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DOMESTIC PETROLEUM COUNCIL

December 21, 2000

Walter C. Rosenbusch
Director
Minerals Management Service
U.S. Department of the Interior
1849 C Street, NW MS-4230
Washington, DC 20240

Re: Proposed Rule: Relief or Reduction in Royalty Rates – Deep Water Royalty Relief for OCS Oil and Gas Leases Issued After 2000; 30 CFR Part 203; RIN 1010-AC71; November 16, 2000

Dear Walt:

On behalf of the large independent exploration and production company members of the Domestic Petroleum Council, this is to express serious concerns with respect to the recently announced royalty suspension volume reductions for the deep waters of the Gulf of Mexico.

Along with our growing reliance on imported oil, the United States is facing the prospect of dramatic increases in natural gas demand and will need to meet that demand in large measure with as-yet-unproven supply from the deep Gulf of Mexico. So, the recent MMS decision to effectively increase deepwater royalty burdens for oil and gas production appears to move in the wrong policy direction.

As you know, DPC members drill most of the independent wells in the United States and hold more than three thousand interests in federal Gulf of Mexico leases, more than one thousand in deep water, including many as operator. For these reasons we are keenly aware of the challenges we must meet in providing the future energy American consumers will need from this rich gas and oil area.

Based on our Gulf of Mexico experience, we are pleased that the MMS is moving to encourage deep natural gas activity in shallower Gulf waters and below salt formations. Applying royalty incentives on a lease basis and certain other proposed changes regarding discretionary royalty relief are positive steps. But the announced deepwater royalty suspension volumes should be revised upward – and continued for leases in 200-to-800 meter water depths for which they were eliminated altogether – to more closely match the incentives that have been in place since enactment of the Deepwater Royalty Relief Act of 1995.

We in no way want to delay or complicate planning for Sale 178, but prompt announcement of suspension volume revisions, with the price-related caps proposed, could enhance the viability of Sale 178 and future sales.

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The DPC expects to join with other industry associations in filing more detailed comments, but we want you to have early benefit of our general views concerning the November 16, 2000, notice of proposed rulemaking relating to the royalty scheme to be used in the upcoming Gulf of Mexico lease sales. Although we understand that the proposal was intended to outline a framework for the continuation of the Deepwater Royalty Relief Act of 1995, which expired on November 28th of this year, the suspension volumes, which will be a major component of the program, were not a part of the notice and were not published until November 29. With the suspension volumes now announced, we have a much clearer picture of what the future leasing program will look like in its entirety and are now better able to comment.

We commend the Agency for the time and effort it put into the rulemaking and for taking time to meet and receive input from the various companies and trade associations interested in the upcoming lease sales. As a result of that input, MMS moved to integrate solutions to some of the collective industry concerns, including the need to encourage subsalt and deep gas exploration and development.

However, MMS has stated that no automatic royalty relief is justified in waters 200-800 meters deep because: 1) substantial amounts of leasing have occurred in the last five years, thus there is a sizeable inventory of unexplored acreage; and, 2) the infrastructure in 200-800 meters has been developed sufficiently to make it economic now for all to drill in these water depths. While MMS was reaching those conclusions, an independent third party analysis of the total resource base in the Gulf of Mexico contracted by a number of companies, including DPC members, was conducted. It established that there exists a considerably larger number of small and medium-sized fields in the deep water areas of the Gulf, particularly in the 200-800 meter water depth range, than is currently included in the MMS resource base assessment upon which the recent deepwater royalty proposal is based. Consequently, we believe the proposed royalty changes would eliminate existing incentives for many marginal fields with resulting reduced leasing, exploration and production in deep water as more prospects are evaluated as uneconomic.

There are wide differences of opinion between industry and MMS concerning field size distribution and access to infrastructure in waters 200-800 meters. These differences are significant enough that, if MMS is incorrect in its assessment, significant natural gas and oil resources will be at risk of being bypassed. Therefore, prior to finalizing the proposed new royalty suspension volume program, MMS and industry at a minimum should jointly undertake additional modeling and/or other efforts to better understand and hopefully narrow field size distribution and exploration and production cost estimate differences. Perhaps a panel of recognized economists and geo-scientists could aid those efforts.

During the interim, we believe that royalty suspension provisions similar to those of the 1995 Act should be continued, with addition of price ceiling provisions contained in the proposed notice of Lease Sale 178.

In addition to the further economic and technical examination we have recommended, we encourage MMS to reevaluate its proposal carefully with respect to two overarching investment considerations facing the exploration and production industry. First, of course, is the clear need to anticipate economics that justify maintaining or increasing capital investments necessary to maintain or increase oil, and more dramatically, domestic natural gas supply. Second, and tightly linked to the first, is the need to be certain that any proposal keeps the Nation's resource development program competitive with similar offshore programs in other producing countries. It is not readily apparent how, or whether, these considerations were taken into account in formulating the November 29 proposal.

In conclusion, it is clear that the results of the royalty incentives under the 1995 Act have been remarkably successful in generating exploration and production activity in the deep waters of the Gulf of Mexico. Unfortunately, a significant part of what is being proposed as its replacement will have the effect of increasing royalty burdens above those that have been in effect for the last several years, with the potential consequences we have outlined. For these reasons we hope we can work with MMS to improve its proposal.

Thank you for considering our views. And please let me know if we can provide anything further.

Sincerely,

William F. Whitsitt
President