



United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240



SEP 22 2004

Dear Payor:

This letter supersedes the "Dear Payor" letters issued on April 16, 1992, June 25, 1992, and January 3, 1994, from the Minerals Management Service (MMS) concerning Percentage of Proceeds (POP) contracts with respect to gas produced from Indian leases.

The following information provides instructions on how to report royalties due on gas produced from Indian leases and sold under POP contracts and includes:

- How to calculate and report your gas value on the Report of Sales and Royalty Remittance (Form MMS-2014).
- How to perform your dual accounting calculation.
- How and where to submit the Gas Transportation Allowance Report (Form MMS-4295) or the Gas Processing Allowance Summary Report (Form MMS-4109).
- How and where to submit transportation and processing contracts.

Enclosure 1 contains information explaining the new reporting requirements of natural gas sold under POP contracts beginning with production month November 2004. Enclosure 2 is a chart showing how to report your gas value on Form MMS-2014, if you sell your Indian gas production under a POP contract.

Under Executive Order 13175 of November 6, 2000, MMS consulted with tribes under 202 Delegated Audit Agreements on formulating this policy.

If you have valuation questions regarding gas sold under POP contracts, please call Mr. Jim Cummings at (303) 231-3771. If you have any questions about how to report POP contract situations on Form MMS-2014, please call your royalty reporting representative at (800) 525-0309.

Sincerely,

Lucy Querques Denett
Associate Director for
Minerals Revenue Management

Enclosures

TAKE PRIDE
IN AMERICA 

**REPORTING REQUIREMENTS FOR INDIAN GAS
SOLD UNDER A PERCENTAGE OF PROCEEDS (POP) CONTRACT**

I. Index Zone Information when Gas is Sold under a POP Contract

A. How do I calculate the index-based value when I sell my gas under a POP contract?

The regulations addressing index-based value at 30 CFR 206.172 (2003) apply to situations where your lease has a major portion provision or the lease provides for the Secretary of the Interior to determine value.

To determine the index-based value of gas produced from an index zone, you must use the methods outlined in the regulations or you may obtain the index-based value from our Internet website at:

<http://www.mim.mms.gov>

Click on the blue tab labeled "Product Valuation" then click on "Index Zone Prices." If you want to determine the index-based value yourself, 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 Minerals Management Service (MMS)-approved publication. The 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 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. If your production is sold beyond the first index-pricing point through which it flows, the value of the gas production cannot be less than the value determined by the Safety Net calculation (30 CFR 206.172(e)).

B. Do I have to perform dual accounting for gas produced from my Indian leases in an index zone when I sell my gas under a POP contract?

Yes, you are required to perform dual accounting if your gas is processed under either an arm's-length or non-arm's-length POP contract and your Indian lease terms require dual accounting. If you are required to perform dual accounting under 30 CFR 206.176 (2003), you have two choices:

1. You may elect to perform actual dual accounting under 30 CFR 206.176(a), or
2. You may use the alternative dual accounting method under 30 CFR 206.173 (2003).

You must make a separate election to use the alternative methodology for dual accounting. Your election will apply to all of your Indian leases in each MMS-designated area.

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 your election through the remainder of a 2 calendar year period. For succeeding elections, each election to use the alternative methodology must remain in effect for 2 calendar years.

You are required to make a dual accounting election on Form MMS-4410, Accounting for Comparison (Dual Accounting), Part B "Election to Perform Actual Dual Accounting or Alternative Dual Accounting." For reporting instructions see the "Dear Payor" letter dated July 8, 2002, on our Internet website at <http://www.nmmlmms.gov>. Click on the blue tab labeled "Reporting Information" then click on "Dear Payor/Reporter letters" and select the appropriate Dear Reporter letter.

You may also download Form MMS-4410 from the website.

II. Alternative Methodology for Dual Accounting in Index Zones

A. If I elect the alternative dual accounting method, and my leases are in an index zone, how do I value my gas that I sell under a POP contract?

The alternative dual accounting methodology adjusts the value of gas before processing to provide the value of the gas after processing. Your gas value under the alternative dual accounting methodology is the MMBtu measured at the Bureau of Land Management approved facility measurement point (FMP) multiplied by the index-based value, multiplied by (1 + increment for dual accounting). The dual accounting increments are listed in the table at 30 CFR 206.173(b)(2)(ii).

The index-based value is already reduced for transportation costs and the dual accounting increment accounts for processing costs; therefore, you must not reduce your processed gas value further by transportation or processing costs.

B. If I elect the alternative dual accounting method and my leases are in an index zone, how do I report my gas value that I sell under a POP contract?

For gas produced from index zones where (1) your gas is sold under either an arm's-length or non-arm's-length POP contract, and (2) you elect alternative dual accounting on Form MMS-4410, Part B, you must report the following on Form MMS-2014:

- Transaction Code (TC) 01 [royalty due].
- Product Code (PC) 04 [unprocessed gas].
- Sales Type Code (STC) "OINX."

III. Actual Dual Accounting Method in Index Zones

A. If I elect the actual dual accounting method and my leases are in an index zone, how do I determine the value of unprocessed gas that I sell under a POP contract?

When you elect the actual dual accounting method in an index zone, the unprocessed gas value is the MMBtu measured at the FMP multiplied by the index-based value.

The index-based value is already reduced for transportation costs; therefore, you must not reduce your unprocessed gas value further by transportation costs.

B. If I elect the actual dual accounting method and the unprocessed gas value is greater than the processed value and my leases are in an index zone, how do I report the value of unprocessed gas that I sell under a POP contract?

For gas produced from index zones where (1) your gas is sold under either an arm's-length or non-arm's-length POP contract; (2) you elect actual dual accounting on Form MMS-4410, Part B, and (3) the unprocessed gas value is greater than the processed gas value, you must report the following on Form MMS-2014:

- TC 01 (royalty due).
- PC 04 (unprocessed gas).
- STC "OINX."

C. If I elect the actual dual accounting method and my leases are in an index zone, how do I determine the value of processed gas that I sell under a POP contract?

When you elect actual dual accounting in an index zone, the processed gas value is the sum of the following:

1. One hundred percent of the residue gas volume (MMBtu) attributable to your lease multiplied by the index-based value. The index-based value is already reduced for transportation; therefore, you must not reduce your residue gas value further by transportation costs.
2. One hundred percent of the value of the gas plant products attributable to your lease. Determine the value of the gas plant products under 30 CFR 206.174 (2003). You may claim applicable allowances for processing and transportation only if you submit the proper forms or contracts to MMS. Under the regulations at 30 CFR 241.51 (2003) if you do not submit the allowance forms or contracts to MMS within the timeframe required under the regulations, MMS

may send you a Notice of Noncompliance (NONC) telling you what you need to do to correct the violation to avoid civil penalties under 30 U.S.C.1719(a) and (b).

For arm's-length POP contracts, your processing allowance is the value of the residue gas and gas plant products retained by the purchaser. For non-arm's-length POP contracts, your processing allowance is determined under 30 CFR 206.180(b) (2003).

In either situation, the processing allowance must not exceed 66 2/3 percent of the value of the gas plant products. Please note that gas plant products not valued under 30 CFR 206.173 (the alternative methodology for dual accounting), have a minimum value requirement (see 30 CFR 206.174(g)(2)).

3. One hundred percent of the value of any drip condensate attributable to your lease recovered downstream of the FMP without resorting to processing. Drip condensate is valued under 30 CFR 206 subpart B (2003) – Indian Oil (typically, drip condensate is not specifically addressed in a POP contract).

D. If I elect the actual dual accounting method and the processed gas value is greater than the unprocessed value and my leases are in an index zone, how do I report the value of processed gas that I sell under a POP contract?

For gas produced from index zones where (1) your gas production is sold under an arm's-length or non-arm's-length POP contract; (2) you elect actual dual accounting on Form MMS-4410, Part B; and (3) the processed gas value is greater than the unprocessed gas value, you must report the following on Form MMS-2014:

- TC 01 (royalty due).
- PC 03 (residue gas).
- PC 07 (gas plant products).
- STC "OINX" for PC 03.
- STC "POOL" for PC 07.
- If required, see the Minerals Revenue Reporter Handbook for other product codes and corresponding STCs.

IV. Non-Index Zone Information when Gas Production is Sold under a POP Contract

A. How do I calculate my initial gross proceeds value in a non-index zone when I sell my gas under a POP contract?

The regulations addressing non-index-based valuation at 30 CFR 206.174 apply to situations where your lease has a major portion provision or the lease provides for the Secretary of the Interior 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.

- You must value your initial gross proceeds for sales of natural gas in a non-index zone under both arm's-length and non-arm's-length POP contracts as processed gas. The Indian Gas Rule at 30 CFR 206.174 addresses the value of gas production for royalty purposes if your lease is in a non-index zone. You may reduce your initial gross proceeds by allowable transportation and processing costs only if you submit the proper allowance forms or contracts to MMS. As stated earlier, under 30 CFR 241.51, untimely submission of allowance forms or contracts could result in an NONC and possible civil penalties.
- For arm's-length POP contracts, your processing allowance is the value of the residue gas and gas plant products retained by the purchaser. For non-arm's-length POP contracts, your processing allowance is determined under 30 CFR 206.180(b).

In either situation, the processing allowance must not exceed 66 2/3 percent of the value of the gas plant products.

B. How do I report my initial gross proceeds value in a non-index zone when I sell my gas under a POP contract?

You must report your initial gross proceeds for sales of natural gas under both arm's-length and non-arm's-length POP contracts on Form MMS-2014 as processed gas. For gas production from non-index zones where the gas production is sold under either an arm's-length or non-arm's-length POP contract, you must report the following on Form MMS-2014:

- TC 01 (royalty due).
- PC 03 (residue gas).
- PC 07 (gas plant products).
- STC "APOP" for PC 03 if your POP sales contract is arm's-length.
- STC "NPOP" for PC 03 if your POP sales contract is non-arm's-length.
- STC "POOL" for PC 07.
- If required, see the Minerals Revenue Reporter Handbook for other product codes and corresponding STCs.

C. Do I have to perform dual accounting for gas produced from my Indian leases in a non-index zone when I sell my gas under a POP contract?

Yes, you are required to perform dual accounting if your gas is processed under either an arm's-length or non-arm's-length POP contract and your Indian lease terms require dual accounting. If you are required to perform dual accounting under 30 CFR 206.176, you have two choices:

1. You may elect to perform actual dual accounting under 30 CFR 206.176(a), or
2. You may use the alternative dual accounting under 30 CFR 206.173.

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. 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 your election through the remainder of a 2 calendar year period. For succeeding elections, each election to use the alternative methodology must remain in effect for 2 calendar years.

You are required to make a dual accounting election on Form MMS-4410, Accounting for Comparison (Dual Accounting), Part B. (See "Dear Payor" letter dated July 8, 2002, or the MMS Internet website noted above for reporting instructions and a copy of the Form MMS-4410.)

D. When do I report the value of my gas based on the major portion value in a non-index area when I sell my gas under a POP contract?

The MMS will determine the major portion value and notify you in the Federal Register of that value and the due date of your additional royalty payment. We also provide the major portion values and due dates on our Internet website noted above.

The value of production for royalty purposes for your lease is the greater 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 greater, you must submit an amended Form MMS-2014 to MMS by the due date specified in the Federal Register notice. You must use Adjustment Reason Code 16 to report your major portion and dual accounting adjustment for leases located in non-index zones. Late payment interest under 30 CFR 218.102 (2003) on any underpayment will not begin to accrue until after the date the amended Form MMS-2014 is due to MMS.

Under no circumstances may the value of production for royalty purposes be less than the gross proceeds accruing to the lessee for gas, residue gas, and/or any gas plant products, less applicable allowances (30 CFR 206.174(g)(1)).

V. Alternative Methodology for Dual Accounting in Non-Index Zones

A. If I elect the alternative dual accounting method and my leases are in a non-index zone, how do I value my gas that I sell under a POP contract?

The alternative dual accounting methodology adjusts the value of gas before processing to provide the value of the gas after processing. Your gas value under the alternative dual accounting methodology is the MMBtu measured at the FMP multiplied by the greater of the major portion value or the value of the unprocessed gas determined under 30 CFR 206.174(c), multiplied by (1 + increment for dual accounting) listed in the table at 30 CFR 206.173(b)(2)(ii).

If your processed gas value is based on the major portion value, you must not reduce the processed gas value further by transportation costs. The dual accounting increment accounts for processing costs; therefore, you must not reduce your processed gas value further by processing costs.

B. If I elect the alternative dual accounting method and my leases are in a non-index zone, how do I report the value of my gas value that I sell under a POP contract?

For gas produced from non-index zones where (1) your gas production is sold under either an arm's-length or non-arm's-length POP contract, and (2) you elect alternative dual accounting on Form MMS-4410, Part B, you must report the following on Form MMS-2104.

- TC 01 (royalty due).
- PC 04 (unprocessed gas).
- STC "APOP" if your POP sales contract is arm's-length.
- STC "NPOP" if your POP sales contract is non-arm's-length.

VI. Actual Dual Accounting Method in Non-Index Zones

A. If I elect the actual dual accounting method and my leases are in a non-index zone, how do I determine the value of the unprocessed gas that I sell under a POP contract?

When you elect actual dual accounting in a non-index zone, the unprocessed gas value is the MMBtu measured at the FMP multiplied by the greater of the major portion value or the value of the unprocessed gas determined under 30 CFR 206.174(c). If your unprocessed gas value is based on the major portion value, you must not reduce your unprocessed gas value further by transportation costs.

B. If I elect the actual dual accounting method and the unprocessed gas value is greater than the processed value and my leases are in a non-index zone, how do I report the value of the unprocessed gas that I sell under a POP contract?

For gas produced from a non-index zone where (1) your gas production is sold under either an arm's-length or non-arm's-length POP contract; (2) you elect actual dual accounting on Form MMS-4410, Part B; and (3) the unprocessed gas value is higher than the processed gas value, you must report the following on Form MMS-2104:

- TC 01 (royalty due).
- PC 04 (unprocessed gas).
- STC "APOP" if your POP sales contract is arm's-length.
- STC "NPOP" if your POP sales contract is non-arm's-length.

C. If I elect the actual dual accounting method and my leases are in a non-index zone, how do I determine the value of processed gas that I sell under a POP contract?

When you elect actual dual accounting in a non-index zone, the processed gas value is the sum of the following:

1. One hundred percent of the residue gas volume (MMBtu) attributable to your lease multiplied by the greater of the major portion value or the value of the residue gas determined under 30 CFR 206.174 that you initially reported on Form MMS-2014. If your residue gas value is based on the major portion value, you must not reduce the residue gas value further by transportation costs.
2. One hundred percent of the value of the gas plant products attributable to your lease determine the value of the gas plant products under 30 CFR 206.174. You may claim applicable allowances for processing and transportation only if you submit the proper forms or contracts to MMS. As stated earlier, in accordance with 30 CFR 241.51, untimely submission of allowance forms could result in an NONC and possible civil penalties.

For arm's-length POP contracts, your processing allowance is the value of the residue gas and gas plant products retained by the purchaser under the terms of your arm's-length POP contract. For non-arm's-length POP contracts, your processing allowance is determined under 30 CFR 206.180(b).

In either situation the processing allowance must not exceed 66 2/3 percent of the value of the gas plant products. Please note that gas plant products not valued under 30 CFR 206.173, (the alternative methodology for dual accounting), have a minimum value requirement (see 30 CFR 206.174(g)(2)).

3. One hundred percent of the value of any drip condensate attributable to your lease recovered downstream of the FMP without resorting to processing. Drip condensate is valued under 30 CFR 206 subpart B. (Typically, drip condensate is not specifically addressed in a POP contract.)

D. If I elect the actual dual accounting method and the processed gas value is greater than the unprocessed value and my leases are in a non-index zone, how do I report the value of processed gas that I sell under a POP contract?

For gas produced from non-index zones where (1) your gas production is sold under an arm's-length or non-arm's-length POP contract; (2) you elect actual dual accounting on Form MMS-4410, Part B, and (3) the processed gas value is greater than the unprocessed gas value, you must report the following on Form MMS-2014:

- TC 01 (royalty due).
- PC 03 (residue gas).
- PC 07 (gas plant products).
- STC "APOP" for PC 03 if your POP sales contract is arm's-length.
- STC "NPOP" for PC 03 if your POP sales contract is non-arm's-length.
- STC "POOL" for PC 07.
- If required, see the Minerals Revenue Reporter Handbook for other product codes and corresponding STCs.

VII. Transportation and Processing Allowances

A. When can I claim a transportation and/or processing allowance in an index zone when I sell my gas under a POP contract?

If your gas is produced in an index zone, you may claim transportation and/or processing allowances only when you perform actual dual accounting and only for determining the value of the gas plant products.

B. When can I claim a transportation and/or processing allowance in a non-index zone when I sell my gas under a POP contract?

If your gas is produced in a non-index zone, you may claim transportation and/or processing allowances to determine your initial gross proceeds or when you perform actual dual accounting.

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

You must send the contract(s) to:

Manager, Indian Oil and Gas
 Compliance and Asset Management
 P.O. Box 25165, MS-396B2
 Denver, Colorado 80225-0165

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

If you have a non-arm's-length transportation contract or no contract, you must either submit Form MMS-4295 (Gas Transportation Allowance Report) or you may use the alternative transportation allowance calculation. If you claim the alternative transportation allowance, you do not need to submit Form MMS-4295.

If your transportation or processing allowance is non-arm's-length under 30 CFR 206.178(b) (2003) or 30 CFR 206.180(b), you must submit actual cost information to support the allowance to MMS on:

- Form MMS-4295 (transportation).
- Form MMS-4109 (processing).

You must submit the forms within 3 months after the end of the 12-month period for which the allowance applies. Send the allowance forms to Indian Oil and Gas Compliance and Asset Management at the above address. As stated earlier, under 30 CFR 241.51, untimely submission of allowance forms could result in a NONC and possible civil penalties.

E. 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, you do not submit Form MMS-4295. You must notify the Indian Oil and Gas Compliance and Asset Management in writing of your election to use the alternative transportation allowance calculation.

Percentage-of-Proceeds (POP) Contract Summary

Form MMS-2014

Zone	Contract Type	Dual Accounting Method	Valuation Method	Product Codes	Sales Type Code	Adjust Reason Code	Allowances
Index	Arm's-length/Non-arm's-length	Alternative	Percent increase method	04	OINX		None
Index	Arm's-length/Non-arm's-length	Actual	Unprocessed gas value is greater than processed gas value	04 ^a	OINX		None
Index	Arm's-length/Non-arm's-length	Actual	Processed gas value is greater than unprocessed gas value	03 ^b 07 ^c Other	OINX POOL ARMS/NARM		07 - Processing and transportation
Non-Index	Arm's-length/Non-arm's-length		Initially report gross proceeds. Make major portion and dual accounting adjustments after major portion value is published.	03 07 Other	APOP/NPOP POOL ARMS/NARM		03 - Post-plant transportation ^d 07 - Processing and transportation
Non-Index	Arm's-length/Non-arm's-length	Alternative	Percent increase method	04	APOP/NPOP	16	None
Non-Index	Arm's-length/Non-arm's-length	Actual	Unprocessed gas value is greater than processed gas value	04 ^e	APOP/NPOP	16	None
Non-Index	Arm's-length/Non-arm's-length	Actual	Processed gas value is greater than unprocessed gas value	03 ^f 07 ^c Other	APOP/NPOP POOL ARMS/NARM	16	03 - Post-plant transportation ^d 07 - Processing and transportation

^aUnprocessed gas value is wellhead MMBtu x index-based value.

^bResidue gas value is 100 percent of the MMBtu x index-based value.

^cMinimum value provision for natural gas liquids value applies.

^dOnly costs of transporting the residue gas to a sales point away from the plant are allowed.

^eUnprocessed gas value is the greater of value based on major portion price or value determined at 30 CFR 206.174.

^fResidue gas value is the greater of value based on major portion price or value determined at 30 CFR 206.174.