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RULES PROCESSING TEAM

OCT 17 2000

October 16, 2000

Walt Rosenbusch
Director, Minerals Management Service
US Department of the Interior
Mail Stop 4024
381 Elden Street
Herndon, Virginia 20170-4814
Attention: Rules Processing Team

RE: Minerals Management Service Proposed Rule, Outer Continental Shelf Oil and Gas Leasing. 65 **FR** 55476-55489, September 14, 2000.

Dear Walt:

The National Ocean Industries Association, American Petroleum Institute, Domestic Petroleum Council, Independent Petroleum Producers Association, International Association of Geophysical Contractors and the US Oil & Gas Association appreciate the opportunity to provide comments on the above referenced Minerals Management Service proposed regulation.

For nearly two years, our associations and member companies have participated in a cooperative effort with MMS focused on the future of royalty relief policies following the expiration of Section 304 of the Deepwater Royalty Relief Act. We believe this effort has been beneficial and anticipate additional dialog will be necessary as royalty relief policies are considered, adopted and implemented.

Our comments today are a compilation of industry observations and answers to the questions laid out in the proposal. These responses are from members of four industry subcommittees established to address key issues relating to royalty relief for Gulf of Mexico leases. These subcommittees include: ultra-deepwater relief (>1600 meters); administrative issues and process simplification; deepwater relief (200-1600 m) and shelf or shallow water royalty relief.

We anticipate companies will provide additional and detailed comments directly to the agency and that this trade association response should not prejudice differing views expressed by any member company. Also, included as part of this submission, is the August 3, 2000 trade association response to the MMS Director's questions asked of us during a June 20, 2000 deepwater royalty relief meeting. As many of the questions asked by the Director are similar to those raised here in the proposed rule, we request that our earlier responses to be included in the record and considered by the agency.

We also encourage MMS to incorporate several fundamental principles into any future royalty relief policies it may develop. First and foremost, are the concepts of certainty and stability. Planning for major OCS investments is a long-term process that becomes nearly impossible if the "ground-rules" are constantly changing. Royalty relief policies also must include predictability and transparency. Operators considering making an application for supplemental deepwater royalty relief should be able to do their own analysis and predict with reasonable accuracy whether MMS would be likely to approve the application. Also, we believe MMS should actively consider incentives in other areas of the OCS and Gulf of Mexico outside of the deep-water province. Finally, it is important for MMS to continue the process that has involved industry in the discussion, examination and consideration of future royalty relief policies.

We thank you for your consideration of our views.

Sincerely,

Robert B. Stewart
President
National Ocean Industries Association

Mark Rubin
Upstream General Manager
American Petroleum Institute

William Whitsitt
President
Domestic Petroleum Council

Albert Modiano
Vice President
US Oil & Gas Association

Ben Dillon
Vice President
Political Affairs & Public Resources
Independent Petroleum Association of America

Charles F. Darden
President
International Association of
Geophysical Contractors

Enclosures:

(1) Trade association response to 65 FR 55476. MMS Proposed Rule on Outer Continental Shelf Oil and Gas Leasing.
(2) Trade association August 3, 2000 response to questions raised at June 20, 2000 deepwater Gulf of Mexico royalty relief meeting.

The National Ocean Industries Association, American Petroleum Institute, Domestic Petroleum Council, Independent Petroleum Producers Association, International Association of Geophysical Contractors, and the US Oil & Gas Association appreciate the opportunity to provide comments on the above referenced Minerals Management Service proposed regulation. Our comments to specific questions asked in the MMS proposal follow.

Future Royalty Suspensions

- What factors should we consider, and how should we evaluate these factors, when we choose water depths beyond which bidders still need leasing incentives in the GOM?

The MMS should consider several factors when choosing water depths in which bidders need leasing incentives. Within the ultra-deep water province, (>1600 m) the costs for exploration and development are considerable, fewer rigs are available to explore these leases and there is a significant lack of infrastructure to support ultra-deep water activities. Within the deepwater province, (200 – 1600 m) the remaining prospects are riskier and smaller.

- What elements besides water depth should we consider, and how should we consider them, when deciding how much royalty suspension to offer on new leases?

Besides water depth, MMS should consider elements related to subsalt drilling, deep drilling and areas with a history of unexpected or poor reservoir performance. Known sub-salt regions should be granted greater suspension volumes up-front due to the significant costs associated with sub-salt exploration. There should also be an automatic upward adjustment in suspension volumes for high-sulphur or low API crude, once samples have been obtained. Discoveries at drill depths encountering a High Pressure/High Temperature environment should trigger an automatic incremental royalty suspension volume. Deep drilling on the shelf could be a prime candidate.

As noted above, companies are exploring deeper horizons on the shelf where the geologic risk is significant and well costs are considerable. Incentives to open up this new frontier and potentially reverse the forecast production declines would be timely.

- Which of the following leasing policies would encourage more domestic investment, given equal expected rates of return, and why would it do so? One offering a: (a) Substantial royalty suspension volume coupled with higher than normal royalty rates (*e.g.*, 20 percent) for additional production between specified cumulative production volumes; or (b) Modest royalty suspension volume but with only normal lease royalty rates for production above the royalty suspension volume?

Given the varied views expressed by our members, we recommend that MMS give close and careful consideration to those comments submitted by producer companies.

- Does the likely increase in bid levels and shift of uncertainty from government to industry that are associated with royalty suspension adversely affect small companies relative to large companies?

Industry would like MMS to clarify this question, as we do not see that the royalty relief program is affecting a company's actions based on the company's size.

Lease-Based Royalty Suspension

- Do you agree with our observation that a lease-based royalty relief program, providing a guaranteed royalty suspension volume to each lease regardless of which field it overlies, is preferable to a field-based royalty relief program, providing a royalty suspension volume to be claimed by the earliest producers on a field?

A lease-based approach could be preferable if it takes into account adjustment for where the lease(s) falls in regard to the boundaries of a field. Basing royalty relief on an individual lease basis, as opposed to the current field basis, means that relief will be sensitive to how the field boundaries happen to match lease boundaries.

- Do you share our expectation that royalty suspension volumes tailored to a typical tie-back development will promote bidding and exploration in the deep water areas that will be available in the next several years?

In the ultra-deep water, the MMS should still be concerned with encouraging stand-alone facilities. In the shallower more mature, heavily explored and developed areas, access to infrastructure may be more common but a significant proportion of the discoveries that may be made can require stand-alone facilities and, even in these water depths, suspension volumes should be targeted to those types of developments.

- Is it reasonable to assume between 2 and 3 leases per field will be developed as a tie-back?

MMS should not assume more than two leases per field will be developed as tie-backs. The MMS royalty relief process should allow automatic adjustment of the suspension volumes if the operator subsequently shows the tieback field is entirely on one lease.

- What benefits would occur for bidders and lessees if we modified the volume suspensions offered on new leases every 3 years as opposed to more frequently?

Industry would like to minimize uncertainty when they are making investment decisions for seismic acquisition and processing and for staffing. The lead-time necessary to accomplish this may vary but a 3-year time frame should be adequate to accommodate almost every situation. Modifications that are much more frequent than that could begin to deter some investment decisions. Again, we encourage MMS to give careful review to the individual company responses to this question.

<u>Rental Payments</u>

- What effect, if any, would rental obligations during periods of royalty-free production have on the way firms plan and manage a project?

We will defer to the opinions of our respective member companies but believe the effect will be minimal.

- Do you agree with our observation that, given current costs, technology and development options in deep water and the dynamic nature of these factors, the program would benefit from periodic adjustments at the time of lease sales in price thresholds for new leases?

No; as stated previously economic terms should be predictable over a time frame of several years in order to encourage the investments that need to be made by industry to prepare for lease sales. MMS should appreciate that frequent changes in the royalty relief program would be a disincentive to industry investment and participation in OCS lease sales.

- Do you believe that adjustments in royalty obligations, other than retroactively for the previous calendar year are desirable? If so, why and what is the nature of the preferred adjustments?

No. Certainty is preferred.

- Do you agree with our preliminary findings that the applicable price thresholds should be 10 to 15 percent below the levels currently applicable under the Act, *e.g.*, $28 rather than $31 per barrel for oil, and $3.45 rather than $3.90 per million British thermal units?

While we support the concept of a price threshold at which royalty suspensions end, it should be borne in mind that industry bears the brunt of low price cycles and high price cycles help to balance this out. The current price threshold recognizes the inflation in costs that have occurred since 1995 and it is not an unreasonable level.

<u>Change to Royalty Suspension Policy for Eligible Leases</u>

One final item of note is a proposed requirement that a lessee with eligible leases issued with a royalty suspension volume notify the MMS Regional Supervisor for Production and Development before starting production. Does this additional notification step impose any meaningful burden on lessees?

No.

August 3, 2000

Mr. Walt Rosenbusch
Director
Minerals Management Service
1849 C Street, NW
Washington, DC 20240

RE: Industry Response to Questions Raised at June 20 Deepwater Gulf of Mexico Meeting

Dear Walt:

Attached is an industry response to the questions raised at the June 20th industry trade association meeting on the future of Gulf of Mexico deepwater royalty relief. The response is made on behalf of the National Ocean Industries Association membership and those of the American Petroleum Institute, Independent Petroleum Association of America, US Oil and Gas Association and the Domestic Petroleum Council.

Although the Deepwater Royalty Relief Act (DWRRA) coincided with an improvement in E&P "market forces," it was clearly a success, resulting in record deepwater leasing activity, record bonus bids to the federal treasury, pushing technology into the deepwater frontier and in significant reserve additions. While conditions have changed in the energy market and energy industry since 1995, we believe maintaining a world class, competitive system of royalty relief for new leases is necessary to keep Gulf of Mexico deepwater exploration an attractive investment opportunity in today's global markets and industry.

The associations appreciate the opportunity to work with you and your staff on the design, elements and conditions of future royalty relief policies in the Gulf and we share a common objective in seeking the continuation of deep water royalty relief for new leases through the agency's existing regulatory authority.

We would like to suggest another meeting between the energy trades and MMS officials in the near term to discuss agency reaction to the industry trade association response and the efforts of the industry working group and its four subcommittees.

Sincerely,

National Ocean Industries Association
American Petroleum Institute
Independent Petroleum Association of America
US Oil and Gas Association
Domestic Petroleum Council

Attachment: Industry Trade Association Responses to MMS (June 20 meeting)

1.) *At the Houston meeting on June 6, the MMS Director addressed how the growth in leasing and deepwater activity over the last 4 years demonstrate successful achievement of the DWRRA objectives. What is industry's perception about the successes of the DWRRA, with respect to exploration and development? To what extent, if any, has this success revealed the importance of royalty relief for the current inventory of unleased blocks?*

The DWRRA has been a dramatically successful program. The timing of the step-up in industry activity seems to show a clear link to the start of royalty suspensions. As the MMS has itself stated, "immediately after the DWRRA was enacted deepwater leasing activity exploded."[1] While factors other than the DWRRA may have contributed, Figure 1 demonstrates that this "explosion" occurred in a relatively low oil price environment. Most importantly, historic data indicate that increased leasing leads directly to increased drilling and production.[2] The large volume of active leases, the steady drilling program, and the growing deepwater infrastructure all indicate that the deepwater GOM will continue to emerge as an integral part of this Nation's energy supply.[3]

In regard to the unleased blocks as well as the blocks that will be relinquished or expire undrilled, current industry perception of these blocks is that they may not be prospective. For blocks that have small uneconomic targets, improvements in drilling and producing technologies and increases in infrastructure development may make some of them economic at some point. Increasing the royalty burden on these leases will delay and reduce any chance of their being produced in the future. Other blocks that have targets that are difficult to image and define may become prospective if investments are made in new seismic acquisition with improved parameters, as well as investments in expensive seismic processing techniques such as prestack depth migration. Clearly again, an increase in the royalty burden can only serve to discourage industry from making the investments required.

Additionally, while most of the blocks that will expire undrilled may be uneconomic to the companies that have held them, at least some of these may be attractive to other companies and may be leased in future sales. At least in the near term the inventory of expiring blocks will be primarily in shallower (less than 5000 feet) portions of the deepwater. Very few blocks will be expiring in the ultra-deep areas (Figure 2).

With regard to the ultra-deep areas of the Gulf of Mexico (>1600m), we believe there is a strong case to be made in support of continued or enhanced relief for unleased blocks. Ultra-deep operations are at the leading edge of OCS technology, operating in a high cost environment without existing infrastructure. Royalty relief for ultra-deep leases will encourage the development of new, higher risk geologic plays that will develop into hubs that will support smaller satellite fields.

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[1]Baud, R. D., R. H. Peterson, C. Doyle, G. E. Richardson, 2000 *Deepwater Gulf of Mexico: America's, Emerging Frontier.* OCS Report MMS 2000-022. New Orleans. pg. 5

[2] Ibid. pg. 75.

[3] Ibid. pg. 77.

2.) *MMS repeatedly hears that industry would like to see a program of deepwater royalty relief for the future with the same suspension volumes for the same water depths, either through a reauthorization of the Act or up to a 15-year policy. We understand the reasons industry would like this, but could you provide specific data and rationale explaining the <u>need</u> for such a program? Would you also discuss some of the major points, data, and reasons that explain industry's viewpoint on the need for royalty relief in the 200 to 1600 meter water depth area?*

--Also, In the Gulf of Mexico OCS, there are differences in the infrastructure between the 200 to 800 meter water depth area and the 800 to1600 meter area. Considering the differences in infrastructure and unleased acreage in these areas what distinction does industry see between them in terms of deepwater royalty relief?

Industry "needs" deepwater royalty relief to increase the overall economic return for the play, to maintain a level of activity that will justify the continuation of regional acquisition of 3D data, and to ensure that the wedge of fields that are not economic without relief are drilled.

Activity in the deepwater is driven by economic expectations. While the deepwater has certainly been a successful play, in that resources have been discovered and economic benefits have been enjoyed by offshore service and supply companies, a study that should be published shortly shows the overall rate of return to lease holders has only been 9% in nominal dollars. Applying an inflation factor would reduce the actual rate of return to 7%.[4] Based on experience in other parts of the world, industry has expectations that better returns can be achieved. Deepwater royalty suspensions have contributed to the attractiveness of the play even though the amount of "relief" contained in the program is fairly small. Even a small change in economic attractiveness can evidently have dramatic effects, as the last few years have shown.

The DWRRA encouraged numerous independent companies to enter into the deepwater play (Figure 3). The intensified competition has led not only to more leases being bid and to higher bonuses being paid, but also a greater number of companies encouraging service companies to shoot vast amounts of 3D seismic data. These "spec" shoots are dependent on underwriting from multiple companies and decreases in the number of companies attracted to the play will directly affect the amount of new data acquisition. In addition, the acquisition of new data is a driver of other activity.

There clearly is a range of field sizes that can be developed if royalty suspensions are in place that would not be economic without these suspensions. Efforts to model the size of this wedge are currently underway. The actual number depends on predictions of the remaining resource and models of development costs. Any prediction will be subject to debate but we believe the volumes involved are significant and that the modeling efforts will support this conclusion.

While the "wedge", however it is calculated, will contain a rather narrow range of field sizes it will lie in a range that is close to the expected target size of many of the remaining deepwater prospects, especially in the shallower (i.e. 200 – 1600 meters) portions of the deepwater. Average field size in the deepwater of current fields and discoveries we expect to be developed

[4] Derman, A., publication pending. Submitted to <u>Oil and Gas Journal</u>.

has been approximately 125 million barrels. That average size, however, will certainly decline as the play becomes more mature.

The impact of deepwater relief is not only in the play economics or an overall increase in the number of fields that could theoretically be economically accessed. Prospects must be leased and drilled before any resource potential can be realized. The most important effect of deepwater relief may be the "comfort level" a company can get, or perhaps better stated as the decrease in the uncertainty, that the exploration well it is deciding to drill will result in something that can be developed at a profit. According to a Department of Energy analysis of a typical deepwater project, the "results of the economic evaluation under conditions of uncertainty show that the major stimulus of the DWRRA may be more from its impact on the relative chance of success and failure, than from the simple gains in expected returns."[5]

The MMS does have the ability to retroactively grant relief to discoveries that cannot be economically developed without that relief. The delays and difficulties involved in applying for and justifying a discovery for that relief, however, will discourage some companies from making a decision to lease or drill a prospect if their expected discovery size would require retroactive relief. <u>A guarantee of royalty suspension volumes in the lease sale is, we believe, essential to ensure that a significant portion of the deepwater resource is developed</u>.

The wedge of fields that are not economic without royalty suspensions exists in all water depths and the 200 – 1600 meter depths are no exception. In addition, the play in these water depths is reaching a mature stage. Most of the large amplitude-defined targets that have been the thrust of industry's efforts have already been drilled. Smaller or more difficult to define targets will have to be drilled for activity to continue. These prospects have dramatically lower chances of success and/or lower economic returns and are, therefore, more influenced by the presence or absence of predictable royalty relief.

While 3D seismic has been shot over most of this water depth range, new surveys with improved parameters are needed to image deep targets. These surveys can only be economically justified if a large number of companies are willing to continue investing in the play. Increasing the royalty burden would be a dramatic disincentive to this industry activity.

There is more existing infrastructure in the 200-800 meter water depth range than in the 800-1600 meter range but any cutoff based on water depth will be arbitrary. In general, costs do increase with water depth and with distance from infrastructure. Costs also depend however on a number of other factors that have nothing to do with water depth. Given identical prospects in each of these water depths, the shallower water prospect would have more value and would seem to need relatively less "relief". The reality is, however that you will not find two identical prospects or operators; and that the better prospects in the shallower water have probably already been drilled. As areas mature, smaller operators become involved and industry is faced with smaller and higher risk opportunities. At this stage, incentives should be increased not decreased.

[5] US Department of Energy, EIA, Natural Gas Issues and Trends: 1998, Appendix C "Economic Analysis of a Representative Deep-Water Gas Production Project". Pg. 186

The DWRRA program has, as the MMS itself has stated, produced dramatic increases in industry activity. Industry's response to the program has been exactly what was hoped for. The strongest justification for extending the program should be the success it has achieved and the "need" for its continuation obviously becomes greater as the play matures and smaller field sizes become the primary targets. We would expect the discussions following a program that has been this successful to be about increasing incentives not ending them. We should be talking about extending this program to all of the water depths and all of the future lease sales administered by the MMS.

There have been allusions made to the program being a "windfall" for industry. While a company may discover an individual field that will have high rates of return, all of the information we have seen points to relatively low rates of return when a company's overall record is taken into account. Any discussion of a "windfall" needs to look at all of the investments companies make in personnel, regional seismic coverage, lease bonuses, and lease rentals. For every "good" field there are also wells drilled that result in dry holes, sub-economic discoveries, and "marginal" fields. As shown above, all of these costs drag the industry rate of return down to a moderate level.

In addition, the program has a built-in protection against a "windfall". The basic program is not applied retroactively – that portion of the DWRRA applies only to fields that must be proved uneconomic to develop without relief. The basic program applies to new leases that must be competitively bid. To the extent that any of these acreage blocks have exceptional value, this will be reflected in the bonuses paid to the government, as long as there are enough companies active in the play to enable a truly competitive sale. Average high bids did rise as the number of companies active in the play increased. Doing away with royalty relief for future sales will, however, undoubtedly discourage competition by discouraging smaller companies and consortia from participating in future lease sales.

In addition, the MMS has, and frequently exercises the right to reject winning bids that they believe do not represent fair market value. They have all of the same seismic data and well information that industry has to make these determinations because industry is required to provide access to that data to the MMS.

3.) To what extent do you see future discoveries on currently-unleased blocks being developed through tie-backs versus stand-alone facilities, in comparison to leased tracts, including those having discoveries?

Many future discoveries that are close to existing infrastructure will be developed as "tie-backs" rather than stand-alone facilities because of the lower capital investments required. Many close-in fields, however, will still be developed with stand-alone facilities. Fields which have multiple reservoirs which require numerous recompletions, fields which require large numbers of wells because of the lack of reservoir continuity, and fields which will require secondary recovery (i.e. water injection), may be more economically developed with stand-alone facilities. Each field will have its own unique economics and it is difficult to project what proportion will be developed with subsea facilities.

4.) *Re. industry investments in deepwater Gulf of Mexico: why aren't the newly-acquired leases in deepwater areas, especially from 200 to 800 meters, being explored and developed currently at a greater rate? Why were those companies that favor continuing relief in these water depths not more active in acquiring leases in recent sales?*

Industry will drill first those prospects that have the greatest potential and the greatest chance of success. The remaining prospects in the shallower water depths are difficult to image and high risk or they are very small. We do not think it is surprising that industry is slow to drill or that companies are hesitant to lease additional blocks. In the last sale there were not many blocks offered that were clearly prospective, as is evident in the small number of blocks that received multiple bids (Figure 4). Nevertheless, there was a significant amount of industry interest with 28 companies bidding in water depths under 6000 feet.

5.) *Re. alternative investment opportunities: what is it that makes areas like offshore West Africa and Brazil more or less attractive than the Gulf of Mexico for investing in exploration and development (what are the pros and cons--is it expected differences in financial terms, concession systems, larger reserves, a ROR comparison? And what role does political risk play in the investment decision?)*

Industry will preferentially invest in countries and plays that they perceive will give them the best return for their investment. All factors are weighed in that determination, including field sizes, number of prospects per concession, discovery rates, oil quality, exploration costs, development costs, financial terms and political risk. Different companies will weigh these factors differently and many companies will, of course, diversify and invest in multiple areas.

West Africa and Brazil have both attracted significant levels of industry activity in deepwater plays and the quantity of oil found in these areas puts them in the same rank as the Deepwater Gulf of Mexico (Figure 5). Figure 6, however, demonstrates that deepwater fields in Brazil and West Africa have been more than twice the average size of those found in the Gulf of Mexico. These large average field sizes have led to rates of return in Brazil, Nigeria and Angola that have ranged between 14% and 17% versus the 7% return in the GOM deepwater. These results will encourage continued industry investment in these areas and that will decrease the pool of capital available for investment in the Gulf of Mexico. The deepwater drilling rig count (Figure 7) does show continued (though declining) activity in the Gulf but it also demonstrates that there is a significant demand for these rigs in other parts of the world.

The specific role of political risk in decisions is not always strictly economic because it is hard to quantify. It is obviously a factor and obviously the U.S. fares well in comparison to many other countries. The U.S. has a stable government and the rule of law is adhered to. Nevertheless, while this is certainly not true of every country it is still true of most. It should also be pointed out that political risk is not just about stable government, it also concerns the interest the government has in promoting oil and gas development and the cooperation and business climate engendered by the bureaucracies set up to regulate the industry.

In June of 1998, NOIA made a series of presentations to MMS during a workshop on Gulf of Mexico royalty policies. At the time, industry and MMS were examining the state of the Gulf of Mexico as we approached the "half-way mark" of the Deepwater Royalty Relief Act. The conditions outlined in the presentation titled, *Offshore Gulf of Mexico as a Global Investment Choice,* remain true today.

- The amount of dollars exposed at lease sales reflects an active competitive area
- The attractive Gulf of Mexico deepwater royalty suspension volumes offset tougher geology and a high carried cost of failure
- Continuance of attractive terms for the Gulf of Mexico is needed to compete with the global commercial terms and areas of more favorable geology.
- Industry can not afford lesser attractive terms to explore for 50-125 mmBOE fields
- Industry can not count on price; therefore it looks to the stability of commercial terms.

6.) Does industry have any suggestions for ways to encourage increased natural gas production from the shelf areas of the OCS?

The obvious answer to encouraging more natural gas production from the shelf is to improve access to OCS acreage and provide the economic incentives necessary to encourage production. The single best incentive that the MMS has at its disposal is royalty relief.

Shelf prospects currently being drilled and produced are decreasing in size and field life span. These prospects are generally found above 12,000 feet subsurface and are relatively routine to drill. Prospects much larger in size exist at greater depths on the continental shelf but the costs to drill to these depths are equivalent to the costs of deepwater wells and the hydrocarbons expected at these depths are natural gas rather than oil. Incentives to open up this new frontier and potentially reverse the forecast production decline would be timely.

To encourage increased natural gas production we recommend MMS:

- Hold Eastern Gulf of Mexico Lease Sale 181 on time, with no tract deletions and with reasonable stipulations;
- Work with industry to improve the regulatory climate governing offshore exploration and production;
- Articulate the need and benefits (enhanced national energy security, and relief from spikes in consumer's gasoline and natural gas prices) of OCS exploration and production of oil and natural gas in the MMS 2002-2007 OCS leasing plan;
- Seek the implementation of recommendations issued in the National Petroleum Council report *Meeting the Challenges of the Nation's Growing Natural Gas Demand*;
- Investigate technologies and incentives for deepwell exploration, including subsalt, development on the shelf;
- MMS and the administration should "reassert paramount national interest" in energy policy decisions; and
- MMS should institute a timely and predictable process providing royalty relief for new deepwater leases in the Gulf of Mexico.

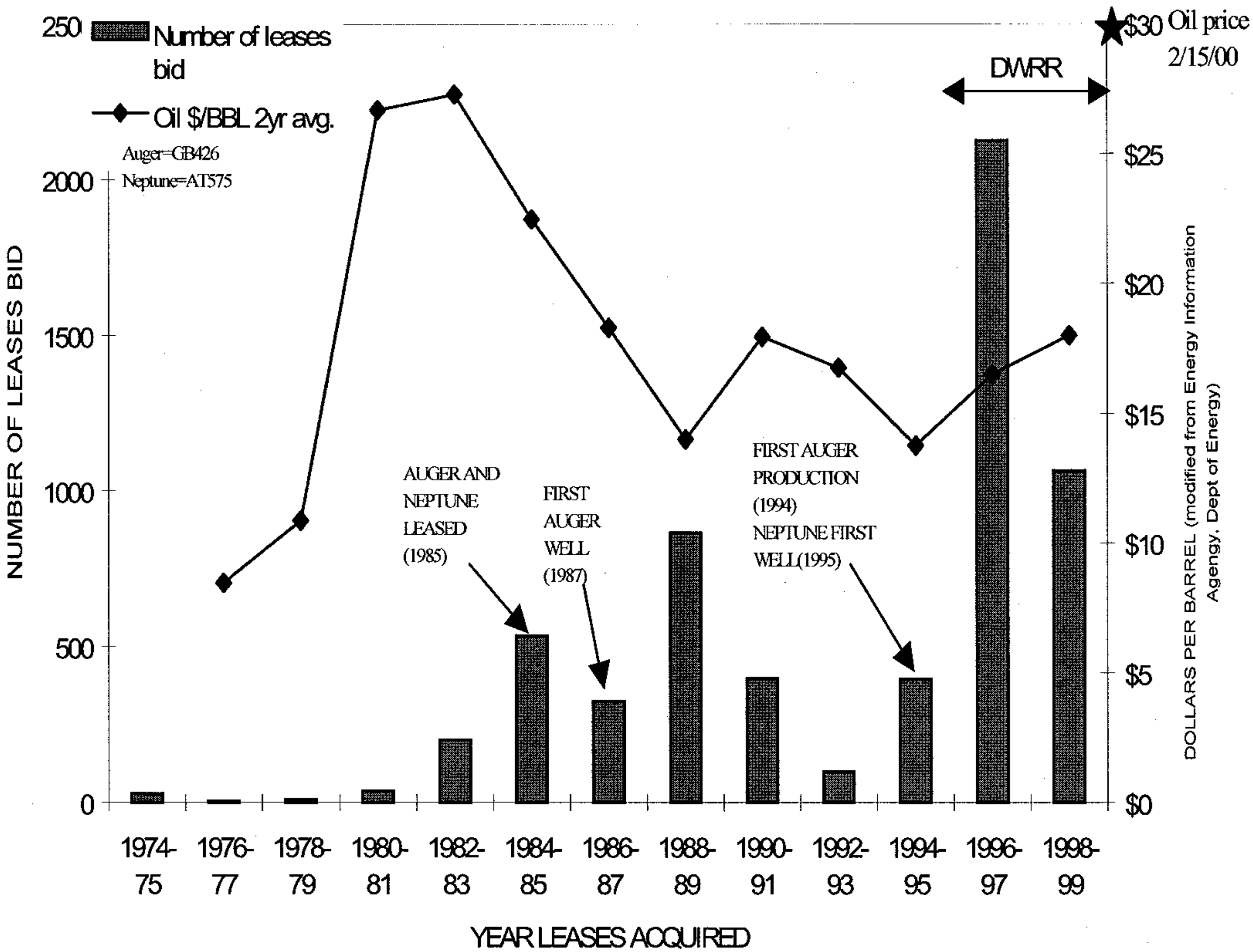

Figure 1 (from Baud etal. MMS 2000-022 Figure 52)

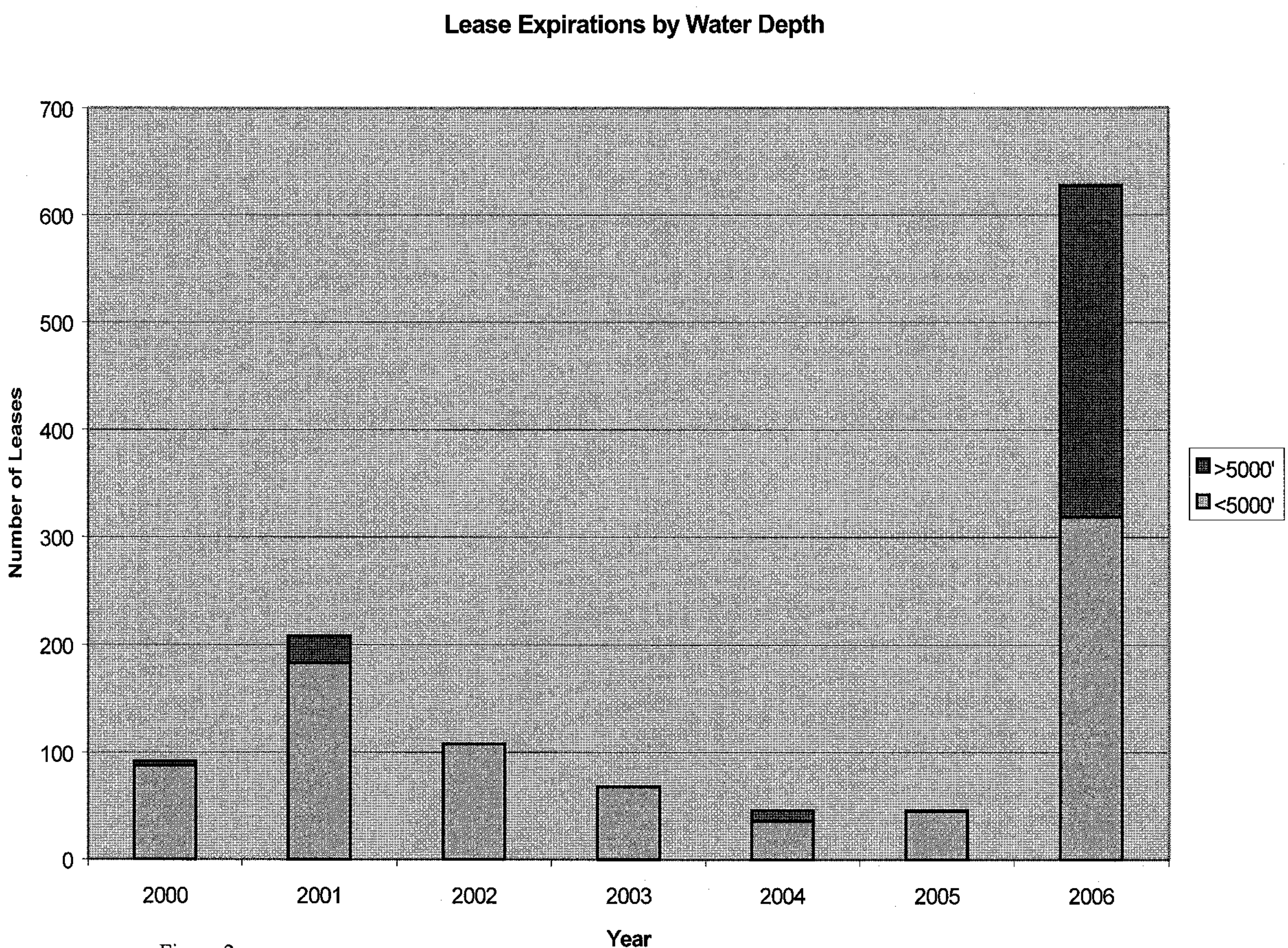

Figure 2

Source: MMS Data

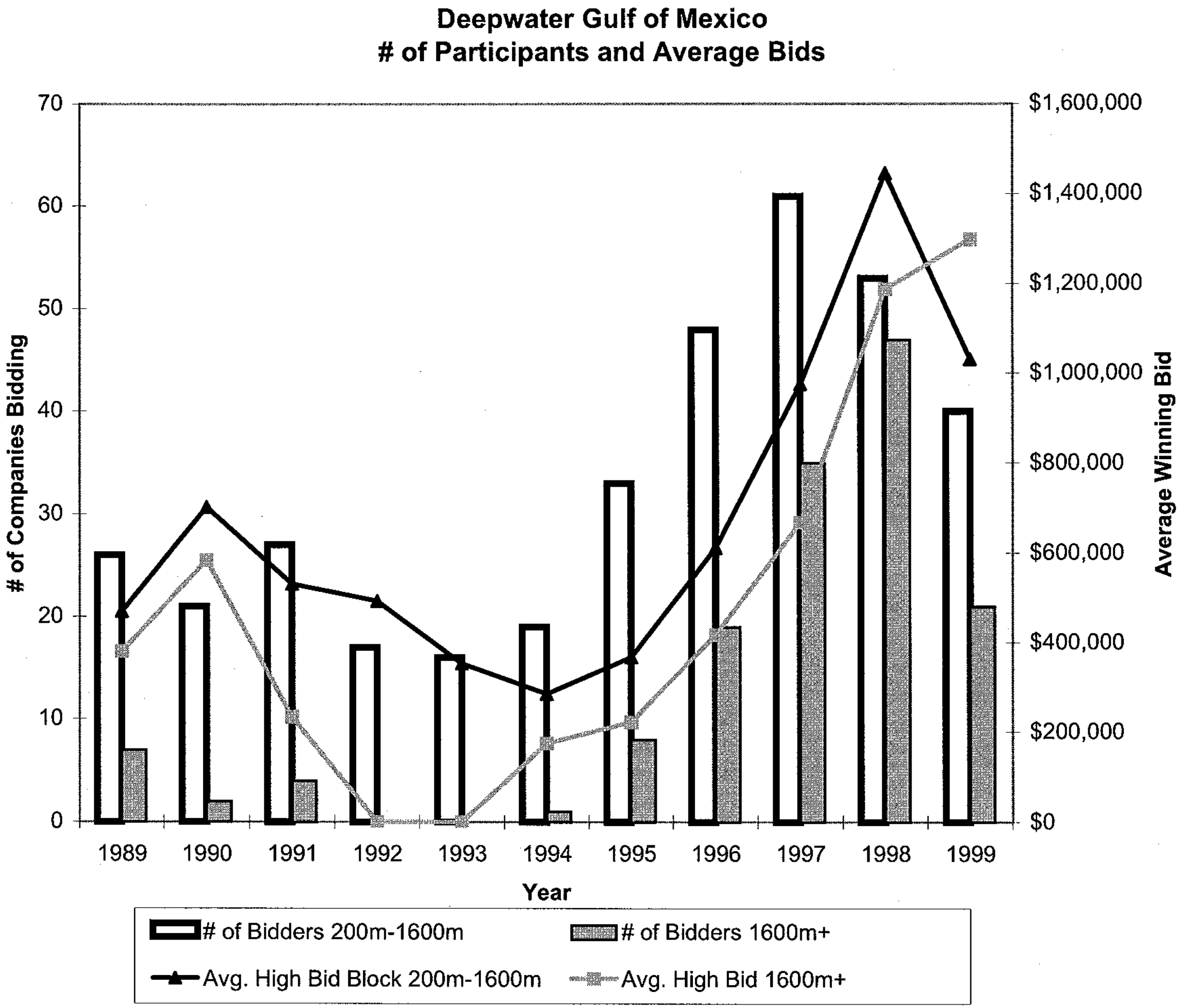

Figure 3 (Source MMS data)

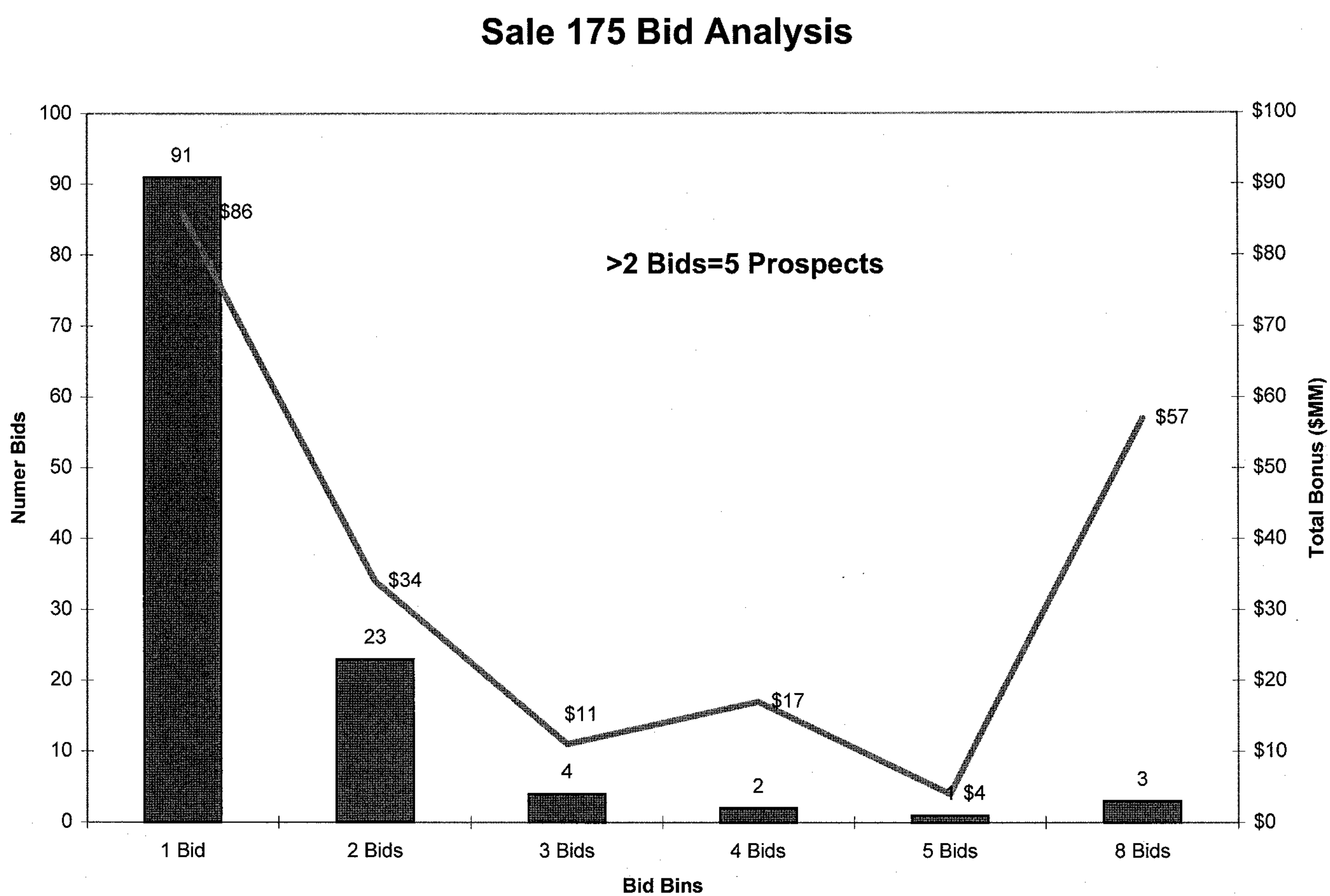

Figure 4 (Source: MMS Data

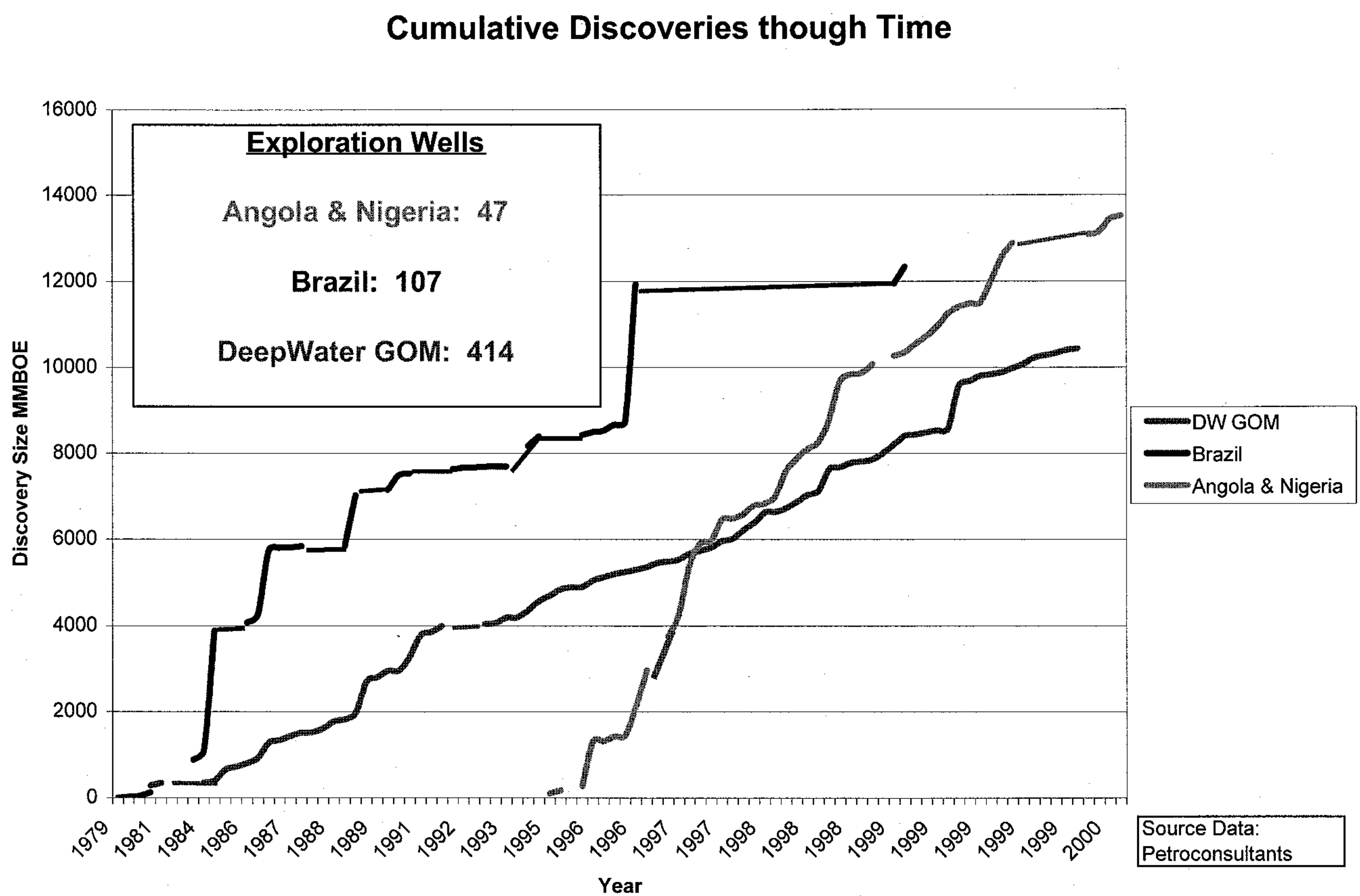
Cumulative Discoveries though Time
Exploration Wells
Angola & Nigeria: 47
Brazil: 107
DeepWater GOM: 414
Discovery Size MMBOE
16000
14000
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Figure 5

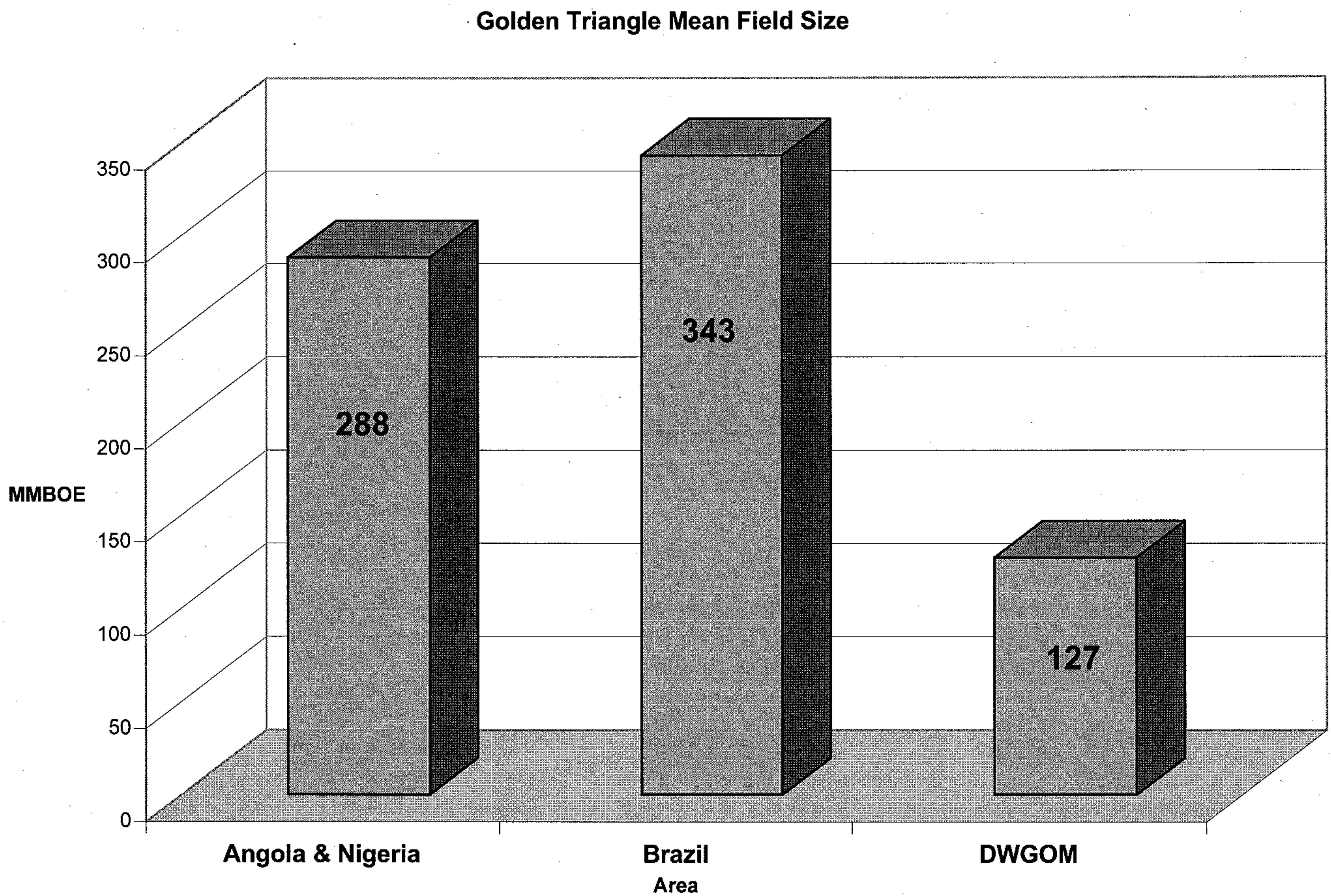
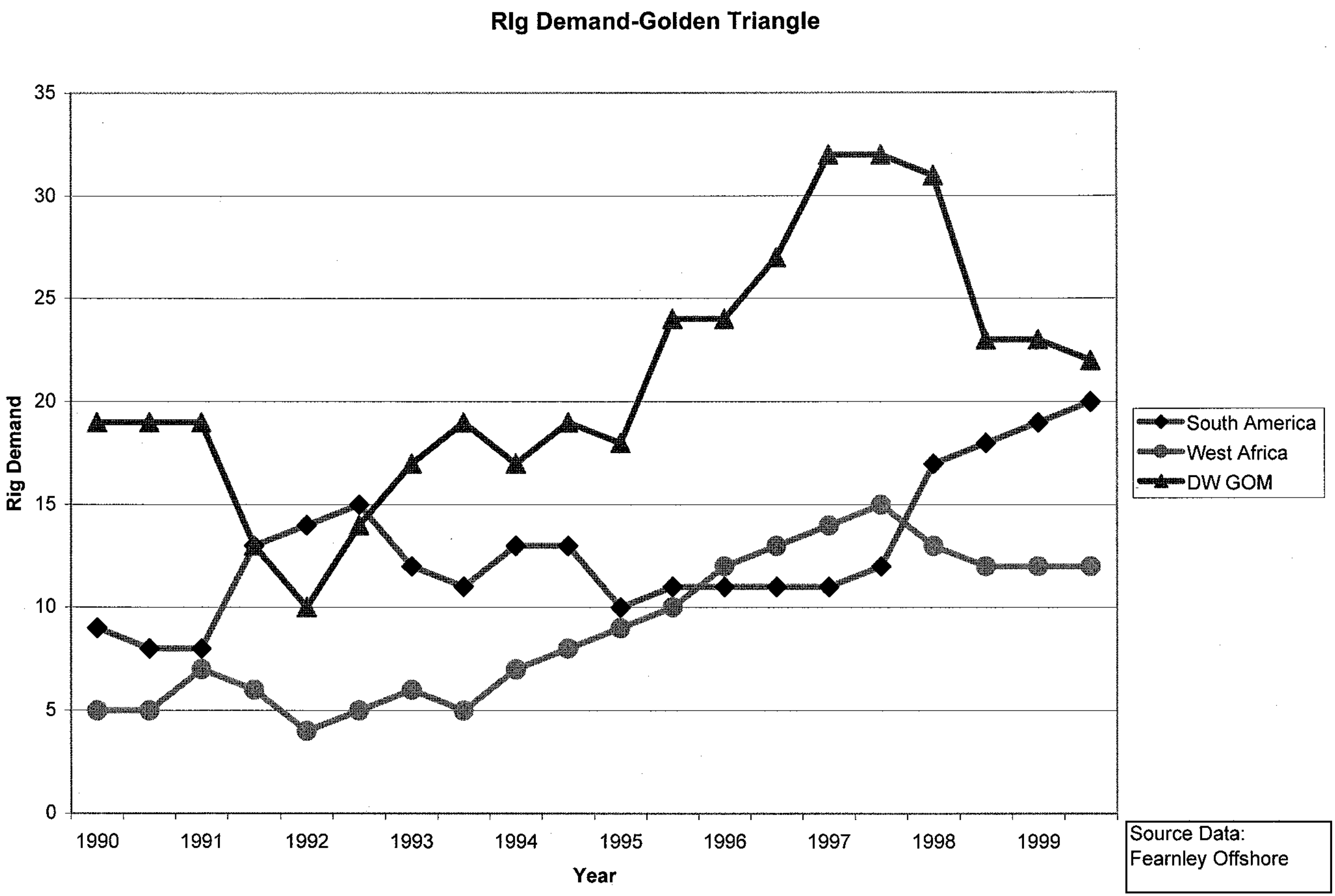


Figure 6 (Source: Petroconsultants)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Year
South America
West Africa
DW GOM
Source Data:
Fearnley Offshore

Figure 7

October 16, 2000

Department of the Interior
Minerals Management Service
Mail Stop 4024
381 Elden Street
Herndon, Virginia 20170-4814

Attention: Rules Processing Team

Dear Sir or Madam:

The National Ocean Industries Association (NOIA) welcomes the opportunity to comment on the proposed rule that outlines how the agency may issue leases after November 2000 with royalty suspension. The proposed rule, along with extensive introductory material, was published in the *Federal Register* on September 14, 2000 beginning at page 55476.

NOIA is a national trade association that represents roughly 280 companies that are engaged in all aspects of exploring for and producing crude oil and natural gas from the nation's Outer Continental Shelf. The evolution of the deep-water frontier in the Gulf of Mexico since the passage of the Deep Water Royalty Relief Act (DWRRA) has been the single most exciting and rewarding development in the U.S. offshore in many years. It has benefited consumers, producers, job seekers and taxpayers alike. The challenge faced by the federal government and the petroleum industry is to work together to fashion a deep-water royalty policy that will be fair to all interested parties and will sustain the successes of the recent past.

The commentary provided with the proposed rule is broken into five main sections: Future Royalty Suspensions; Lease-Based Royalty Suspension; Rental Payments; Relief Suspension During High Prices and Change to Royalty Suspension Policy for Eligible Leases. Each of these sections concludes with one or more questions on which you seek comment.

Most of those questions require "real-world" experience in analyzing and evaluating the economics of a variety of deep-water prospects and projects. Because the NOIA staff lacks that type of experience, we have assembled a large working group that involves producers of all sizes. That group is organized around four sub-groups including: ultra-deep water (1600 meters and greater); process simplification; deep-water (200-1600 meters) and shelf or shallow-water royalty policy. Because these groups do possess the skills and experience to comment on the above-mentioned questions, we have parceled out the questions to those best able and most willing to formulate comments. We expect to file a compilation of comments on your questions under separate cover.

Proceeding in this way allows industry to be as responsive as possible and allows NOIA to confine its comment to general principals that we believe should be borne in mind as we pursue this process to completion. We expect that a number of individual companies will furnish comments as well. It is worth noting that API, IPAA, USOGA and DPC have joined us in this effort from the outset.

Future Royalty Suspensions: The proposed rule is a little like being handed a photograph and specifications for a new automobile but not its price. Obviously, a future investment decision in the deep-water Gulf of Mexico must await the receipt of the whole picture. We appreciate the need for additional analysis before coming to conclusion about appropriate suspension volumes. We hope to have the opportunity to participate with you in this process as we have in the past. We believe that the record of the last 18 months or so clearly demonstrates that both the agency and petroleum industry benefit from working together.

We believe that whatever suspension volumes are finally decided on, they should be grounded on sound data and analysis. While some may take exception to the end result in this area, objections should be muted if the logic and rational are clearly understood by all.

We further believe that leaving the royalty suspension volumes in place for a minimum of three years will provide operators with some measure of the certainty required for them to plan their deep-water strategies. This also affords MMS an opportunity to examine how well the program is working over the span of at least six Gulf of Mexico lease sales. This kind of evaluation would be impossible if deep-water royalty policy changes on a year-to-year basis, or worse, on a sale-by-sale basis. Some may argue for a longer "certainty period" but directionally we think you are on the right path.

At the risk of being repetitive, as you begin to consider what to do at the expiration of the initial three-year period, we urge you to involve industry in your deliberations at the earliest possible moment.

Lease-Based Royalty Suspension: At first blush, it appeared to us that offering suspension volumes on a lease-by-lease basis rather than on a field-by-field basis might simplify and improve the process. However, it now appears that some operators believe that the lease-by-lease approach might be fraught with more rather than fewer problems. At this point, we can only urge you to examine closely the collective comments that we will provide on this topic as well as the individual comments of producers.

Rental Payments: We have reviewed the Evaluation Report issued in March of last year and understand the rationale for imposing a holding fee until royalty-bearing production begins. No offshore investor is anxious to see costs increase. However, in conversations with a small sample of operators we get the sense that they do not consider this change a major obstacle to future deep-water investment. It seems that in the context of the many millions it takes to successfully develop a deep-water prospect, this proposed change in policy is not seen as a "deal-breaker." Bear in mind that these views are based on a very small sample of our member-operators and you may hear differing points of view when you review the comments of individual companies.

In closing, we want to again thank MMS for including industry in the process of thinking through where the deep-water royalty policy should go following the expiration of Section 304 of DWRRA. There are certain basic principles that our members will be looking for in any new policy, such as the framework currently being proposed. First, certainty and stability: Planning for major OCS investments is a long-term process that becomes nearly impossible if the "ground-rules" are constantly changing. Second: Predictability and transparency: Operators considering making an application for supplemental deep-water royalty relief should be able to do their own analysis and be able to predict with fair accuracy whether MMS would approve that application. Third: Future consideration of whether incentives are called for in other areas of the Gulf of Mexico outside of the deep-water province. Fourth: Continuation of the inclusive process that has carved out a role for industry in consideration of these policies.

We thank you for your consideration of our views.

Sincerely,

Robert B. Stewart