

78

Fax Transmission



1220 L Street, Northwest
Washington, D.C. 20005-4070
202-682-8000

Date: October 16, 2000

RULES PROCESSING TEAM

To: Department of Interior
Minerals Management Service
Attention: Rules Processing Service
Fax: 703-787-1546
(Alternative Fax Number: 703-787-1093)

OCT 16 2000

From: Linda Bauch
Regulatory and Scientific Affairs
202-682-8170

Number of Pages 11 total, including cover sheet

Attached please find the American Petroleum Institute's comments to MMS regarding the agency's proposed rule regarding issuance of OCS leases with royalty suspensions after November 2000, and plain-language revision of existing rules for bidding systems and joint bidding restrictions.

If you have problems receiving this fax, please call Pat Leonard-Moore at 202-682-8485.

Thank you.



1220 L Street, Northwest
Washington, D.C. 20005-4070
Phone: 202-682-8116
Fax: 202-682-8426
E-mail: rubinm@api.org

Mark Rubin
Upstream General Manager

October 16, 2000

RULES PROCESSING TEAM

OCT 16 2000

VIA COURIER AND FACSIMILE

Department of the Interior
Minerals Management Service
Attention: Rules Processing Team (RPT)
Mail Stop 4024, 381 Elden Street
Herndon, Virginia 20170-4817

**American Petroleum Institute Comments on the Minerals Management Service
(MMS) Proposed Rule regarding issuance of OCS leases after November 2000, 65
FR 55476 (September 14, 2000)**

Ladies and Gentlemen:

The American Petroleum Institute (API) appreciates the opportunity to provide comments on the MMS proposed rule on issuance of Outer Continental Shelf (OCS) leases with royalty suspensions after November 2000. The proposed rule also presents a plain-language revision of the existing rules for bidding systems and joint bidding restrictions. API represents over 500 member companies engaged in all aspects of the oil and natural gas industry in the United States, including exploration and production, refining, transportation and marketing. A significant portion of the domestic oil and natural gas produced by API members comes from exploration and production activities in federal waters and our members have a great interest in the proposed rule. API submits these comments in addition to the comments filed jointly by API, the National Ocean Industries Association, the Domestic Petroleum Council, the U.S. Oil and Gas Association, and the Independent Petroleum Association of America.

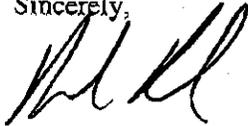
The 1995 Deep Water Royalty Relief Act stimulated exploration and production in the deepwater Gulf of Mexico (GOM) frontier and has been an essential factor in successfully spurring the expansion of domestic deepwater oil and natural gas supply. However, with significant resources yet to be discovered and produced in the deepwater GOM, API and its members continue to support a multi-year extension of deepwater royalty relief. API and its members appreciate the opportunities afforded industry over the past two years to present its views regarding extension of the deepwater royalty relief program.

API supports MMS's intent to provide both flexibility and certainty in a revised royalty relief program. We urge MMS to consider fully API's comments regarding several premises the agency is following in developing its new royalty relief program and also to consider other pertinent issues raised in these comments, including those regarding lease-based royalty

Department of the Interior
October 16, 2000
Page 2

suspensions, the administrative process required for discretionary relief, use of tie-backs versus stand-alone facilities, and certain proposed plain-language revisions. If you have any questions regarding these comments, please contact Linda Bauch of API's Regulatory Affairs Department at 202-682-8170 or Ed Porter of API's Policy Analysis and Statistics Department at 202-682-8539.

Sincerely,

A handwritten signature in black ink, appearing to be 'Ed Porter', written in a cursive style.

Attachment (1)

Comments submitted
by the
American Petroleum Institute
to the
U.S. Department of the Interior
Minerals Management Service
Proposed Rule Regarding Issuance of OCS Leases with
Royalty Suspensions by MMS after November 2000, and
Plain-language Revision of Existing rules for
Bidding Systems and Joint Bidding Restrictions
65 FR 55476 (September 14, 2000)

The American Petroleum Institute (API) welcomes this opportunity to submit additional written comments concerning the MMS proposed rule outlining why and how the agency may issue Outer Continental Shelf (OCS) leases with royalty suspensions after November 2000. The proposed rule also presents a plain-language revision of the existing rules for bidding systems and joint bidding restrictions. API is a trade association that represents more than 500 member companies engaged in all aspects of the oil and natural gas industry in the United States, including exploration and production, refining, transportation and marketing. A significant percentage of domestic oil and natural gas produced by API members comes from exploration and production in federal waters and our members have a great interest in the proposed rule.

API and its members have engaged in a constructive dialogue and exchange of information with MMS regarding the future of deepwater royalty relief policies, following expiration in late November 2000, of the automatic suspension provisions (Section 304) of the Deepwater Royalty Relief Act (the Act). API looks forward to continued dialogue with MMS as the agency develops and implements its proposed rule and policy concerning the issuance of post-November 2000 OCS leases with royalty suspensions. API also joined the National Ocean Industries Association (NOIA), the Domestic Petroleum Council (DPC) the U.S. Oil and Gas Association (USOGA), and the Independent Petroleum Association of America (IPAA) in submitting joint comments that address the questions raised by MMS in the proposed rule.

General Comments

API and its member companies support a multi-year extension of deepwater royalty relief. We support the MMS decision to provide royalty relief for the deepwater Gulf of Mexico (GOM)

leases (200+ meters). The provisions of the 1995 Deepwater Royalty Relief Act have been an essential factor in spurring the expansion of domestic deepwater oil and natural gas supply. As the automatic suspension provisions of the Act expire, it is important that any new program sustain the process that has started. Deepwater activity remains an essential component of any national energy policy aimed at expanding domestic supply.

The revised MMS deepwater royalty relief program should provide certainty and reasonable terms in its administration and provide as much predictability and lead time as practical for all prospective bidders. Planning for these deepwater projects is a time-consuming process that would become very difficult if the royalty rules were to change frequently. As industry moves into deeper water, the costs, risks, and difficulties associated with projects increase significantly. Therefore it is critical that the amount of royalty relief granted, as stated in the sale notice, remains fixed and not subject to frequent changes. We encourage MMS to offer tracts for lease with specified royalty suspension volumes that are fixed and in an amount that realistically encourages exploration and development.

The administration of the discretionary royalty relief program should be reasonable in terms of time, required elements, and cost. We also urge MMS to avoid devising a "zero sum game" wherein the agency changes any of the OCS lease sale commercial terms (e.g., bids, rents, and/or royalties) in exchange for deepwater royalty relief.

Finally, it must be recognized that MMS cannot successfully develop royalty relief policy in a vacuum. The deepwater exploration and production business is a global business, and deepwater activity in the Gulf of Mexico must remain competitive with other equally attractive geologic prospects elsewhere in the world, such as those in Brazil, Angola and Nigeria. From both an international competitiveness perspective and a domestic energy policy perspective, moves to reduce deepwater royalty relief could unwisely discourage investment in the deepwater Gulf of Mexico at a time when competition for deepwater exploration dollars is intense and global.

MMS Premise Regarding Amounts of Royalty Relief Needed

While industry welcomes the flexibility that MMS foresees from the proposed rule, we believe that several basic premises presented by MMS result in inappropriate program limitations. These assumptions lead the agency to "expect" generally smaller royalty suspensions than were mandated by the Act. One of the principal advantages of moving to a more flexible program is to

allow new information to be incorporated into MMS's evaluation of deepwater resources on an ongoing basis. Therefore, the size or direction of future suspension volumes, compared to the earlier automatic suspension volumes specified in the Act, should continue to be realistic and mutually beneficial. We believe the key to maintaining a program that is beneficial to both industry and government is using this flexibility to continuously encourage the development of high risk and expensive deepwater resources.

MMS Premise Regarding Maturity of Deepwater Exploration and Level of Infrastructure

MMS argues that the suspended volumes will be smaller under the new program because of the maturity of the deepwater. In particular, MMS argues (a) that existing infrastructure will improve the economics of nearby resources, and (b) that later deepwater projects will face less development risk than pioneering projects. While both premises are plausible in particular areas, it is premature to generalize these conclusions to the whole deepwater area. For example, movements into ultradeep waters will require new pioneering efforts and new sources of development risk from those faced in projects to date. There is no reason to presume these risks to be smaller than those faced to date. These risks include but are not limited to reservoir connectivity, reservoir performance, limited production experience, deepwater rig availability and price volatility, and undeveloped and relatively untested technology. Given the continued presence of these risks, industry encourages MMS to establish several additional deepwater relief water depth categories with increasingly higher suspension volumes to ensure continued development of ever deeper frontiers.

Second, although the establishment of infrastructure at properties developed to date improves the economics of new leases in their vicinity, the adequacy of that existing infrastructure hinges largely on the size and distribution of the remaining undiscovered resource base. The size of that resource base is undergoing a significant reassessment by industry and MMS. Industry encourages MMS to set suspension volumes in these intermediate depth ranges at levels appropriate to support vigorous development of a resource base consistent with these recent reassessments.

MMS Premises Regarding Future Oil and Natural Gas Prices

MMS also presumes that future suspension volumes are likely to be lower than in the past because prices are far higher than in the past and expected to remain so. API contends that this is an inappropriate characterization of the market environment. Certainly prices are at recent highs

currently, but it has been less than two years since they were at historic lows. While it appears true that recent prices are very volatile, no one can predict or conclude that there has been a permanent shift upward in the price that can reasonably be expected by an offshore producer over the life of a deepwater investment.

While we believe that price thresholds above which royalty suspensions do not apply continue to be appropriate, we see no reason that these thresholds should not remain the same as those specified by the Act (adjusted for inflation). Furthermore, we disagree with MMS's plans to count volumes produced against royalty suspension volumes when prices are above the price threshold. Only royalty-free volumes should be counted against royalty suspension volumes.

Lease-Based Royalty Suspensions

MMS proposes moving to a lease-based royalty relief program to simplify how the agency applies royalty suspensions to leases. Industry's joint comments state that basing royalty relief on an individual lease basis as opposed to the current field basis could be preferable under the proper circumstances. API requests MMS to consider modifying its current policy regarding designating leases to fields. Current MMS policy dictates OCS leases being placed in fields after well operations indicate the presence of hydrocarbons. API recommends that MMS provide prospective bidders with its designation of which blocks are in which fields—if a field has been previously established—*prior* to when a lessee's exploratory drilling indicates the presence of hydrocarbons. Knowing whether or not a tract is in an existing field would assist potential bidders in determining the applicability of royalty suspension volumes prior to leasing and prior to drilling and provide more certainty regarding the potential value of tracts.

Under the proposed rule, the field to which a post-November 2000-issued "royalty suspension lease" is assigned would not affect how much royalty suspension volume that lease realizes. However, under Section 260.124 (b)(1) of the proposed rule, the royalty-free production from a royalty suspension lease will count as part of any royalty suspension volume remaining for the field to which the agency assigns that lease. That determination will affect the economics of the various existing pre-November 2000-issued "eligible leases" on that field, as defined by MMS. Additionally, existing fields with significant cumulative production could reduce or nullify the royalty suspension volumes granted eligible leases under the automatic suspension provisions of the Deepwater Royalty Relief Act. Advanced notice of field designations sooner rather than later

would assist lessees in assessing the efficacy and applicability of royalty relief on specific blocks/leases.

Administrative Process

MMS notes that the agency "may enlarge" the scope of its discretionary royalty relief program. API and its members strongly support an expanded discretionary royalty relief program to promote development or increase production on producing leases, on non-producing leases that would not otherwise be economic to develop, and to promote development of marginal resources on producing or non-producing leases. Production from these leases will further the development of oil and natural gas resources in deep and ultra deepwater areas of the OCS and will help the nation meet its energy needs. Since MMS is contemplating smaller automatic suspension volumes on the post-November 2000-issued deepwater leases, the prospect of qualifying for additional discretionary royalty relief under a timely and reasonable process is critical. The potential for additional royalty relief, properly granted, would enhance the economics of deepwater GOM prospects that are competing for limited E&P dollars with prospects in foreign offshore areas. Therefore, API urges MMS to revise its administrative procedures in an effort to develop a timely, cost effective, less complicated administrative mechanism for application of its discretionary royalty relief program.

The need for an improved administrative mechanism is the same issue and set of concerns that an industry administrative issues subcommittee is currently discussing with MMS regarding the process for applying and qualifying for discretionary royalty relief for leases issued prior to late November 1995 or for those otherwise uneconomic leases described above. The current process is complex, costly, and lengthy. To date only seven such applications have been made by industry and only four of those applications have been approved. In light of the anticipated increase in the scope of the discretionary program under the new rule, API urges MMS to actively pursue improvements to the entirety of the application, review and approval process for discretionary royalty relief.

Use of Tie-Backs vs. Stand-Alone Facilities

While many future discoveries that are close to existing infrastructure will be developed as "tie-backs" rather than as stand-alone facilities because of resource size and lower capital investments required, many close-in fields will still be developed with stand-alone facilities. Fields that have multiple reservoirs that require numerous recompletions, fields that require large numbers of

wells because of the lack of reservoir continuity, and fields that will require secondary recovery (i.e. water injection), may be developed more economically with stand-alone facilities. Also, leases in the frontiers of the ultradeep waters will typically be developed on a stand-alone basis. Each field will have its own unique economics and it is difficult to project what proportion will be developed with subsea facilities. API takes the view that attempting to tailor the suspension volumes to specific tie back facilities at the time of the lease sale would be unrealistic.

Criteria for Discretionary Royalty Relief

Under the Section 260.121 Plain English Rewrite Q&A, MMS outlines criteria for granting discretionary royalty relief by suspension volumes. Under 43 U.S.C. 1337(a)(1)(H), the Secretary of the Interior may suspend royalties by time period, volume, or value of production. API recommends that MMS clarify the proposed rule to confirm the agency's existing regulatory authority to grant royalty relief in terms of time or value as well as in production volumes.

30 CFR 260.130—Criteria Used by MMS for Selecting Bidding Systems

Industry is concerned that MMS may be considering using multiple bidding systems and variables in a single lease sale, and that may unnecessarily increase the complexity of the sale process. We urge MMS to avoid unnecessary experimentation with bidding systems. Several decades ago MMS experimented with several alternative bidding systems that were generally regarded by industry and government as inferior to the current system. In addition, as currently proposed, Sec. 260.130 appears to allow for the use of multiple bidding systems in a given lease. If this is not intended, the language should be clarified. If intended, it would appear to introduce a new and unnecessary administrative burden and degree uncertainty into the process.

30 CFR 260.303—Joint Bidding Requirements

The definition of a "person" for purposes of the restricted bidders list should be clarified to ensure that it not include affiliate companies for purposes of joint bidding. Furthermore, as the language is currently worded, the proposed rule could be interpreted to prohibit restricted bidders from entering into post-lease sale agreements (unitization, joint development, farm-outs, property sales) that are currently allowed to promote efficient resource development. The proposed rule should be clarified to permit agreements between persons on the restricted bidders list that are entered into after the lease sale. Section 260.303(d) could be clarified by inserting after the word "agreement" the words "prior to a lease sale."

30 CFR 218.151(a)—Rental Fees

The proposed (a)(2) language is in direct conflict with the standard OCS Lease Form (March 1986), which provides as follows:

“Sec. 4. Rentals. The Lessee shall pay the Lessor on or before the first day of each lease year which commences prior to a discovery in paying quantities of oil or gas on the leased area, a rental shown on the face thereof.”

A declaration of producibility under 30 CFR 250.115 is a central key event in the life of a lease. It moves the lease from an exploratory status to a producing status and makes the lease eligible for a suspension of production for time needed to develop and further define reserves. Re-classifying this obligation as a rental directly implies that production status has not begun.

Under the existing lease form, once a declaration of producibility has been made, the lease shifts to a producing status with minimum obligations under Section 5 of the lease form, which reads:

“Sec. 5. Minimum Royalty. The Lessee shall pay the Lessor, at the expiration of each lease year which commences after a discovery of oil and gas in paying quantities, a minimum royalty as shown on the face hereof or, if there is production, the difference between the actual royalty required to be paid with respect to such lease year and the prescribed minimum royalty if the actual royalty paid is less than the minimum royalty.”

These requirements, which apply to *all* OCS leases, also comport with Congress's intent under the Deepwater Royalty Relief Act to encourage exploration and development of the deepwater Gulf of Mexico. However, on a lease that is eligible for deepwater royalty relief, there is no royalty due until the minimum suspension volumes have been produced. Therefore, there can be no difference due as a minimum royalty. If, in the alternative, MMS now feels compelled to assess some annual maintenance payment, then MMS could add as an additional lease sale stipulation for deepwater leases issued after final promulgation of this proposed rule, a requirement that those leases pay a rental prior to first production and forgo any minimum royalty payments due prior to that production. API requests MMS to clarify its intent regarding this continuation of rentals due prior to first production and after a discovery has been made on a lease. Failure to clarify this issue will result in continued confusion between the language of the existing OCS lease form, provisions of the Deepwater Royalty Relief Act, and the particular implementing regulations.

30CFR 218.151(b)—“Pugh Clause”

This provision should be clarified to eliminate any ambiguity over whether rental is due on a part of a lease not included in a “Participating Area” of a unit. On the OCS, production attributed to any part of a lease in a Participating Area is credited toward the production obligation of the whole lease. This practice normally eliminates any requirement to pay rental on the lease. It is only when a lease has been officially divided into two separate leases that rental should be due on the non-producing lease. In such a case, each lease should receive a new designation number and be responsible individually for paying rental or minimum royalty.

A Final Caution

While there is much in the proposed rule that is commendable, industry recognizes that without specification of the suspension volumes, the value of the program remains uncertain and our evaluation of it necessarily incomplete. In return for greater flexibility for the government in this program, there is a loss of certainty relative to the system established by the Act. While this may be necessary, it is essential that as the details are developed by MMS every effort be made to keep these uncertainties to a minimum. We also recognize that there is an asymmetry in the risk faced by industry and government in the bidding for deepwater leases. If the suspension volumes are set higher than needed to encourage continued deepwater exploration or to ensure project viability, competitive bidding will return any such excess values to the government in the form of increased bonus bids. If the suspension volumes are set too low, there is no automatic mechanism to encourage continued deepwater exploration or ensure project viability. In such a case, the program will rely entirely on the effective operation of the discretionary relief mechanism to ensure efficient levels of resource development. Industry looks forward to working with MMS to simplify and improve the operation of this discretionary process.