



United States Department of the Interior



MINERALS MANAGEMENT SERVICE ROYALTY MANAGEMENT PROGRAM

P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

**MMS-RVSD-O&G
Mail Stop 3520**

APR 16 1992

Dear Payor:

On September 13, 1991, the Minerals Management Service (MMS) published a final rule in the Federal Register affecting the determination of gas value, for royalty purposes, in situations where the lessee's arm's-length contract for the sale of gas prior to processing provides for the value to be determined based on a percentage of the purchaser's proceeds resulting from processing the gas (56 F.R. 46527, "Revision of Valuation Regulations Governing Gas Sales Under Percentage-of-Proceeds [POP] Contracts"). This rule, effective November 1, 1991, amended gas product valuation regulations to change valuation of gas sold under arm's-length POP contracts from the processed gas valuation regulations to the unprocessed gas valuation regulations. The MMS also adopted a new provision in the unprocessed gas valuation regulations requiring that the value for royalty purposes for gas sold under arm's-length POP contracts be no less than a value equivalent to 100 percent of the value of the residue gas, less any applicable allowances for transporting the residue gas away from the plant. The rulemaking did not affect any requirements for accounting for comparison (30 CFR § 206.155 (1991)) or major portion analysis (30 CFR §§ 206.152(3)(i) and 206.153(3)(ii) (1991)) contained in the terms of Indian leases.

For the period March 1, 1988, through October 31, 1991, gas sold under all POP contracts (arm's-length and non-arm's-length) was valued under the processed gas valuation regulations at 30 CFR § 206.153 (1991). Operators were required to report the disposition of such gas to the Production Accounting and Auditing System (PAAS) on the Monthly Report of Operations (Form MMS-3160) or the Oil and Gas Operations Report (Form MMS-4054) as gas transferred to a plant. Payors were required to report royalties for this gas to the Auditing and Financial System (AFS) using Product Code 03 (processed gas), Product Codes 07, 19, and 05 (natural gas liquids, sulfur, and drip/scrubber condensate, respectively), and associated transportation and processing allowances on the Report of Sales and Royalty Remittance (Form MMS-2014). Lastly, payors were required to file Gas Transportation Allowance Reports (Form MMS-4295) and Gas Processing Allowance Summary Reports (Form MMS-4109) with the Royalty Valuation and Standards Division (RVSD) prior to claiming any allowances on the Form MMS-2014. With publication of the final rule in the Federal Register, these requirements have been replaced for gas sales under arm's-length POP contracts. Reporting requirements for gas sales under non-arm's-length POP contracts remain unchanged.

To clarify the effects of the rule and explain the valuation and reporting requirements to be followed, MMS is providing the following guidance:

(1) PAAS Reporting Requirements

Beginning November 1, 1991, operators with gas sales subject to arm's-length POP contracts will report the disposition of that gas as "Sold" on the Form MMS-3160 or the Form MMS-4054. Operators with gas sales subject to non-arm's-length POP contracts and operators with gas sales subject to arm's-length POP contracts under Indian Leases that have accounting-for-comparison requirements (30 CFR § 206.155(b) (1991)) must continue to report the disposition of such gas as "Gas Transferred" and identify the plant where processing occurs.

(2) AFS Reporting Requirements

- (a) Payor Information Form (PIF): Payors must update all PIF's applicable to leases with gas sales subject to arm's-length POP contracts for each lease/revenue/selling arrangement combination. The revised PIF's must indicate an end date of October 31, 1991, for reporting Product Code combinations of 03, 07, and 19 (and 05 if appropriate) and establish a start date of November 1, 1991, for reporting Product Code 04, unprocessed (wet) gas.

Payors with Indian Leases who are periodically required to report gas as processed gas for accounting-for-comparison purposes will not be required to update their applicable PIF's.

- (b) Form MMS-2014: After submittal of the amended PIF's, payors will begin reporting the gross proceeds received under the arm's-length POP contract (but no less than a minimum of 100 percent of the value of the residue gas attributable to the processing of the payor's gas) and the volume of gas measured at the well head as Product Code 04 on Form MMS-2014. Payors with gas sales under non-arm's-length POP contracts must continue to report Product Codes 03, 07, and 19 and file the appropriate allowance forms before claiming any allowances.
- (c) Form MMS-2014 for Indian Leases subject to accounting-for-comparison requirements: The requirements for accounting for comparison (30 CFR § 206.155) contained in the terms of Indian leases are not affected by the rulemaking. All payors with arm's-length POP contracts under Indian Leases that contain accounting-for-comparison requirements must continue to value gas on the greater of the unprocessed gas value as determined under 30 CFR § 206.152 (1991) or the processed gas value as determined under 30 CFR § 206.153.

If Indian lease terms require accounting for comparison and the value of the unprocessed gas is greater, payors will report value (determined in accordance with the regulations) using Product Code 04 on the MMS-2014. However, when the value of the processed gas is greater than the value of the unprocessed gas, payors are required to report royalties utilizing Product Codes 03, 07, and 19 (and 05, if appropriate) on the Form MMS-2014 and file the applicable allowance forms before claiming any allowance.

(3) Allowance Reporting Requirements

Because the arm's-length POP rule is prospective only, payors are required to have the appropriate Forms MMS-4295 and MMS-4109 filed as specified in the regulations at 30 CFR §§ 206.156 through 206.159 (1991) for the period prior to November 1, 1991. Effective November 1, 1991, payors will not be required to file Forms MMS-4295 and MMS-4109 for gas sold under arm's-length POP contracts except in accounting-for-comparison situations.

If payors currently have an allowance form on file showing an estimated allowance for Calendar Year 1991, an allowance form showing the actual allowance (report type 2) must be filed with MMS for the period January 1, 1991, through October 31, 1991, by January 31, 1992, in accordance with the allowance regulations at 30 CFR § 206.157 (c)(1)(iii) and 206.159 (c)(1)(iii) (1991).

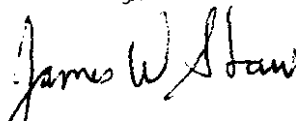
(4) Compliance with Applicable Regulations

The rule is effective prospectively beginning November 1, 1991. Payors will be held responsible for complying with all regulations applicable for the period prior to November 1, 1991. Payors that failed to file the appropriate allowance forms prior to deducting an allowance on the Form MMS-2014, exceeded the allowance limitation without approval from MMS, and/or erroneously reported gas sold under POP contracts as unprocessed gas for the period from March 1, 1988, through October 31, 1991, will be contacted and required to bring those earlier royalty payments into compliance with the rules governing gas valuation for that period. As provided by the regulations in effect prior to November 1, 1991, payors that failed to file appropriate allowance forms may be subject to interest assessments or additional royalties and interest assessments on the amount of any deduction erroneously claimed on the Form MMS-2014.

Questions pertaining to this letter should be directed to the following offices:

PAAS	Reporter Contact Branch (Form MMS-3160)	1-800-525-7922
AFS	Reference Data Branch (PIF's)	1-800-525-9167 or (303) 231-3504
	Lessee Contact Branch (Form MMS-2014)	Contact your company Lessee Contact Branch representative
RVSD	Transportation and Processing Branch (Forms MMS-4295 and MMS-4109)	(303) 231-3163
	Oil and Gas Valuation Branch (questions on valuation issues)	(303) 231-3548

Sincerely,



James W. Shaw
Associate Director for
Royalty Management