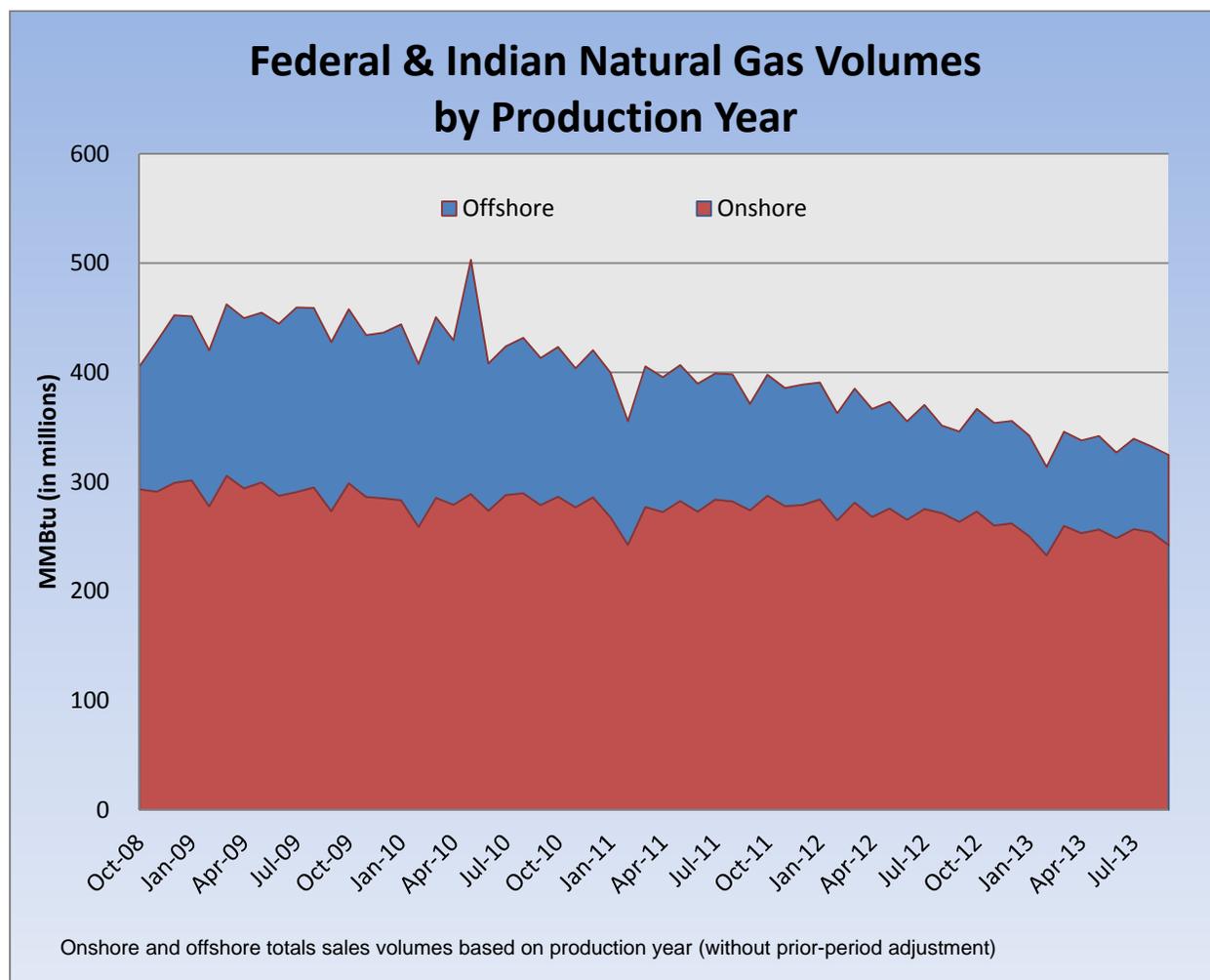


Oil prices in FY 2013 saw the NYMEX WTI average price move within \$1 of the offshore average prices. Additional pipeline takeaway capacity at Cushing, new pipeline projects to avoid Cushing altogether, and the continued proliferation of crude-by-rail from North Dakota began to alleviate the bottleneck we had previously seen at Cushing. Some of these new projects created a glut of light sweet crude in the Gulf Coast, further bringing NYMEX WTI and offshore prices into parity.

On average, the NYMEX price remained fairly stable, losing \$.02 per barrel between FY 2012 and FY 2013. Offshore averages made a more significant move, decreasing by \$3.00 per barrel. However, the yearly average does not tell the whole story as Q4 FY 2013 NYMEX prices reached \$106 per barrel on average. Offshore prices climbed over the year to \$108, but had overall fallen from a high of \$119 in FY 2012.

Onshore prices recorded a \$1.50 per barrel increase in FY 2013 compared to FY 2012. The month-to-month prices also rose during the year from approximately \$86 per barrel in October 2012 to \$99 in September 2013. The pipeline expansions mentioned above continued to help onshore prices trade closer to its offshore counterpart by enabling onshore producers to get their crude to the Gulf Coast where it could trade against Gulf crudes and international crudes.

Federal and Indian Natural Gas Volume Observations:



Federal and Indian natural gas production continued to fall in FY 2013 with volumes down an average of almost 9 percent from FY 2012 driven mostly by losses in the GOM. Total Federal and Indian natural gas production has fallen by about 27 percent since FY 2009. There were no storm related shut-ins for the GOM during FY 2013.

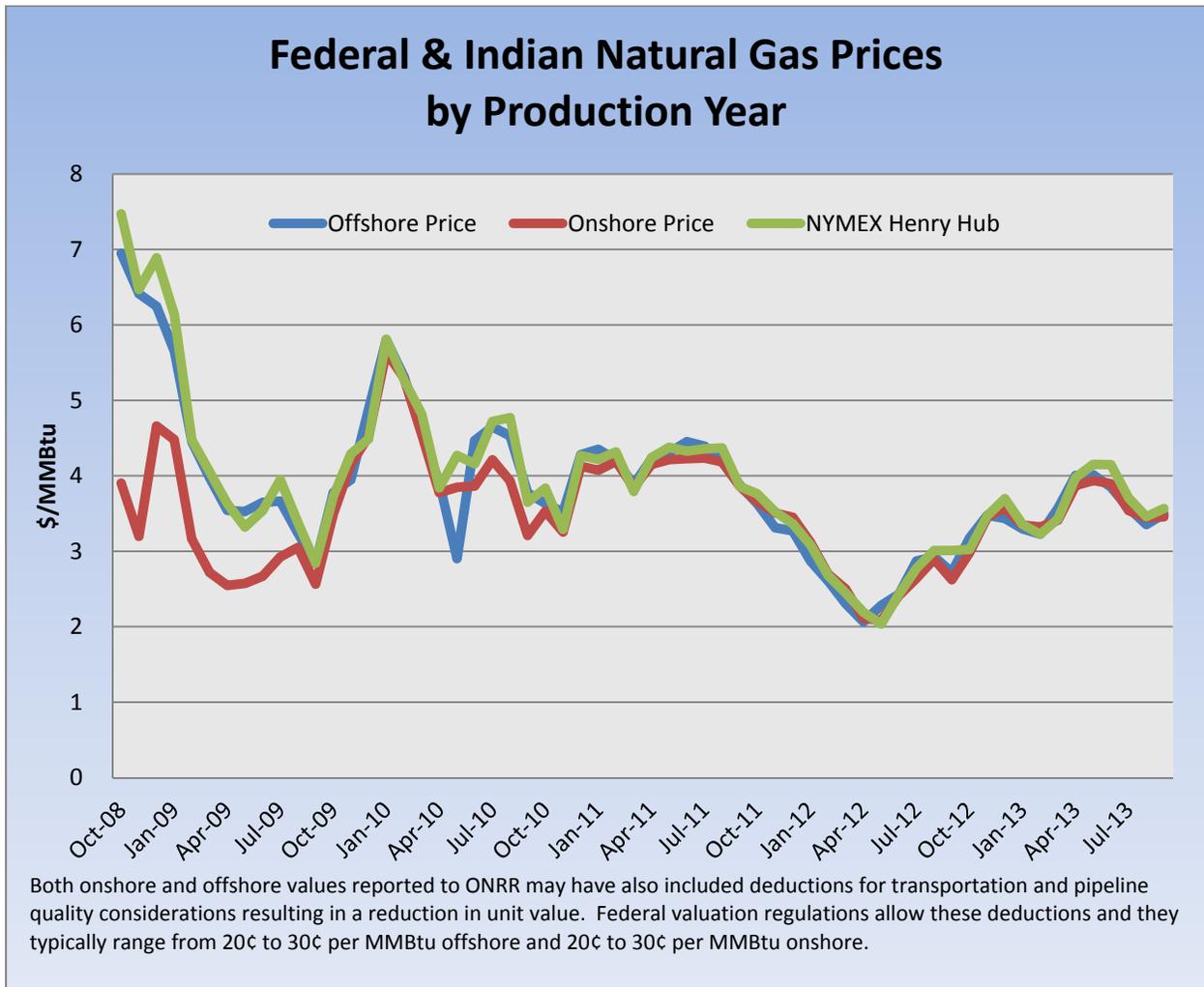
Gas production has dropped around 7 percent onshore and by 12 percent in the GOM since FY 2012. When looking at declines since FY 2009, onshore production has fallen around 13 percent and GOM production has dropped 42 percent. The GOM decline is indicative of producers focusing on higher-valued deepwater oil plays. Many new GOM developments are also in deepwater and could be subject to royalty relief for a period of time.

The steady decline in total Federal and Indian natural gas volumes has become the status quo over the last several years despite the shale resource boom. Natural gas prices strengthened in FY 2013 relative to FY 2012 prices; however, they remain relatively weak compared to liquids prices. This

disconnect continues to drive producers to liquids-rich and oily plays which are mostly in areas with little or no Federal production.

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

Observations:

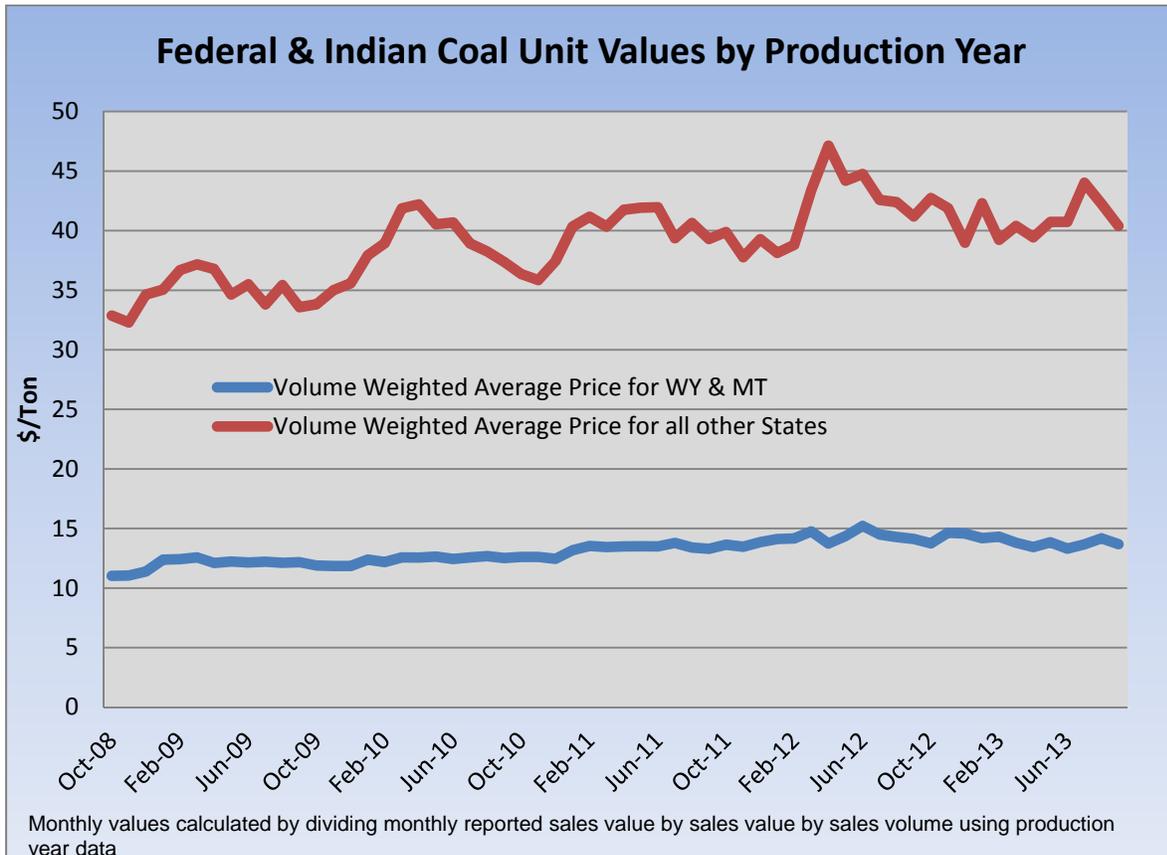


Natural gas prices rebounded in FY 2013, with the average NYMEX value increasing nearly 26 percent from FY 2012 reflecting strength in demand and a return to a normal winter. The FY 2013 heating degree days were up 16 percent from FY 2012. Natural gas demand for residential and commercial heating along with an increase in industrial use was up in FY 2013. Upcoming retirements in coal fired power plants are expected to be replaced by natural gas plants in the near future.

Natural gas prices reported to ONRR for offshore and onshore production 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. Gas produced in the Rockies and GOM has been displaced from outlets in the consuming Northeast causing a decrease in prices for these regions.

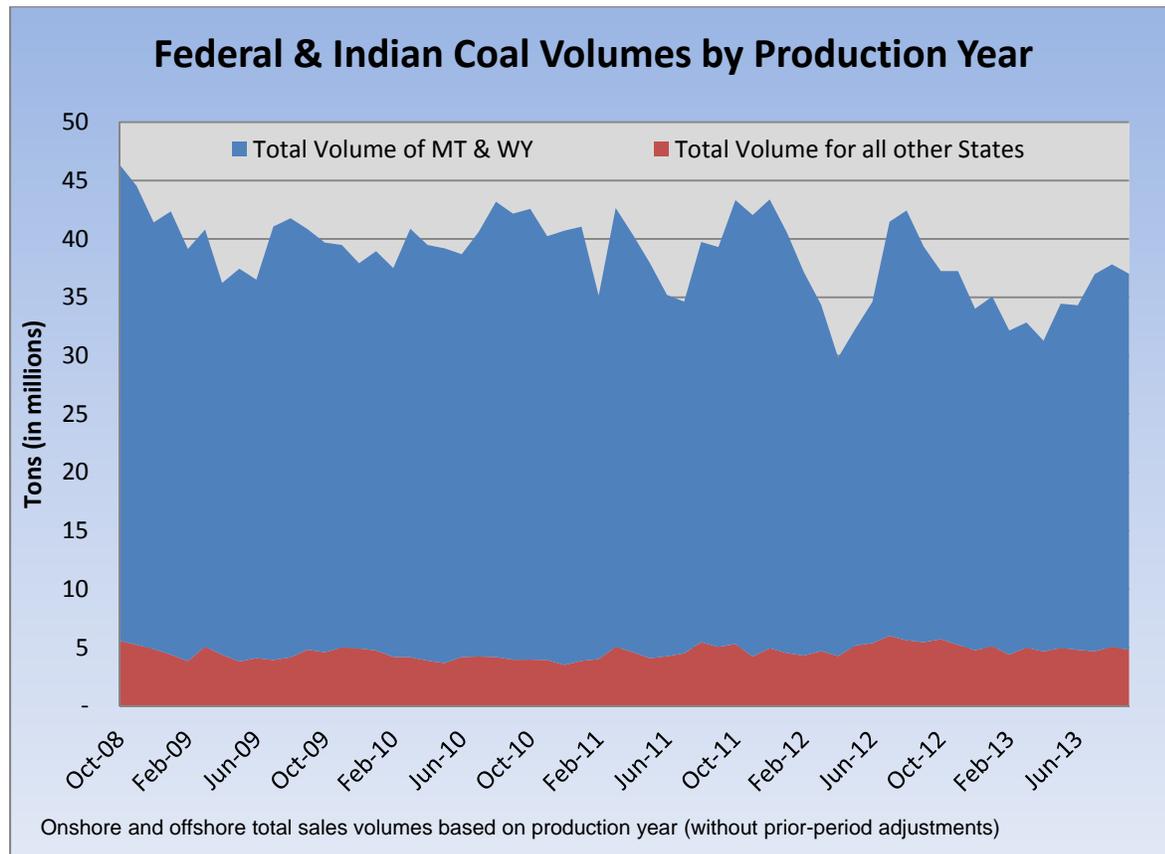
Coal Value Observations:



In FY 2013, the average selling price for Federal coal produced in the Powder River Basin (PRB) decreased slightly to \$13.95/ton from the FY 2012 price of \$14.18/ton. Federal coal mined in Utah saw its average selling price rise by \$1.09/ton to \$41.07/ton. Federal coal mined in Colorado dropped in price by \$4.91/ton, resulting in an average selling price of \$42.76 for FY 2013. The average selling price for all non-PRB Federal coal production fell to \$41.10/ton in FY 2013 from FY 2012’s price of \$41.62/ton. (ONRR data)

The U.S. generated 39.3% of its electricity from coal in FY2013 according to the U.S. Energy Information Administration (EIA). The EIA data indicates that the percentage of electricity the U.S. gets from natural gas decreased from FY 2012 to FY 2013. Overall, the U.S. generated less electricity in FY 2013 than in FY 2012.

Federal and Indian Coal Volume Observations:



Federal coal production for FY 2013 fell by 9.6% from FY 2012 levels. This drop in Federal coal production can largely be attributed to a decrease in PRB mine production. PRB production fell nearly 11% (39.7 million tons) in FY 2013. Production decreased by 9.6% for all other Federal coal. Overall, Federal production fell by 40.4 million tons.

Coal exports for FY 2013 fell by 6.5% from FY 2012. The EIA is projecting that U.S. coal exports will continue to fall in the near future. The EIA stated that the fall in exports was related to economic weakness in Europe and slowing Asian demand.

Federal Coal Exports

A December 2012 Reuters story purported that the U.S. was not collecting royalty on the full value of Federal coal that was sold overseas due to “loopholes” in the regulations. The article, citing former and current regulators, stated that coal mined in the Powder River Basin (PRB) which sells for about \$13/ton domestically, was selling at \$30/ton in Asian markets. In response to this story, the Senate Committee on Energy and Natural Resources sent a letter to then Secretary of the

Interior Ken Salazar outlining their concerns on royalties being collected on Federal coal mined in the PRB and exported to Asian markets.

The Office of Natural Resources Revenue (ONRR) responded to the Reuters story and the Senate inquiry by forming a task force to investigate the situation in coordination with the DOI Office of Inspector General. The task force is composed of ONRR representatives from Audit and Compliance Management, Asset Valuation, and State and Indian coordination along with State and Tribal Royalty Audit Committee auditors from Wyoming and Montana. The task force is auditing 15 Federal mines in the PRB to ensure that Federal coal lessees have paid royalties in accordance with Federal laws, lease terms, and regulations.