RULES PROCESSING TEAM

MAY 2 3 2003

NOIA NATIONAL OCEAN INDUSTRIES ASSOCIATION

ipaa America's Oil & Gas Producers

US Oil & Gas Association

DPC Domestic Petroleum Council

NGSA Natural Gas Supply Association

May 23, 2003

Department of the Interior
Minerals Management Service
381 Elden Street
Mail Stop 4024
Herndon, VA 20170-4817

ATTN: Rules Processing Team (Comments)

RE: Proposed Rule - Relief or Reduction in Royalty Rates – Deep Gas Provisions (68 Fed. Reg. 14868, March 26, 2003).

Dear Sir or Madam:

As representatives of the Nation's natural gas and oil industry, the Domestic Petroleum Council, the Independent Petroleum Association of America, the International Association of Drilling Contractors, the National Ocean Industries Association, the Natural Gas Supply Association, and the US Oil & Gas Association appreciate the opportunity to respond to your request for comments on the proposed rule. Our six national trade associations represent thousands of companies, both majors and independents, engaged in all sectors of the U.S. oil and natural gas industry, including exploration, production, refining, distribution, marketing, equipment manufacture and supply, and other diverse offshore support services. Either directly or indirectly, we are all working to explore for and produce hydrocarbon resources from the nation's Outer Continental Shelf (OCS) in an environmentally sensitive manner. The proposed regulation, therefore, is of particular importance to us.

The proposed rulemaking would provide royalty relief for existing shallow water leases under the authority of the Deep Water Royalty Relief Act of 1995 (Pub. L. 104-58). It would establish a two-tiered royalty suspension program for leases issued before January 1, 2001, in the Gulf of

Mexico, in waters less than 200 meters of water depth that commenced drilling before March 26, 2003. The incentive would include a royalty suspension volume for a lease on the first 15 billion cubic feet (BCF) of deep gas production for a new well drilled and completed from 15,000 feet to 18,000 feet subsurface and on the first 25 BCF for a new well drilled 18,000 feet or deeper subsurface. In addition, up to two royalty suspension supplements per lease of 5 BCF, applied to future oil and gas production anywhere on the lease, would be allowed for unsuccessful wells drilled to a target reservoir of 18,000 feet or deeper.

The undersigned associations commend the Minerals Management Service (MMS) for the proposal and strongly support the proposed rulemaking. We recommend that some provisions of the proposal be amended to allow sidetracking to be covered under the incentive and to provide for the extension of the five year limitation on a case by case basis. In addition, we strongly recommend the addition of a third tier of relief for ultra deep gas drilling. Finally, we strongly oppose the auction mechanism described in the notice.

Proposed Rule

The natural gas market is in a state of transition. Historically, the needs of gas consumers have been largely met by traditional supply sources from existing U.S. basins and imports from Canada. Today, the North American market consumes roughly 25 trillion cubic feet (TCF) of natural gas per year. Demand continues to rise, and according to forecasts by various organizations, U.S. natural gas demand is expected to reach 30 TCF per year by 2015.

As America's natural gas needs are increasing, the production from traditional supply sources is declining. The increased demand and declining production requires that the industry seek resources in places that have not been as economic or as attractive in the past. One of these areas is the potential for deep gas on the Gulf of Mexico continental shelf. The MMS Gulf of Mexico Regional Office has reported that while 80% of Gulf gas comes from shallow water, "shallow water gas production is in a steep slide." While the shallow waters of the offshore Gulf of Mexico have been an area of substantial exploration, sediments located at depths greater than 15,000 feet below sea level and in less than 200 meters of water depth are relatively unexplored.

While the shelf is an area of extensive history and activity, the depths below 15,000 feet are, in a sense, a new potential exploratory frontier. Out of the more than 50,000 wells drilled in the shallow waters of the Gulf of Mexico, only 5% have penetrated deeper than 15,000 feet subsea, while only 1% have penetrated depths greater than 17,000 feet subsea. These numbers are startling when you consider that the MMS estimates that there could be up to 20 TCF of recoverable natural gas below this depth.

Industry has only recently developed the technology to explore at these depths. Drilling advances now allow us to reach greater depths, and 3D seismic technology, and the manner in which this data is analyzed, allows us to see what lies at these depths and to identify new targets. However, drilling success remains highly challenging. Even with seismic reprocessing, targets at such depths remain unclear, temperature and pressure regimes are intense, and industry's technological tool kit is still in its early stages.

Drilling at these depths on the shelf is also very expensive. The projects require significantly more geological and geophysical data acquisition and manipulation, unconventional rig specifications, innovative well construction techniques, and increased costs for support facilities. While drilling costs for conventional shallow water wells average between $6 and $7 million, drilling one deep gas exploratory well can result in costs ranging from $10 to $80 million. If exploration is successful, development will follow, but deep wells face a high risk of failure, so in order to justify the high capital outlays required, these projects require the discovery of large resource accumulations with potential for high flow rates. Furthermore, this incentive will spur industry to overcome the many technical challenges involved in deep shelf drilling, so that the heretofore untapped deep gas pools may be harvested.

We strongly support the MMS proposal to accelerate the discovery and production of natural gas from wells drilled to deep depths on existing shallow water leases. If successful, deep gas is one of the few short-term options available to help stem our current domestic natural gas production decline and deliver significant new production through infrastructure that is already in place.

Sidetracks

We object to the exclusion of sidetracking operations from the proposal. Sidetracking existing well bores is a common practice followed in the Gulf of Mexico. With over 3,500 shelf platforms in existence, it makes sense to use a previously drilled well bore to drill a new deep test. This allows for conservation and efficient use of existing infrastructure, less impact on the environment, and a safer operation. If a deep gas well can be mechanically drilled using an existing well bore, then the well should be drilled that way. We strongly recommend that the MMS reconsider this exclusion, and encourage the use of existing wells to drill, develop and produce deep gas opportunities.

Five Year Time Limit

There is concern that five years from the effective date of the rule is not enough time to explore for and produce deep reserves, given the technological challenges that such production will entail. We recommend that MMS amend this provision to grant the authorized officer the authority to extend the time on a case-by-case basis, for circumstances in which additional time is justified to safely develop and start production. Examples of the technical justification would include: high temperatures and high pressures requiring special wellheads, downhole tubulars, downhole equipment, and composition of gas that may require special equipment or unusual metallurgy.

Ultra Deep Royalty Relief

While we applaud the MMS' initiative in proposing to accelerate gas production, we believe that the proposal could be enhanced with an additional tier of royalty relief. Many companies believe that the real targets of opportunity lie beneath the 20,000 foot depth. Large targets are always developed first, and the government needs to encourage exploration to discover those deeper targets. The difference in cost to drill an 18,000 foot well and a 20,000 foot well is dramatic. These regions remain frontier areas in many ways, and unless significant relief is offered for production in this important potential province, the ultra deep gas frontier will remain largely untapped. Therefore, we strongly recommend that an additional tier of relief be granted under the rule.

The third tier of relief would be a royalty suspension volume for a lease on the first 35 BCF of deep gas production for a new well drilled and completed from 20,000 feet or deeper subsurface. This added relief would compensate for the unique challenges present in these uncharted depths. The third tier would be added to the two tiers already outlined in the proposed rule -- a royalty suspension volume on the first 15 BCF of deep gas production for a new well drilled and completed from 15,000 to 18,000 feet subsurface, and a royalty suspension volume on the first 25 BCF of deep gas production for a new well drilled and completed from 18,000 to 20,000 feet subsurface.

The ultra deep incentive is included in the proposed energy bills currently under consideration in the United States Congress. This relief would provide incentives to all companies, large and small, to take the risks associated with the newly identified deep gas plays. It would provide greater relief for the areas of the greatest potential and the highest cost to develop. And, combined with the existing infrastructure on the Gulf of Mexico shelf, new gas reserves could be brought to market very quickly.

Auction Mechanism Discussion

We strongly oppose the auction mechanism, as described in the notice. Under the proposed rule, the MMS would create an incentive to accelerate deep gas drilling for companies holding leases in shallow waters on the Gulf of Mexico shelf. The auction mechanism would defeat the purpose of the rule, denying relief to those that need it most. An auction would not serve as an incentive to drill wells that would not otherwise be drilled.

In addition to our overriding opposition to the auction proposal, we also oppose the cumbersome administrative structure that the auction mechanism would attach to the deep gas royalty relief program. Under the proposed rule, a company drills a qualified well and is granted the relief. With an auction, a company would have to wait for the auction, and would not be willing to invest any time, manpower or funding into the project until granted the winning bid at the auction. This would slow down the acceleration of drilling.

Finally, companies that receive winning bids in an auction would not necessarily have to then use the granted relief to drill the well. After placing a winning bid, a company may decide not to drill a deep gas well on the lease due to the time that has passed since it was placed or some other intervening factor that makes the project uneconomic. Other companies that may have been willing to drill will be unable to do so because they would not have been granted the relief in the auction. The current proposed rule solves this problem by requiring that the well be drilled before the relief is granted.

Thank you again for considering our comments on the proposed rule. If you have any questions or need additional information, please feel free to contact Kim Harb at (202)347-6900.

Sincerely,

National Ocean Industries Association

Independent Petroleum Association of America

US Oil & Gas Association

International Association of Drilling Contractors

Domestic Petroleum Council

Natural Gas Supply Association