

**Gulf Coast Land Institute**

# **OCS Deep Gas Royalty Relief Proposed Rule**

**J. Keith Couvillion**

**October 16, 2003**

# Agenda

- Definitions
- Review of Existing OCS Royalty Incentives
- Proposed Deep Gas Royalty Rule
- Review of Royalty Suspension Volumes & Supplements
- Lease Qualification Criteria
- MMS Notification
- Existing Lease Royalty Incentive Stipulation
- Units
- Production Measurement
- Pending Issues (Final Rule)

# Definitions

MMS - Minerals Management Service

OCS - Outer Continental Shelf

GOM - Gulf of Mexico

RSV - Royalty Suspension Volume

RSS - Royalty Suspension Supplement

Shelf - Water Depth less than 200 Meters (656')

TVD SS - Total Vertical Depth Subsea

BCFE - Billion Cubic Feet Equivalent

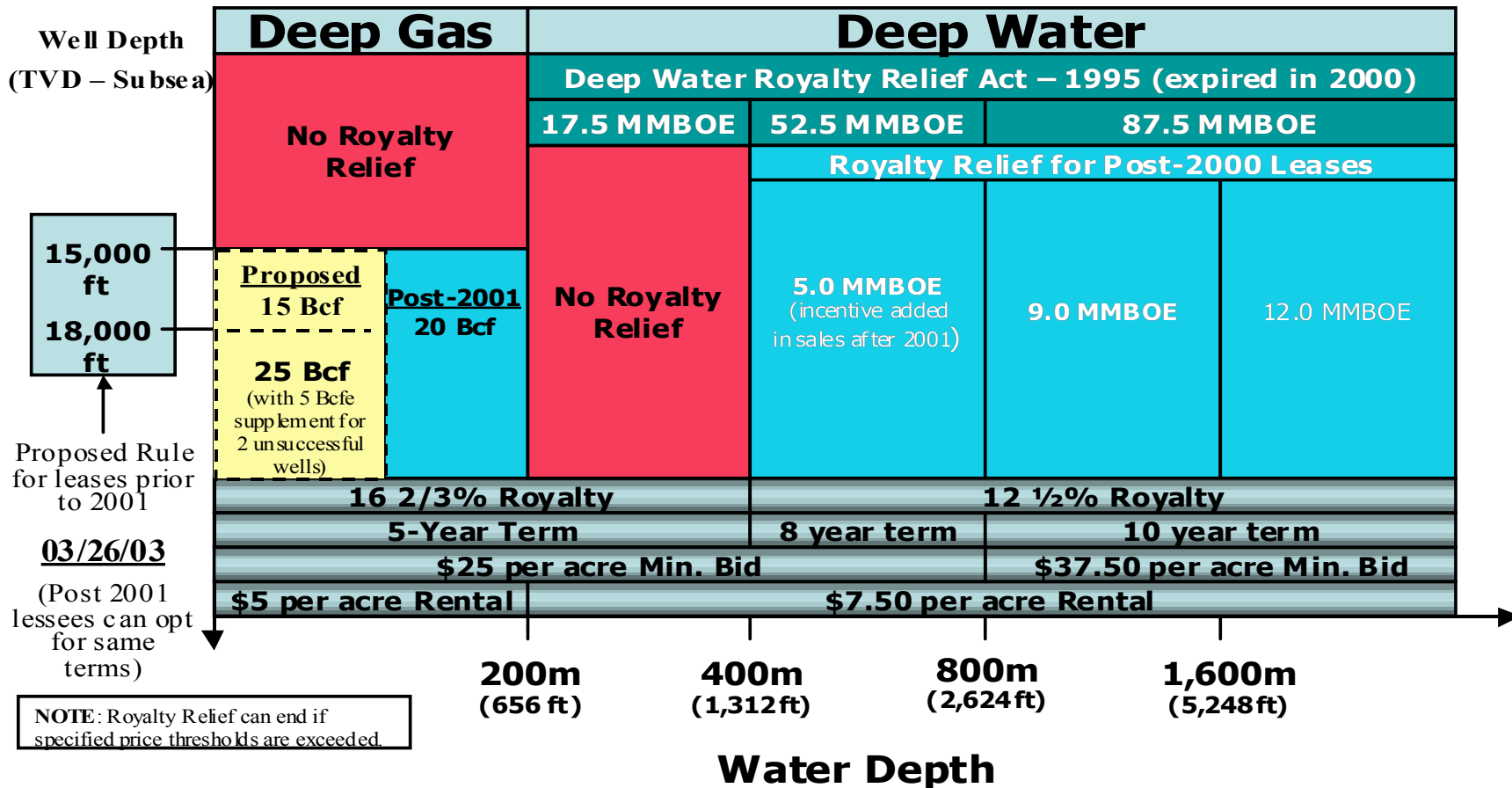
# Current Incentive to Encourage Production

## 30 CFR 203

- Royalty Suspension for Deepwater Leases
  - Supplemental Discretionary Royalty Relief
  - Royalty Relief for Deep Gas on new Leases located on the Shelf
  - End of Lease Royalty Reduction or Suspension
- 
- Lease Extension Option for Subsalt Prospects

# Royalty Relief Summary

## MMS Gulf of Mexico Royalty Relief Incentives (Volumes of Royalty Suspension)



# Shelf Deep Gas Objectives

- Near and mid-term shortfall in US natural gas supply
- Offset declines in Shelf production
- Estimated undiscovered resources between 5 and 20 trillion cubic feet
- Advances in seismic imaging and drilling techniques
- Existing infrastructure

# MMS Program Design

- Meaningful incentive
- Immediate effect
- Emphasis on most prospective depths
- Categorical relief
- Minimize unnecessary relief
- Use a familiar royalty incentive format

# Proposed Rule

- Published in the Federal Register on March 26, 2003
- Volume 68, Number 58, Pages 14868-14886
- Amends Title 30 CFR 203 (Relief or Reduction in Royalty Rates)
- Adds Parts 203.40 - 203.48



# Shelf Leases Affected

- Rule applies to each qualified Lease issued before January 1, 2001
- Rule could apply to 2,250 active Shelf leases
- Could apply to 1000+ post January 1, 2001 active Shelf leases
- Rule will not apply to 170 existing Shelf leases that have produced from deep wells (> 15,000 feet)

# Eligible Shelf Leases

- Wholly located in the GOM west of 87° 30' west longitude
- In water depths less than 200 meters (656 feet)
- Has not produced gas or oil from completions 15,000 feet TVD SS or deeper in a deep well that commenced drilling before March 26, 2003

# Types of Royalty Relief

- Royalty Suspension Volume
- Royalty Suspension Supplement

# Royalty Suspension Volumes

<b>Well Depth (TVD-SS)</b>	<b>Successful Deep Well</b>
<b>From 15,000' to less than 18,000'</b>	<b>15 BCF</b>
<b>18,000' or deeper</b>	<b>25 BCF</b>

# Royalty Suspension Volume Qualification

- Successful well completed 15,000 feet TVD SS or deeper that commenced drilling after March 26, 2003
- Well produces gas from a deep well before 5 Years after the effective date of the final rule

## RSV Guidelines

- Successful qualified well must be located on the Lease before it may use any royalty suspension volume.
- Once production begins, the lessee must use the RSV for all gas production from deep wells on or allocated to that lease.
- The RSV only applies to natural gas reported on OGOR-A.

# Royalty Suspension Supplements

<b>Well Depth (TVD-SS)</b>	<b>Unsuccessful Deep Well</b>
<b>From 15,000' to Less than 18,000'</b>	<b>0</b>
<b>18,000' or deeper</b>	<b>5 BCFE</b>

## Royalty Suspension Supplement Qualification

- Unsuccessful well targets a reservoir at least 18,000 feet TVD SS
- Drilling commenced after March 26, 2003
- Well started before production begins from a deep well located on the lease
- Receives confirmation from MMS that well qualifies



## RSS Guidelines

- RSS could be used against any shallow gas or oil (5.62 MCF = 1 BO) produced from the lease.
- A lessee could not obtain both a full RSV and RSS from the same wellbore.

# Royalty Suspension Supplement Incentive

A lease could qualify for:

Up to 2 RSS	10 BCF
+ RSV	<u>25 BCF</u>
Total	35 BCF

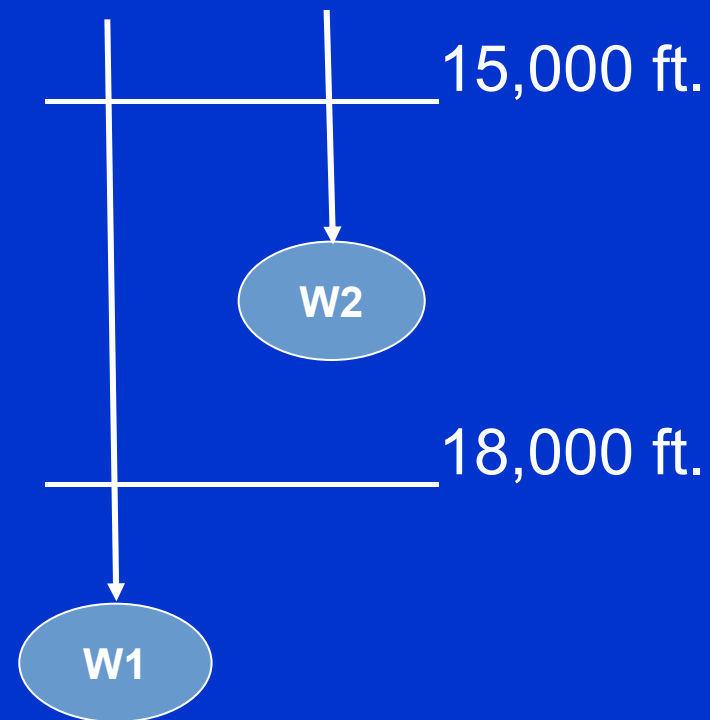
# Activity Qualification

- New wellbore (No sidetracks of existing wellbores)
- Limited to new reservoir
- Depth of completion for successful well (top of perforated interval)
- Reach target reservoir for unsuccessful well
- First deep well to produce establishes lease royalty suspension volume

# Sharing Royalty Suspension Volume on the Lease

If W1 produces first, lease gets 25 BCF (W2 can share up to 15 BCF of 25 BCF).

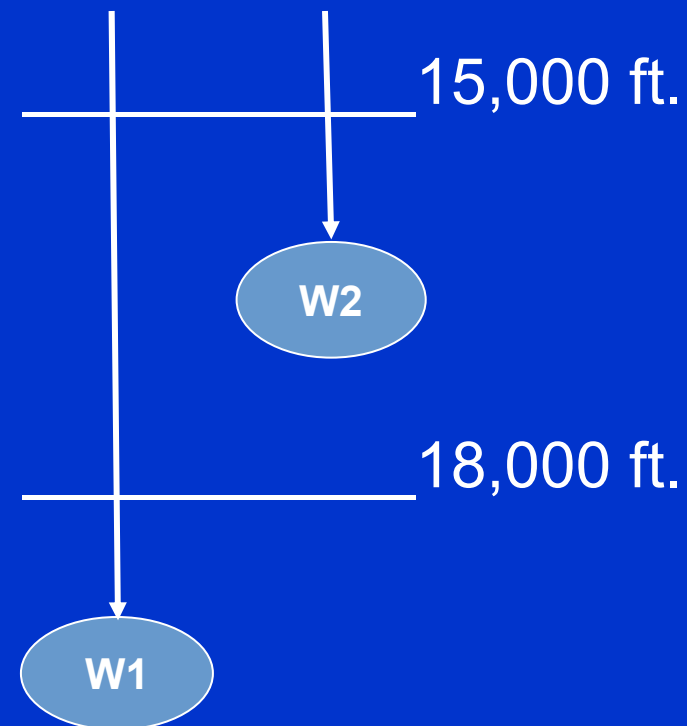
If W2 produces first, lease gets 15 BCF (W1 can share up to 15 BCF).



# Sharing Royalty Suspension Volume and Supplement on the Lease

If W1 is unsuccessful, lease gets 5 BCFE royalty suspension supplement.

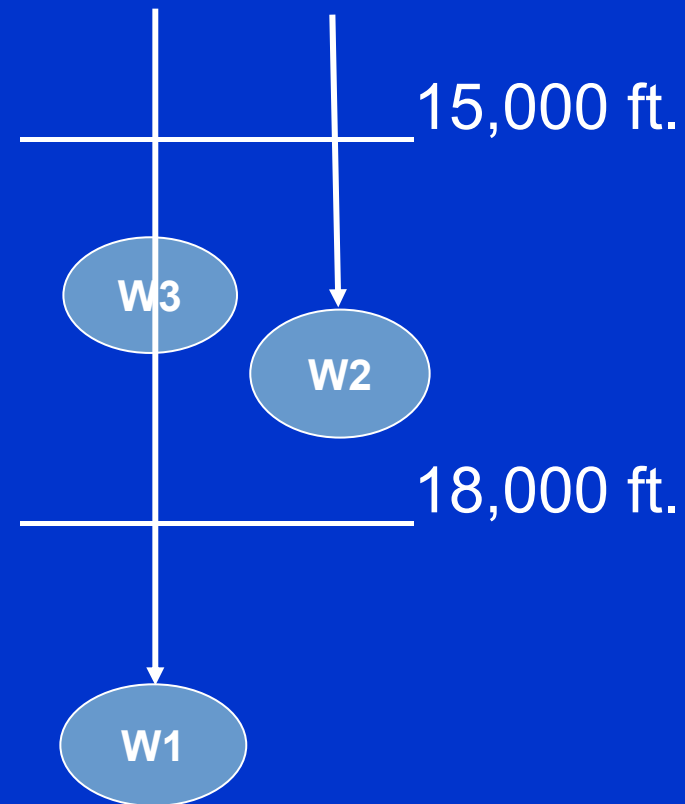
If W2 then produces, lease also gets 15 BCF royalty suspension volume for total of 20 BCF.



# Sharing RSV, RSS in Well

If W1 is unsuccessful RSS used up, and

- If W2 establishes RSV, W3 can use up to 10 BCF of 15 BCF RSV.
- If W3 establishes RSV (produces before W2), lease gets only 10 BCF RSV.



## MMS Notification

- Intent to commence drilling deep well
- Beginning of deep production
- Unsuccessful deep well has been drilled
- Substitute regulations for lease provisions

# Activity Notification

⇒ Letter to the Regional Supervisor of Production and Development

⇒ **Intent to Drill Deep Well**  
[30 CFR 203.43(a) and 46(a)]

- Anticipated spud date, Lease Number, Area/Block, Well Number
- Estimated target depth

⇒ **Deep Production Begins**  
[30 CFR 203.43(b)]

- Within 30 days
- Lease Number, Area/Block, Well Number, Perforated Interval, Reservoir Name, and Date Production Commenced
- Well Logs
- Request confirmation of the size of the RSV



# Unsuccessful Well

Letter to the Regional Supervisor of Production and Development [**30 CFR 203.46(b)**]

- Within 60 days after reaching total depth
- Compare the “Producibility” test and provide data confirming that an unsuccessful well was drilled (providing supporting geological, geophysical and economic data)
- Request confirmation that RSS applies

# Producibility Test

(30 CRF 250.115 & 116)

## Well Fails

### G&G Data:

- Any well test data,
- Digital well logs showing target

## Well Passes

### G&G Data:

- Any well test data,
- Digital well logs showing target
- Structure and Amplitude Map
- Reserve estimate
- Seismic volume used for evaluation

### Economic Data:

- Point Estimate (production profile, costs etc...)
- Prospective costs only
- No P&A costs for well
- Before tax analysis
- Oil and Gas prices published by MMS
- <15% ROR is uneconomic
- Assume royalty suspension volume

# Substitute Lease Provision

[30 CFR 203.48(b)]

⇒ Letter to the Regional Supervisor of Production and Development

- Within 180 days after effective date of final rule
- Specify decision to exercise option
- Provide Lease Number and Area/Block

⇒ One-Time Option

# Substitution Consideration

<b>Rule Terms for Pre-Existing Lease</b>	<b>Sale Terms for post-2000 Leases</b>
<b>For 1<sup>st</sup> well completed on lease:</b> <b>At 15,000 – 18000 ft., RSV = 15 BCF</b> <b>At 18,000 ft. or deeper, RSV = 25 BCF</b>	<b>For 1<sup>st</sup> well completed on lease at 15,000 ft. or deeper, RSV = 20 BCF</b>
<b>For dry well 18,000 ft. or deeper, RSS = 5 BCF</b>	<b>No RSS</b>
<b>Deep well qualified for RSV, RSS</b>	<b>Deep well to new reservoir qualifies for RSV</b>
<b>Deep well spud after March, 2003, deep production by 5 years after final rule</b>	<b>Deep production by 5 years after lease issuance.</b>
<b>NYMEX annual price above \$5/MMBtu (escalated) retracts RSV and RSS</b>	<b>NYMEX annual price above \$3.50/MMBtu (escalated) retracts RSV for CGOM 2001 leases</b>
<b>Royalty relief stops when RSV and RSS reached</b>	<b>Royalty relief stops at end of month when RSV reached</b>

# Price Thresholds (Shallow Water Deep Gas)

Calendar Year	Implicit Price Deflator for GDP	Gas Price Threshold (\$/MMBTU)		Actual (\$/MMBTU) Average NYMEX Nearby Delivery
		Sale 178 (Well Depths >15,000 ft)	Sales After 178	
2000	107.04	\$3.50	\$5.00	\$4.33
2001	109.37	\$3.58	\$5.11	\$4.06
2002	110.66	\$3.62	\$5.17	\$3.36
2003	112.50(e)	\$3.68	\$5.26	

NYMEX Year-to-Date 2003 Average		\$5.62
	<u>Sale 178</u>	<u>After Sale 178</u>
Sept -Dec Average Needed to Suspend Relief	\$0.97	\$4.75
Estimated (e) Threshold Target Price Level	\$3.68	\$5.26
Gap Between Threshold and Current Average	-\$1.94	-\$0.36

(Footnote: 1. These price thresholds apply to pre-act leases, certain eligible leases, and leases issued in 2002 and 2003. )

Note: The implicit price deflator for the 2003 GDP is an estimate (e).

# Bypasses and Sidetracks

- A bypass is drilled to the same target reservoir as the original well
- Bypasses are generally drilled because of a mechanical problem with the well
- In the Proposed Rule
  - Bypasses are eligible for RSV and RSS
  - Sidetracks are not eligible for either RSV or RSS

# Offshore Units

- Unit Eligibility
- Production Eligibility
- Allocation of Production

# Unit Production Allocation

- ⇒ Separate Participating (Productive) Areas will be used to allocate royalty-bearing and royalty free gas production
  - Shallow PA (shallow reservoirs and ineligible deep reservoirs)
  - Deep PA (reservoirs with successful qualified wells)
- ⇒ Each PA will have its own allocation adding up to 100%
- ⇒ MMS Unitization Policy
  - Current Requirement: A lease must have a producing well to receive an initial allocation
  - Additional Requirement: A lease must have a Successful Qualified Well to receive an initial allocation for the Deep Participating Area



# Production Measurement and Allocation

⇒ Single Producing Reservoir on Lease

- Traditional allocation procedure

⇒ Shallow and Deep Producing Reservoirs on same Lease

- Separate metering equipment for different types of royalty from lease

## Miscellaneous Issues

- ⇒ Minimum Royalties are due during royalty free production
- ⇒ RSV and RSS can be transferred
- ⇒ Unused RSV and RSS terminate when lease expires

# Pending Issues

- ⇒ Sidetrack and Deepening of Existing Wells
- ⇒ Price Thresholds
- ⇒ Effective Date of Rule

# Final Rule

- ⇒ Final Rule Submitted to Office of Management and Budget on October 8, 2003
- ⇒ 90 day review period
- ⇒ Anticipate final rule to be published before Thanksgiving

**Questions ???**

**Thank You**