

Government when a lessee breaches its operational obligation to diligently protect the lease from drainage. See *Benson-Montin-Greer*, 123 IBLA 341 (1992); See 43 CFR 3100.2 and 3162.2(a). Just as the other means of satisfying the requirement to protect from drainage (drilling of an offset well or communitization) are indivisible, and thus joint and several, so is the alternative of compensatory royalty payments. It is proposed that the liability of a record title owner or operating rights owner for payment of compensatory royalty would not be proportionate to the share owned. In other words, each record title owner and operating rights owner would be jointly and severally liable for the total amount of compensatory royalty due.

As explained above, it is MMS's principal proposal in this rule that the liability of a record title owner for royalties and other payments is limited to its proportionate ownership interest in the lease, or takes if greater. However, MMS would like comment on whether MMS should hold each record title owner liable for the royalties and other payments due on all the production from the lease. In other words, under this alternative, all record title owners would be jointly and severally liable for all the royalties and other payments, like they are proposed to be for compensatory royalties. Commenters are requested to provide legal authority and citations to support their comments either in support of, or opposed to, this alternative proposal.

b. *Operating rights owners.* When a lease is issued, the record title owner owns operating rights for the lease equal to its percentage of record title. The operating rights owner is the person who has the right to take production from the lease equal to its percentage of operating rights ownership. The record title owner may sever some or all of its operating rights and transfer them to another person. In such event, under § 211.14.(b), if you are the transferee of the operating rights, you would incur liability for royalty due on production from, or allocated to, the lease, and for other payments, in the amount MMS determines to be owed. The liability would be determined essentially the same as for record title owners.

Therefore, at a minimum, you would be liable for royalty and other payments based on a percentage equal to your percentage of operation rights ownership in the lease. To illustrate, assume a Lease is issued to Record Title Owner A and Record Title Owner B, each owning 50 percent. Record Title Owner A then transfers half of its operating rights to you. In this example,

you would be liable for royalty due on 25 percent of the lease production. However, under proposed § 211.14(b)(1)(ii), if you actually take 40 percent of the production from the Lease and sell it, your liability extends to 40 percent of the production. Like record title owners, your liability exists even if you assigned the obligation to make the royalty payments to another person, such as the purchaser of the production.

Under proposed § 211.14(b)(2), if you own operating rights that were not transferred from your record title interest, paragraph (a) determines your liability. This is because your record title interest would be equal to or greater than your operating rights interest and would govern your liability. If you own operating rights that were transferred from the record title interest, you are jointly and severally liable for royalty and other payments with the person who holds the record title interest from which your operating rights were transferred. However, you are still only liable for your percentage interest. You are not jointly and severally liable for the percentage of the operating rights interest that the record title owner either retained or transferred to another person. But, if you take more than your percentage entitlement, then you expand your joint and several liability. Thus, if in the above-described example you take 40 percent of the production, Record Title Owner A takes 10 percent and Record Title Owner B takes 50 percent, you and Record Title Owner A are jointly and severally liable for 40 percent of the production. If the example is changed and you take 10 percent of the production and Record Title Owner A takes 40 percent, then you are jointly and severally liable with Record Title Owner A for royalty on 25 percent of the production (equal to your percentage of operating rights ownership). (Remember: this section addresses liability only. The responsibility to report and pay may be different and is addressed later.)

As an operating rights owner, you also would be jointly and severally liable with the same other persons as the record title owner described under proposed § 211.14(a), including:

- any other person assigned or who has assumed the obligation to pay royalty or make other payments,
- any person who filed a PIF for the production or other payments for which you are liable, and
- any other person who is liable for the payments under this part.

For operating rights owners, like for record title owners, MMS's principal proposal in these rules is to determine

liability based on percentage of ownership, or takes if greater. MMS would like commenters to address whether it should provide instead that all operating rights owners are jointly and severally liable for all royalties and other payments due from the lease. Comments should include legal authority and citations in support of the comment.

c. *Persons who file PIFs with MMS.* Under MMS's current royalty accounting and collection procedures, any person may report and pay the royalties and other payments owed on lease production. It may be the record title owner, an operating rights owner, an operator or even a purchaser. However, the MMS's Automated Financial System (AFS) requires that a royalty payor file a Payor Information Form (PIF) (Form MMS-4025 for oil and gas and Form MMS-4030 for solid minerals) and be assigned a payor code before the system will accept the monthly Report of Sales and Royalty Remittance (Form MMs-2014). See the MMS "Oil and Gas Payor Handbook," Volume 1, at Chapter 2; and the MMS "Solid Minerals Payor Handbook" at Chapter 2.

When MMS determines either through its automated compliance procedures or an audit that royalties are underpaid, MMS will bill or order payment from the payor for that deficiency. The payor is billed because that is the person on whom MMS has information in its system regarding that production; MMS's Royalty Management Program does not maintain data on record title owners or operating rights owners. Therefore, while there are other persons who may be liable for some or all of the royalty deficiency (such as the record title owner or an operating rights owner), it is essential that MMS be able to look first to the payor for the underpayment. It would be the payor's responsibility to then seek appropriate contribution from other parties.

Under existing procedures, MMS has always considered that the person who filed the PIF would be liable for underpaid royalties. However, in *Mesa Operating Limited Partnership*, 125 IBLA 29 (Dec. 31, 1992), Mesa filed Payor Information Forms and paid MMS royalties on production it purchased from several Indian oil and gas leases. Mesa did not own any interest in these leases. MMS ordered Mesa to pay additional royalties found to be owed on these leases. Mesa administratively appealed MMS's order and the Interior Board of Land Appeals (IBLA) held that when Mesa filed the Payor Information Forms and made royalty payments, that