



United States Department of the Interior

OFFICE OF NATURAL RESOURCES REVENUE

P.O. Box 25165
Denver, Colorado 80225-0165

AUG 27 2012

CERTIFIED MAIL --
RETURN RECEIPT REQUESTED

Subjects: 1. Dual Accounting for Indian Leases
 2. Arm's-Length Sales of Indian Gas Beyond the First Index Pricing Point

Dear Reporter:

The purpose of this letter is to remind you of your obligation to properly calculate, report and pay royalties in those instances where dual accounting is required by Indian lease terms, and those instances where you pay royalties on Indian gas produced in an index zone and sold beyond the first index pricing point pursuant to an arm's-length sales contract (safety net sales).

You are hereby given notice that failure to comply with Indian lease terms and regulations may subject you to Office of Natural Resources Revenue (ONRR) enforcement actions, including civil penalties.

What steps must you take if you believe you are exempt from the dual accounting requirements under an Indian lease?

The royalty terms of most standard Indian leases require lessees to compute royalties based on the higher of either the wellhead value of the gas or the processed value. Indian lease royalty terms state, in part:

“It is understood that in determining the value for royalty purposes of products, such as natural gasoline, that are derived from treatment of gas, a reasonable allowance for the cost of manufacture shall be made, such allowance to be two-thirds of the value of the marketable product unless otherwise determined by the Secretary of the Interior on application of the lessee or on his own initiative, and that royalty will be computed on the value of gas or casing-head gas, or on the products thereof (such as residue gas, natural gasoline, propane, butane, etc.), **whichever is greater.**” [Emphasis added]

As a result, the lessee agrees to perform dual accounting under the terms of the lease.

If you believe you are exempt from the dual accounting requirements under an Indian lease, you must submit Form MMS-4410, Accounting for Comparison (Dual Accounting) and certify that you are exempt based on one of five reasons in Part A “Certification For Not Performing Dual Accounting” 30 CFR § 1210.153(a)(1) (2011). The five reasons for not performing dual accounting are:

1. *Lease terms do not require dual accounting.* Certain older Indian leases do not contain language that requires dual accounting.
2. *None of the gas from the lease is ever processed.* This exemption indicates that gas produced from the Indian lease is never processed **at any time by anyone**.
3. *Gas has a Btu content of 1000 Btu's per cubic foot or less at the lease's measurement point(s).* Gas royalties are computed based on quality and quantity measured at the Bureau of Land Management (BLM) approved facility measurement point typically at the wellhead¹. Regulations at 30 CFR § 1206.173(b)(4)(ii) (2011) specifically exclude from dual accounting, leases whose gas at the facility measurement point is equal to or less than 1000 Btu per cubic foot.
4. *None of the gas from the lease is processed until after gas flows into a pipeline with an index located in an index zone.* You are certifying that Indian gas produced from leases **in** an index zone is not processed **by any party** at any point between the facility measurement point and the first interconnect with a pipeline having a published index price, see 30 CFR § 1206.176(c) (2011).
5. *None of the gas from the lease is processed until after gas flows into a mainline pipeline not located in an index zone.* You are certifying that Indian gas produced from leases **outside** of an index zone is not processed **by any party** at any point between the facility measurement point and the first interconnect with a mainline pipeline, see 30 CFR § 1206.176(c) (2011).

How do you determine the minimum value for royalty purposes when you sell gas produced from Indian leases under an arm's-length sales contract beyond the first index pricing point?

The Indian Gas Valuation regulations at 30 CFR § 1206.172(e), effective January 2000, specify how to determine the minimum value for royalty purposes of gas sold beyond the first index pricing point pursuant to an arm's-length sales contract.

The regulations refer to these minimum values as "safety net" prices. You are required to calculate safety net prices each calendar year pursuant to the formula specified in the regulations and report these prices on the Safety Net Report (Form MMS-4411).

You must determine safety net price calculations for each sales month and for each index pricing zone. You must pay additional royalties if the safety net price differential is positive.

You must submit all Form MMS-4411's and, if applicable, the associated Form MMS-2014 (Report of Sales and Royalty Remittance) and payment to ONRR no later than June 30th following each calendar year that you have safety net sales.

¹ The facility measurement point is typically at the wellhead. The Bureau of Land Management (BLM) must approve any measurement of gas that occurs off the lease or agreement area.

This letter does not require that you perform any type of restructured accounting, reporting, or recalculation and payment of royalties. This letter is not an appealable decision, order, Notice of Noncompliance, or Civil Penalty Notice under 30 CFR Part 1290 Subpart B (2011) or 30 CFR Part 1241 (2011). If ONRR issues you an order, Notice of Noncompliance, or Civil Penalty Notice at a later date in accordance with the matters addressed in this letter, we will provide your appeal rights at that time.

If you have any questions contact Joel Arnold, Supervisory Auditor, Central Audit and Compliance Management at (405) 879-6007.

Sincerely,

A handwritten signature in black ink, appearing to read "Theresa Walsh Bayani". The signature is fluid and cursive, with a large initial "T" and a long, sweeping underline.

FOR Theresa Walsh Bayani
Program Director
Audit and Compliance Management