United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

CVD/PAB
Mail Stop 3671

JAN 30 1997

Dear Reporter:

On August 13, 1996, President Clinton signed into law the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (RSFA). Since RSFA amended the Federal Oil and Gas Royalty Management Act of 1982 in several important ways, the Minerals Management Service (MMS) anticipates that you will have a number of questions about how it affects royalty reporting requirements. MMS will amend its regulations at Title 30 of the Code of Federal Regulations to address the reporting requirements of RSFA.

This letter addresses several basic questions, explains Section 6 of RSFA regarding reporting and payment requirements, and provides interim reporting guidelines for you to use when reporting royalties on Federal leases and agreements.

1. When does RSFA take effect?

The provisions of RSFA apply to production removed and sold from a Federal lease, unit participating area or communitization agreement (agreement) beginning September 1996. This includes any volumes sold from inventory held at a site prior to the royalty determination point during that month.

2. For reporting purposes, does this Act apply to Indian or Solid Mineral Leases?

No. Although parts of Section 205 (Delegation of Royalty Collection and Related Activities) may affect solid minerals leases, the reporting provisions of RSFA apply only to Federal onshore and offshore oil and gas leases.

3. Who is responsible for reporting royalties under RSFA?

RSFA states that a lessee or operating rights owner must report and pay royalties. However, a lessee or operating rights owner may designate another party to report and

pay on its behalf. The MMS will publish separate guidelines on how to establish a designee and who is actually liable for royalty payments. If you currently report and pay royalties to MMS on a Federal lease, continue to do so until we publish additional guidelines.

4. How do I report and pay royalties on Federal properties?

MMS requires royalty reporting at the "accounting identification" (AID) number level. An AID number is the 10-digit lease number plus the 3-digit revenue source code used to uniquely identify the source of production; that is, a unit participating area, a communitization agreement, or lease-basis production.

In order to report and pay properly, you must determine which type of production your AID number identifies:

1. Lease-basis production

   Production occurring on the lease that is not allocated to an agreement.

2. Agreement production

   a. Production attributable to an agreement that contains only Federal leases having the same royalty rate and royalty distribution; that is, all revenue is distributed to the same State or surface management agency (100 percent Federal Agreement).

   b. Production attributable to any agreement not identified in paragraph 2.a. (mixed agreement).

If you report on an AID number identified in paragraphs 1 or 2.a. above, you must report and pay royalties based on the actual volume of production sold or removed from the lease/agreement by you or on your behalf (takes). For example, assume total oil sales from an agreement consisting of two Federal leases with the same royalty rate and same royalty distribution is 100 barrels, and you own 50 percent of one of the leases but take all 100 barrels. You must report and pay royalties on all 100 barrels.

If you report on an AID number identified in paragraph 2.b. above, you must report and pay royalties based on the volume of production sold or removed from the agreement allocated to your lease under the approved allocation schedule (entitlements), no matter who takes the production. For example, assume total oil sales from an agreement with one Federal lease and one State lease with each lease receiving a 50 percent allocation, is 100 barrels. If you own 50 percent of the Federal lease but take all 100 barrels, you must report and pay royalties on 25 barrels. The other operating

rights owner(s) in the Federal lease must report and pay royalties on the remaining 25 barrels.

5. How can I determine which agreements meet the criteria stated in paragraph 2.a. above?

We can help you determine which agreements meet the criteria stated in paragraph 2.a. above. The agreements are listed on MMS's Worldwide Web Homepage at http.//www.rmp.mms.gov. If you are unable to access our Homepage, need assistance, or have questions on the agreements, please contact our Reference Data Branch at 1-800-525-9167.

6. How does subsection 6(d) affect my royalty liability?

This subsection does not change a lessee's or operating rights owner's ultimate liability to pay royalty on its entitled or allocated share. This subsection does establish a requirement to report and pay on the volume taken in certain situations, but does not relieve the lessee or operating rights owner's of its obligation should the taking party be unable to pay.

7. Does MMS expect me to balance any over- or under-allocated production in August 1996?

No. MMS has always required royalties on 100 percent of the volumes removed, sold, or allocated to a lease each month, regardless of who takes or sells the production.

8. Are there alternative methods for reporting and paying royalties?

Yes. If all lessees in an agreement contractually agree to an alternative method, they may submit a written request to MMS for approval. The proposed alternative cannot reduce the royalty obligation that would otherwise be due. You must receive approval from MMS before using your requested method to report royalties.

9a. Are there any exceptions to the entitlements reporting requirements of subsection 6(d)?

Yes. If a mixed agreement meets the criteria established by RSFA, MMS may grant an exception to entitlements reporting for that agreement. The criteria are as follows:

> The combined equivalent production volumes of less than 15 barrels of oil and 90 thousand cubic feet (Mcf) of gas per producing well per day.

However, MMS, in concurrence with each State, may modify the criteria.

9b. How do I get an exception?

You must apply to and receive approval from the Chief, Compliance Verification Division, MMS, before you can begin reporting under the exception. We will publish guidelines on how to obtain an exception to entitlements reporting and a list of eligible properties after we complete consultation with the States.

9c. How do I report under the exception?

If MMS grants an exception, you can report on "takes" throughout the year and you must "true-up" to entitlements by the end of June of the next calendar year. Interest will begin accruing on January 1 following the production year. We will publish guidelines on how to report under the exception after we complete consultation with the States.

10. How does subsection 6(d) impact adjustments to sales periods prior to September 1996?

This subsection does not impact sales periods prior to September 1996. Unless MMS directs you to change your method of reporting (takes or entitlements), you should use your original reporting method to make any adjustments for prior periods. We will notify you of any additional guidelines in a separate letter.

11. What guidance will MMS issue regarding other provisions of RSFA?

We are working closely with the States and the oil and gas associations to implement other provisions of RSFA and draft any necessary regulations. To obtain updates on our progress, please see the MMS Homepage or call Ms. Jan Therkildsen at 1-800-525-0309, extension 3604.

Please contact Mr. Roman Geissel at 1-800-634-6423, extension 3226, if you have questions regarding this letter.

Sincerely,

Lucy R. Querques
Associate Director for
Royalty Management