



**PIONEER**  
NATURAL RESOURCES USA, INC.

**RULES PROCESSING TEAM**

**MAY 23 2003**

May 16, 2003

Rules Processing Team  
Department of the Interior  
Minerals Management Service; Mail Stop 4024  
381 Elden Street  
Herndon, Virginia 20170-4817

Re: Notice of Proposed Rulemaking (NPR) – March 26, 2003  
AD01 – Deep Gas Provisions – 30 CFR Part 203

Dear Sir/Madam:

Pioneer Natural Resources, Inc. (Pioneer) appreciates the opportunity to comment on this important rulemaking. As background, Pioneer is an independent Exploration and Production Company based in Las Colinas, Texas with extensive interest in the Gulf of Mexico. Pioneer has ownership in 109 Federal OCS Leases in the Gulf of Mexico with daily production of approximately 230 MMCFE/Day. Pioneer has two areas of exploration focus over the next two to three year period: deepwater and deep gas on the shelf in the Western Gulf. Because of our commitment towards deep gas exploration, we are vitally interested in this proposed rulemaking and believe we are well qualified to comment on it.

#### **General Comment**

The Department of the Interior and the MMS, in particular, are to be commended on its initiation of this important rulemaking to facilitate the finding and development of deep gas reserves. Pioneer shares your concern that the growing gap between projected natural gas demand in the U.S. and gas reserve replacement is alarming. Without focused and meaningful incentives in the remaining few areas of access, such as the Central and Western Gulf, it is difficult to envision how the U.S. is going to meet its future energy needs. A simple, properly designed deep gas royalty relief program will provide some incentive for E&P operators to offset the additional expense of operating in the deep, hot environs associated with deep gas exploration and production.

Pioneer's comments below address the elements of the proposed rulemaking from the perspective of a serious E&P participant that sees significant potential in the deep gas resources in the Gulf. We also provide you with our views on the effectiveness (and shortcomings) of other royalty incentive programs, e.g., deep water royalty relief, that are beyond the scope of this rulemaking. The inclusion of this latter discussion is intended to provide a context for presenting our views on the proposed rulemaking that will ensure that the final deep gas regulation will avoid the issues that some of us have encountered in the existing programs. We fully recognize that the MMS will not be able to address the issues raised in non-deep gas royalty incentive programs in this

rulemaking exercise, but hope you will consider a review of them in a separate effort to the extent the underlying statutes permit.

**Pioneer's Experience with Current and Proposed Royalty Relief Programs on Operated Properties.**

The table presented in Attachment I compares Pioneer's current and proposed capital projects against the eligibility requirements for the deep water and proposed deep gas royalty relief programs as of May 2003. The results are disappointing. As of today, Pioneer has spent \$364 MM and intends to spend an additional \$ 433MM to explore for and develop deep water and deep gas reserves. As indicated by the table, none of the projects would qualify for royalty relief this year under the two programs if prices remain at or near current levels due to price thresholds being surpassed or unless technical modifications are made to the eligibility requirements.

The royalty relief incentives under the Deep Water Royalty Relief Act were definitely a significant factor in our decision to drill and develop the two deep water projects shown in the table. Unfortunately, due to the use of threshold prices, it appears that this incentive will not be operative this year, and could prove to be inoperative for some time to come depending on commodity prices in an ever tighter supply/demand marketplace. We believe this is an unwise outcome and should be avoided in the promulgation of the deep gas royalty incentive currently before the MMS. When gas prices are rising, signaling that demand is growing faster than supply, lessees should be afforded the full suite of incentives available to meet the demand, including deep water royalty relief suspension volumes. To actually *eliminate* an incentive in the face of a tightening of supplies is exactly the opposite of what should be done.

Turning to the four deep gas projects in the table, while royalty relief incentives under a deep gas regulation were not contemplated, per se, in the decision to include these wells in the 2003 drilling budget, the long anticipated regulations provided an encouragement to begin to focus on these types of prospects in the Gulf. The first of these wells, Project A (Actual lease, block and well names are contained in our administrative notification letter to the MMS Regional Office, Production and Development dated May 6, 2003), was actually drilling on the date the regulation was proposed; the other three are in various stages of planning, and will be subject to additional economic analyses prior to actually being spudded. The final regulation will be an important consideration in our decisions on all four of the wells. For Project A, apparently ineligible under the proposed regulations due to its being spudded prior to March 26, 2003, the decision to complete or sidetrack and develop will have to clear an economic hurdle that could be improved with the inclusion of royalty relief volumes. This factor could prove to be critical in the case that the well discovers marginal reserves. As noted below in our recommendations, we believe the goals of the regulations—to add substantial domestic natural gas reserves—would be furthered if wells such as these with economic decisions still pending were included in the final regulation. The second deep gas project, Project B would apparently be ineligible under the proposed rulemaking due to the lease having already produced from a deep gas formation at about 16,500 feet. Project B has a depth target of about 20,100 feet and seeks to discover, develop and produce reserves that are in a completely different geological structure. As discussed below in our recommendations, the MMS should consider making wells drilled on leases with previous deep gas production eligible leases when they are drilled to substantially different depths and/or to different geographic structures. Finally, the last two deep gas projects would appear to be otherwise eligible except for the application of the price thresholds, at least for this calendar years. Should lessees expect commodity prices to fall below the threshold prices in future years, they could actually *delay* their deep gas drilling program in order to time the eligible production

stream to coincide with periods of relief. As argued below, threshold prices not only send the wrong signal to those of us attempting to deliver more supply, but could result in the delay of a drilling program to periods that would prove more profitable.

**Restatement of Objective, Terms of Reference and Authority Granted the Secretary of the Interior in the Outer Continental Shelf Deep Water Royalty Relief Act of 1995.**

Pioneer believes the MMS objective is to:

Establish an incentive program to add as many gas reserves as possible and accelerate natural gas production over the next several years to meet anticipated demand while other new North American sources of gas come on line.

Pioneer believes the following guiding principles should be utilized when designing the incentive program. The program should be:

- Simple to understand and implement.
- Considerate of revenue obligations to the U.S. Treasury.
- Structured to get deep footage drilled and quantify the deep gas potential of the Central and Western Gulf.
- Recognize that royalty incentives are operative at both the exploration decision stage as well as the development/infrastructure phase.
- Not distort decision-making with regards to well timing, completion depth, and development/completion strategy and infrastructure.

Pioneer also believes it is important to restate the authority granted to the Secretary in the Royalty Relief Act of 1995.

*In the Western and Central Planning Areas of the Gulf of Mexico and the portion of the Eastern Planning Area of the Gulf of Mexico encompassing whole lease blocks lying west of 87 degrees, 30 minutes West longitude, the Secretary may, in order to —*

- i) promote development or increased production on producing or non-producing leases; or*
- ii) encourage production of marginal resources on producing or non-producing leases;*

*through primary, secondary, or tertiary recovery means, reduce or eliminate any royalty or net profit share set forth in the lease(s). With the lessee's consent, the Secretary may make other modifications to the royalty or net profit share terms of the lease in order to achieve these purposes.*

Pioneer's following comments on the proposed rule are intended to meet the spirit of the restated objective, design principles, and authority provided to the Secretary of the Interior in the Royalty Relief Act

**Specific Comments – Price Thresholds**

Pioneer recommends that the MMS entirely drop the threshold pricing requirements contained in the proposed rulemaking. As mentioned in the preamble of the Deep Gas proposed regulation, one of the key drivers is to immediately increase gas reserves and production volumes to meet short term demand while other sources of North American gas are brought on line in the 2006

timeframe. With current YTD May 2003 price above the current proposed threshold, there is no incentive in this rulemaking to drill deep gas this year.

Also, as mentioned in the Pioneer's capital budget discussion, the regulations as written, might provide a disincentive to drill deep gas targets this year. Some operators with existing deep gas drilling or development plans may try to delay operations in an attempt to time development with pricing just below proposed threshold levels.

Beyond today's commodity prices, it would be easy to envision a natural gas supply/demand market in which prices stayed above the threshold price during the entire term of the regulation. Under this scenario, the incentives intended in the regulation would never be operative and thus, do nothing to improve the natural gas supply picture for the nation. This certainly is not the intent of the regulation and should be avoided by the elimination of threshold prices. In short, the intent of this rulemaking should simply be immediately add reserves and volumes, regardless of price, not just those that would be economic at \$ 5.00 and below.

**Specific Comments – *Successfully qualified deep well* definition:**

As previously mentioned, Pioneer has a planned drilling program as outlined above to explore for deep gas in the western gulf area over the next several years. Promulgation of these proposed rules should assist us in adding even more reserves as royalty suspension on qualifying leases helps with key decisions such as sidetrack and/or completion, vs. abandonment after the well is drilled.

Pioneer is currently drilling a deep gas well on a possibly eligible lease and is experiencing well trouble due to extreme temperature and pressure. The additional costs of the well could negatively impact the decision to sidetrack and/or complete the well if well results are marginal. The presence of royalty incentives could favorably impact the post-drilling decisions regarding sidetracks and/or completion..

As written, the subject well would not fall under the definition of a *Successfully qualified deep well (30 CFR 203.0)* because it was spudded on February 17, 2003. (Not after March 26, 2003 as proposed in the definition). Pioneer recommends the following suggested change (**in bold**) to the definition of *Successfully qualified deep well* to ensure all deep gas wells on eligible leases with economic decisions still before them are included in the royalty incentive program.

*Successful qualified deep well* means a new deep well completed on your lease:

- (1) That was **in initial drilling operations on March 26, 2003** or begins drilling after March 26, 2003, and
- (2) That begins producing natural gas, including gas associated with oil production before (Date that is five years after the effective date of the final rule).

**Specific Comments – Sidetracks, Completions, Workovers and Infrastructure.**

Pioneer believes the economic cases to design this proposed royalty relief program are too focused on the drilling costs and not enough on completion, workover and infrastructure costs. The preamble to the proposed rule indicates the MMS utilized data from the API 1999 & 2000 joint survey on Drilling Costs. It is believed this survey did not include data on completions,

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workover and infrastructure costs. These development costs tend to be much more expensive for high pressure / high temperature wells.

Deep gas royalty relief will provide incentive to drill for deep gas, however where it is most helpful is with decisions around completion, sidetracks, workovers and infrastructure development decisions once some amount of reserves have been quantified. Our experience in high temperature / high pressure areas indicates operators encounter much higher than normal completion costs and need to plan for at least one expensive workover to maintain production. The completions in the Norphlet trend, referenced in OCS Report MMS 2001-037 (*The Promise of Deep Gas in the Gulf of Mexico*) were tremendously expensive and almost all of the wells needed extremely expensive workovers to maintain production.

As highlighted in *The Promise of Deep Gas in the Gulf of Mexico*, a deep gas well produced 65 MMCFD for 32 days before “problems with the completion caused the well to be shut in and abandoned” in 1999. This illustration of deep gas potential provided by the MMS demonstrates the need for royalty relief in the post-exploration phase and is a great example of why it should be considered.

The MMS should also consider including deep gas sidetracks into the rule because they relate to the infrastructure statement contained in the background of the preamble. It says; “Production from deep wells on existing leases in shallow water, where significant infrastructure already exists, is the most attractive source on the OCS of additional natural gas to meet near and mid-term energy needs of the nation.” Failure to include sidetracks under the rule could drive operators to make inefficient decisions to qualify a well under the program. For example, an operator with an existing platform with shallow production may choose to drill a new deep well bore away from the platform instead of utilizing an existing wellbore on the platform to drill to the same deep target. Under the proposed regulations, the new wellbore could qualify and the sidetrack would not qualify. Drilling the new wellbore could be considered an inefficient use of capital if the same objective could be reached at less expense from an existing well bore. The incentive of the program should be to get new, deep footage drilled. It should not pay for footage that has already been drilled and quantified.

#### **Specific Comments – Lease Eligibility and Existing Infrastructure**

Pioneer recommends the MMS consider dropping section 203.40 c) from the lease eligibility requirements of the Deep Gas Provisions to potentially add more reserves and production from the Gulf of Mexico. As previously mentioned in the Capital Budget section, the Project B (20,100’ target) lease would apparently not qualify for royalty relief because of previous deep gas (16,500’ interval) production on the lease. This also seems to be in conflict with the previously cited existing infrastructure statement included in the background section of the preamble. Royalty relief availability for this proposed well could influence completion and development decisions if the deep gas well is marginally successful.

It is also unclear why the MMS excluded leases where previous deep gas production has occurred because the statute language cited above indicates the Secretary has the authority to grant royalty relief.

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**Specific Comments – Utilize Drilling Depth to a Pre-defined Target, instead of Top Perforated Interval to Define a “Deep Well” and Serve as a Simple Basis for Deep Gas Royalty Relief.**

Pioneer believes the MMS should utilize drilling depth to a pre-defined target instead of top perforated interval to define a “Deep Well”. Attempting to utilize top perforated interval could encourage some operators to make poor completion decisions in an attempt to qualify their well.

As a general statement which essentially summarizes our overall comments on the proposed rule, Pioneer believes a deep gas royalty relief program that simply requires the operator to drill to a deep, pre-defined, bona fide target to qualify for some volume of relief to be used anywhere on the lease would encourage the most deep footage being drilled below 15,000’.

**Specific Comments – Other Issues**

Pioneer will defer comments on unitization, and auction issues to the industry trade associations that will be commenting on the proposed regulation. It should be noted that we are supportive of their comments.

Pioneer believes the recommended changes in this comment letter to be within the spirit of the rulemaking and provide for a more effective program to add deep gas reserves and capacity in the shortest timeframe to meet the nation’s forecasted demand for natural gas.

If you have any questions or comments regarding these comments, please do not hesitate to contact me in Las Colinas at (972) 969-3990.

Thank you for the opportunity to comment on this important rulemaking.

Very truly yours,



Jay Still  
Vice President, Gulf of Mexico

Attachment

cc: API Offshore Issues Group  
Domestic Petroleum Council  
Independent Association of Drilling Contractors  
US Oil and Gas Association  
National Ocean Industries Association  
Offshore Operators Committee  
Denny Bullard

## Attachment I

Lease Number & Sale Number	Project Description	Capital Budget (Spent / To be Spent \$ MM) **	Qualifies for Royalty Relief as of May 2003 (Yes / No)	Comments
<b><i>Deepwater Royalty Relief Program</i></b>				
OCS G-19025 & 19030 (Sale #168)	New Field Deep Water Development in 3 <sup>rd</sup> month of production	(\$0MM / \$300MM)	No	Royalty relief volume confirmed by MMS, however actual NYMEX YTD (\$ 5.78) exceeds threshold target of \$4.12
OCS G-20745 (Sale #171)	New Field Deep Water Development to come on production Dec. 2003	(\$50 MM / \$53MM)	No	Should meet all royalty relief requirements except threshold price.
<b><i>Proposed Deep Gas Royalty Relief Program</i></b>				
* Project A (lease sale # 177)	Exploration Well currently drilling. Target 15,700	(\$14MM / \$ 44MM)	No	Well was spudded (2/17/2003) before March 26, 2003 NPRM. Threshold Price Problem.
*Project B (lease sale #62)	Exploration well on a lease which is currently producing. Spud August 2003. Target -20,100'.	(\$ 0MM / \$80MM)	No	Lease had previous gas production from around 16,500. Threshold price problem.
*Project C (Sale # 174)	Exploration well on new lease. Spud May 2003 Target – 18,200'	(\$0MM / \$71MM)	No	Threshold price problem.
*Project D- (Sale # 180)	Exploration well on new lease. Spud Dec. 2003 Target – 18,000'	(\$0MM / \$185MM)	No	Threshold price problem.

\* Note: Actual lease, block and well names are contained in our administrative notification letter to the MMS Regional Office, Production and Development date May 6, 2003.

\*\* Note: Full projects costs (e.g. wells, structures, facilities, pipelines)