United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

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Dear Payor:

This "Dear Payor" letter addresses the new requirements of the Indian Gas Valuation Regulations effective **January 1, 2000,** and includes instructions regarding:

- How to calculate and report the gas value on the Report of Sales and Royalty Remittance (Form MMS-2014).
- How to show your dual accounting election.
- Where to submit new forms and transportation and processing allowance contracts.

On **August 10, 1999,** the Minerals Management Service (MMS) amended the regulations governing the valuation of natural gas produced from Indian leases (64 FR 43506). These amendments add alternative valuation methods to the March 1, 1988, valuation regulations to ensure that Indian lessors receive maximum revenues from their natural gas production and to improve the accuracy of royalty payments at the time the royalties are due.

The Indian gas regulations resulted from a negotiated rulemaking between MMS, industry, and Indian representatives. The new rule simplifies the valuation of natural gas produced from Indian lands and accomplishes the major portion and dual accounting provisions of Indian lease terms in a more contemporaneous manner.

Under the amended Indian gas regulations, you will determine the value of gas production on the basis of whether the gas is produced from an index zone or a non-index zone. In addition, you must submit new forms and copies of arm's-length transportation and processing contracts to MMS. The rule also allows lessees to elect whether to perform actual accounting for comparison (dual accounting) or alternative dual accounting.

Enclosure 1 contains information explaining the new valuation and reporting requirements beginning with sales month **January 2000.**

If you have valuation questions regarding the amended Indian Gas Valuation Regulations, please call Ms. Theresa Walsh Bayani at (303) 275-7247 or Mr. Richard Adamski at (303) 275-7242. If you have any questions on how to report on the Form MMS-2014, please call your royalty reporting representative at 1-800-525-0309.

Sincerely,

Lucy Querques Denett
Associate Director for Royalty Management

Enclosure

AMENDMENTS TO GAS VALUATION REGULATIONS FOR INDIAN LEASES

Table of Contents

I. INDEX ZONE INFORMATION

A. How do I know if my Indian lease is in an index zone?

On **November 30, 1999**, the Minerals Management Service (MMS) published in the *Federal Register* at 64 FR 66771 a list of the index zones and their associated MMS-designated areas. An index zone is a field or an area with an active spot market that contains published indices applicable to that field/area and approved by MMS. If your Indian lease is located in one of these MMS-designated areas, then your lease is in an index zone.

The following table shows you which MMS-designated area is in which index zone:

MMS-Designated Area	Index Zone
Alabama-Coushatta	East Texas
Wind River Reservation	Northern Rocky Mountains
Jicarilla Apache Reservation Navajo Tribal Leases in the Navajo Reservation Southern Ute Reservation Ute Mountain Ute Reservation	San Juan Basin
Includes the following counties in Oklahoma: Alfalfa, Beaver, Cimarron, Cleveland, Creek, Garfield, Grant, Harper, Kay, Lincoln, Noble, Nowata, Oklahoma, Pawnee, Payne, Pottawatomie, Rogers, Texas, Tulsa, Washington, Woods	Oklahoma Zone No. 1
Includes the following counties in Oklahoma: Beckham, Blaine, Caddo, Canadian, Comanche, Cotton, Custer, Dewey, Ellis, Garvin, Grady, Greer, Harmon, Jackson, Jefferson, Kingfisher, Kiowa, Logan, Major, McClain, Roger Mills, Stephens, Tillman, Washita, Woodward	Oklahoma Zone No. 2
Includes the following counties in Oklahoma: Adair, Atoka, Bryan, Carter, Cherokee, Choctaw, Coal, Craig, Delaware, Haskell, Hughes, Johnston, Latimer, Le Flore, Love, Marshall, Mayes, McCurtain, McIntosh, Murray, Muskogee, Okfuskee, Okmulgee, Ottawa, Pittsburg, Pontotoc, Pushmataha, Seminole, Sequoyah, Wagoner	Oklahoma Zone No. 3

B. How do I determine the index-based value?

The regulations addressing index-based value at 30 CFR § 206.172 (64 FR 43506) apply to situations where your lease has a major portion provision or the lease provides for the Secretary to determine value.

To determine the index-based value of gas produced from leases in an index zone, you must use the following procedure:

1. Calculate the average of the highest reported prices for all index-pricing points in the index zone for each MMS-approved publication. MMS-approved publications are *Inside F.E.R.C.'s Gas Market Report* and the *Natural Gas Intelligence Weekly Gas Price Index* (except any individual index prices excluded by MMS from an index zone in an MMS-approved publication).

2. Sum the averages calculated above and divide by 2 (the number of publications).

3. Reduce the number calculated in No. 2 above by 10 percent, but not less than 10 cents per MMBtu or more than 30 cents per MMBtu. The result is the index-based value per MMBtu for production from all leases in that index zone.

C. What is a safety net price and do I have to calculate a safety net price if my Indian leases are in an index zone?

Your safety net price for an index zone is the volume-weighted average contract price per delivered MMBtu under your or your affiliate's arm's-length contracts for the disposition of residue gas or unprocessed gas produced from your Indian lease in the index zone.

You must calculate a safety net price for each month and for each index zone where you have an Indian lease from which gas production is sold beyond the first index pricing point through which it flows.

You must include in your calculation only sales under those contracts that establish a delivery point beyond the first index pricing point through which the gas flows and that include any gas produced from or allocable to one or more of your Indian leases in that index zone, even if that contract also includes gas produced from Federal, State, or fee properties.

You must not reduce the contract price for any transportation costs incurred to deliver the gas to the purchaser.

You must determine for each month, the number that is 80 percent of the safety net price you calculated for an index zone. You must also calculate the number that equals 125 percent of the monthly index-based value. You must perform this calculation separately for each index zone.

For any index zone, if the number you calculated as 80 percent of the safety net price exceeds the number you calculated at 125 percent of the index-based value (the safety net differential), then you owe additional royalty on the safety net differential.

For each index zone, the safety net differential (SND) is equal to:

SND = [(0.80 x S) - (1.25 x I)]

where I is the index-based value, and

S is the safety net price.

If the safety net differential is positive, the lessee owes additional royalties.

To calculate the additional royalties, make the following calculation for each of your Indian leases in an index zone that produced gas that was sold beyond the first index-pricing point through which the gas flowed:

Lease royalties owed = SND x V x R, where

R = the lease royalty rate, and

V = the volume allocable to the lease that produced gas sold beyond the first index pricing point.

Add the numbers calculated for each lease in the previous step. The total is the additional royalty owed. Further instructions for calculating the safety net price are in 30 CFR § 206.172(e) (64 FR 43506).

D. How do I report my additional royalty due for the safety net differential?

You must submit an amended Form MMS-2014 to MMS. Follow the reporting guidance provided in the *Oil and Gas Payor Handbook, Volume II*, Section 4, Adjustments, Recoupments, and Refunds. You must reverse the data you originally reported on the Form MMS-2014 and report new entries that reflect the total royalty due. Use adjustment reason code **01** (Pricing Adjustment) on both the reversal line and the new correcting line.

Late payment interest on any underpayments related to the safety net differential will begin to accrue from the end of the sales month in which royalties are due.

E. Where and when do I submit the Safety Net Report (Form MMS-4411)?

Annually, you must report the monthly safety net price for each index zone to MMS on Form MMS-4411 not later than June 30 following the previous calendar year. Form MMS-4411 is available on the Royalty Management Program's website on the Internet at:

http://www.rmp.mms.gov/custserv/pubserv/forms.htm

You must send Form MMS-4411 to the State and Indian Compliance Division at the following address:

Minerals Management Service
State and Indian Compliance Division
P.O. Box 25165, MS 3660
Denver, Colorado 80225-0165

II. NON-INDEX ZONE INFORMATION

A. How do I know if my Indian lease is in a non-index zone?

The following is a list of MMS-designated areas for which you must value the production using the non-index based method:

- Blackfeet Reservation
- Crow Reservation
- Fort Belknap Reservation
- Fort Berthold Reservation
- Fort Peck Reservation
- Northern Cheyenne Reservation
- Rocky Boys Reservation
- Turtle Mountain Reservation
- Ute Allotted Leases in the Unitah and Ouray Reservation
- Ute Tribal Leases in the Unitah and Ouray Reservation
- Navajo Allotted Leases in the Navajo Reservation

B. How do I determine the non-index-based value?

The regulations addressing the non-index-based value at 30 CFR § 206.174 (64 FR 43506) apply to situations where your lease has a major portion provision or the lease provides for the Secretary to determine value. In a non-index zone, MMS will determine the major portion value and notify you in the *Federal Register* of that value.

The value of production for royalty purposes for your lease is the higher of either the value determined under 30 CFR § 206.174, which you initially used to report and pay royalties on Form MMS-2014, or the major portion value. If the major portion value is higher, you must submit an amended Form MMS-2014 to MMS by the due date specified in the *Federal Register* Notice. Late payment interest under 30 CFR § 218.102 (1999) on any underpayment will not begin to accrue until after the date the amended Form MMS-2014 is due to MMS.

III. DUAL ACCOUNTING INFORMATION

A. How and where do I submit the Certification for Not Performing Accounting for Comparison (Dual Accounting) (Form MMS-4410)?

If gas produced from any of your Indian leases is never processed or is not processed until after the gas flows into a pipeline with an index located in an index zone or into a mainline pipeline not in an index zone, then immediately submit a separate Form MMS-4410 for each lease to the Royalty Valuation Division at the following address:

Minerals Management Service
Royalty Valuation Division
P. O. Box 25165, MS 3150
Denver, Colorado 80225-0165

This is a one-time notification. Form MMS-4410 is available on the Royalty Management Program's website on the Internet at:

http://www.rmp.mms.gov/custserv/pubserv/forms.htm

If a change in your circumstances occurs regarding disposition of the gas that would require dual accounting, then you must notify MMS (please use the above address), in writing, by the end of the production month in which the change occurs.

B. How do I make a dual accounting election?

If you are required to perform dual accounting, you must elect to perform either actual dual accounting, under 30 CFR § 206.176 (64 FR 43506), or the alternative methodology for dual accounting, under 30 CFR § 206.173 (64 FR 43506).

You must make a separate election to use the alternative methodology for dual accounting that will apply to all of your Indian leases in each MMS-designated area. Lease prefixes for designated areas are listed in *Federal Register* at 64 FR 66771.

You may elect to begin using the alternative methodology for dual accounting at the beginning of any month. The first election to use the alternative methodology will be effective from the time of election through the end of the following calendar year. Afterwards, each election to use the alternative methodology must remain in effect for 2 calendar years.

C. How do I report my dual accounting election using new calculation method codes 04 and 05?

Beginning with sales month **January 2000,** you will make your election by reporting either the new calculation method code **04** Dual Accounting or **05** Percent of Increase (alternative dual accounting) in column 15 of Form MMS-2014. You must continue to report the calculation method code each month that you submit Form MMS-2014.

Below is a sample Form MMS-2014 line that illustrates how to report your dual accounting election:

- Report the Transaction Code **01.**

- Report the Calc Method Code **04** for Dual Accounting or **05** for Percent of Increase unless you have certified that the lease is exempt from dual accounting.

- Report one of the following applicable Product Codes: **03, 04, 05, 07, 12, 15, or 16.**

LINE No.	AID No.	PROD CODE	SELLING ARR CODE	SALES MO/YR	TRANS CODE	ADJ REAS CODE	SALES QTY
1	5180000010 001	04	001	01/2000	01		995.00

QUALITY MEASUREMENT	CALC METH	SALES VALUE	ROYL QTY	ROYL VALUE	PYMT METHOD CODE
1200	04	1735.67	199.00	347.13	05

D. When and how must I use Major Portion/Dual Accounting Adjustments?

You will use Adjustment Reason Code **16 only** to report major portion/dual accounting adjustments for leases located in non-index zones. You will make these adjustments only after you receive written notice in the *Federal Register* from MMS of the major portion price.

When you report your value, adjusted for major portion/dual accounting, you must submit an amended Form MMS-2014 to MMS by the date specified in the written notice in the *Federal Register*.

You must use Adjustment Reason Code **16** on your amended Form MMS-2014 so that late payment interest on any underpayment will not begin to accrue until after the date that the amended Form MMS-2014 is due to MMS.

You must report the Adjustment Reason Code **16** on both the reversal line and the new correcting line. Below is a sample Form MMS-2014 that illustrates how to report Adjustment Reason Code **16:**

- Report the reversal line using the original line data with **opposite** values and then report the new correcting line.

- Report the Adjustment Reason Code **16** on **both** the reversal line and the new correcting line.

- Report the Transaction Code **01.**

- Report the Calc Method Code **04** for Dual Accounting or **05** for Percent of Increase unless you have certified that the lease is exempt from dual accounting.

- Report one of the following applicable Product Codes: **03, 04, 05, 07, 12, 15, or 16.**

When you make major portion adjustments, the detailed information on a Form MMS-2014 will look like this:

LINE No.	AID No.	PROD CODE	SELLING ARR CODE	SALES MO/YR	TRANS CODE	ADJ REAS CODE	SALES QTY
1	5180000010 001	04	001	01/2000	01	16	-995.00
2	5180000010 001	04	001	01/2000	01	16	995.00

QUALITY MEASUREMENT	CALC METH	SALES VALUE	ROYL QTY	ROYL VALUE	PYMT METHOD CODE
1200	04	-1735.67	-199.00	-347.13	05
1200	04	1855.73	199.00	371.15	05

IV. TRANSPORTATION AND PROCESSING ALLOWANCES

A. When and where must I submit copies of my arm's-length transportation and processing contracts?

If your transportation or processing contract is arm's-length, you do not submit the Gas Transportation Allowance Report (Form MMS-4295) or the Gas Processing Allowance Summary Report (Form MMS-4109).

However, you must submit to MMS a copy of your arm's-length transportation and processing contract(s) and all later amendments to the contract(s) within 2 months of claiming the allowance on the Form MMS-2014.

You must send the contract(s) to the State and Indian Compliance Division at the following address:

Minerals Management Service
State and Indian Compliance Division
P.O. Box 25165, MS 3660
Denver, Colorado 80225-0165

B. Must I still file transportation and processing allowance forms if I have a non-arm's-length contract or no contract?

If your transportation or processing contract is non-arm's-length under 30 CFR § 206.178 (b) or 30 CFR § 206.180 (b) (64 FR 43506), you must submit actual cost information to support the allowance to MMS on:

- Form MMS-4295 (transportation), and/or
- Form MMS-4109 (processing)

within 3 months after the end of the 12-month period for which the allowance applies.

You must send the allowance forms to the State and Indian Compliance Division at the above address.

C. How and when do I elect to use the alternative transportation allowance calculation?

As an alternative to computing your transportation allowance under 30 CFR § 206.178(b), you may use as the transportation allowance 10 percent of your gross proceeds but not to exceed 30 cents per MMBtu.

If you choose the alternative transportation allowance calculation for non-arm's-length or no-contract situations under 30 CFR § 206.178(c)(1) (64 FR 43506), you must do so at the beginning of a production month and it must remain in effect for an entire calendar year.

If you choose the alternative transportation allowance calculation, then you do not submit Form MMS-4295.

You must notify State and Indian Compliance Division in writing of your election to use the alternative transportation allowance calculation and the list of applicable leases at the following address:

Minerals Management Service
State and Indian Compliance Division
P.O. Box 25165, MS 3660
Denver, Colorado 80225-0165