



IN REPLY
REFER TO:

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225



JUN 18 1992

Dear Payor:

On May 15, 1991, the United States Court of Appeals for the Fifth Circuit in *Mesa Operating Limited Partnership v. U.S. Dept. of the Interior*, 931 F.2d 318 (5th Cir. 1991), *cert. denied* -- U.S. --, 112 S.Ct 934, 117 L. Ed.2d 106 (1992), decided that the Department of the Interior acted properly and within its authority in requiring Federal and Indian lessees¹ (lessees) to pay royalties on reimbursements received from purchasers for certain production-related costs under the authority of section 110 of the Natural Gas Policy Act, 15 U.S.C. 3320, and the Federal Energy Regulatory Commission (FERC) Order No. 94 and related orders (FERC 94 payments).

Many lessees had appealed orders to pay, or to recalculate and pay, royalties on the FERC 94 payments to the Director of the Minerals Management Service (MMS). Now that the *Mesa* litigation has been completed, many of the pending administrative cases have been resolved by the decision of the Assistant Secretary for Land and Minerals Management.² Other cases are in the process of being decided.

Some lessees are now raising, for the first time, the argument that certain of the reimbursed amounts were actually not reimbursements for costs of putting the production into marketable condition (which are royalty bearing), but instead, involve costs of transportation or processing for which an allowance may be appropriate. It is the policy of the MMS that royalty value is determined by deducting certain allowable costs of processing and transportation. However, a lessee's entitlement to apply for an allowance for such costs does not affect the principle that royalty is owed on FERC 94 payments. The court in *Mesa* upheld the Department's view that those payments are part of gross proceeds. Any allowance for which a lessee may apply is administered separately, and in the same manner as any other request for an allowance.

MMS will continue to permit lessees to apply for retroactive transportation or processing allowances, which will be evaluated in the same manner as all other applications for such allowances for the relevant period(s) involved. In order to expeditiously resolve the issues

¹The term lessee includes all royalty payors responsible for paying royalties on Federal or Indian leases.

²Decisions by the Assistant Secretary are final actions of the Department and are judicially reviewable in Federal District Court.

on these payments, some of which were due more than eight years ago and as lessees had ample opportunity to make these applications (or to inform MMS of their intent to make these applications) during the pendency of the litigation and administrative appeals, MMS will grant leave to file these retroactive allowance requests only if they are received by August 14, 1992, by the Royalty Valuation and Standards Division (RVSD), Denver Federal Center, Building 41, P.O. Box 25165, Denver, CO 80225-0165.

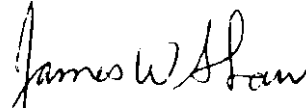
MMS will suspend all cases still pending before the Director until August 14, 1992, to permit lessees to submit their allowance requests. If the case in which a lessee wishes to request an allowance is currently under appeal to the Director and the appellant wishes to consolidate the request for allowance with the current appeal, the appellant must first submit a request to file an additional statement of reasons and then file a copy of its request to the RVSD with the Division of Appeals, 381 Elden Street, Herndon, VA 22070-4817.

For cases that are pending before the Interior Board of Land Appeals (IBLA), MMS does not believe that the allowance issue is properly before the Board in most cases and thus that it may not now be asserted in the pending appeal. Rather, it is subject to independent request to RVSD as described above.

For those cases that were decided by the Assistant Secretary for Land and Minerals Management or the IBLA, and where the lessee contested the payment solely on the grounds that the Secretary's interpretation of the statute is impermissible, MMS will require payment of the full amount ordered to be paid plus applicable late payment charges. If the lessee submits a request for a retroactive allowance, MMS will determine through the process outlined above, whether, and to what extent, such a request may be granted. In either case, MMS will not stay any order to pay or recalculate and pay.

If you have any questions regarding this policy, please contact me at 303-231-3058.

Sincerely,

A handwritten signature in black ink, appearing to read "James W. Shaw". The signature is written in a cursive, slightly slanted style.

Associate Director for
Royalty Management