United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Minerals Revenue Management
P.O. Box 25165
Denver, Colorado 80225-0165
www.mrm.mms.gov

MAY 1 3 2008

MMS/MRM/RIK
Mail Stop 330B2

Dear Operator:

The Minerals Management Service (MMS) has selected one or more offshore Federal leases in the Gulf of Mexico (GOM), which you operate, to be included in the Royalty In-Kind (RIK) program where we will take crude oil and condensate royalty production in-kind beginning July 1, 2008. **It is your responsibility to notify the applicable working interest owners of this decision.**

This letter provides the procedures and establishes the terms and conditions under which the United States (MMS) will take crude oil royalties in-kind. Our authority is the Outer Continental Shelf Lands Act of 1953 (43 U.S.C. § 1353) and the royalty provisions contained in your Federal lease. For purposes of this letter, royalty oil means the Federal lease oil and condensate production multiplied by the lease royalty rate.

Term

MMS will take all royalty oil in-kind from your properties flowing to the Facility Measurement Point(s) (FMP) listed in Enclosure 1, beginning July 1, 2008, and will continue taking royalties in-kind until we notify you that the in-kind status is terminated. We will provide Operators with at least a 30 day prior written notice when terminating the in-kind status.

MMS and MMS' Designee

MMS may act by or through a duly authorized Designee. Enclosure 1 provides MMS' Designee at each custody transfer point. The Designee will agree in writing to comply with all provisions of this letter that are applicable to MMS when the Designee acts on our behalf. You are required to direct communications to MMS and our Designee. We will provide written notification when the Designee changes or is no longer authorized to act on our behalf for the purposes of this letter.

MMS requires the designee to agree, when acting on behalf of MMS, to use industry practice set forth by the Council of Petroleum Accountants Societies (COPAS) for nominating and scheduling transportation services.

MMS' Obligation to Take

MMS agrees to take 100 percent of the royalty oil delivered to the delivery point for the account of MMS. The Lessee will not incur royalty-related penalties because MMS' failure to take delivery of oil volumes as communicated by the Operator.

Fulfillment of Royalty Obligations

Delivering the accurate volume of royalty oil, taking into account the effects of normal operational imbalances, in accordance with the terms of this letter will satisfy in full the Lessee's royalty obligation to MMS. You will use a predetermined allocation (PDA) equal to the royalty rate when available. MMS will take into account the impact of normal industry operational imbalances.

All rent or minimum royalty obligations remain the responsibility of the Lessee. If the Lessee owes minimum royalties, MMS will issue a bill. The Lessee will have 30 days to review the bill and make payment or appeal the bill.

Royalty Oil Delivery

The delivery points for royalty oil produced from the properties are identified in Enclosure 1. MMS or Designee will take custody and responsibility for royalty oil at the delivery point.

You can be reimbursed for transportation and quality bank debits and/or quality differentials associated with royalty oil delivery to points identified in Enclosure 1 that are downstream of the FMP in accordance with the applicable MMS regulations. In addition, you must pay MMS for any quality bank credits received associated with royalty oil delivery to points identified in Enclosure 1 that are downstream of the FMP in accordance with the applicable MMS regulations. You will be required to report quality bank debits and credits for properties where the quality bank is passed back to the operator/producer or where a quality differential exists on a pipeline where there is not an instituted quality bank, as allowed in applicable MMS regulations. Please use the applicable GravCap tables to calculate the quality differential on pipelines where there is not an instituted quality bank. If gathering upstream of the FMP is approved by MMS, you may take this deduction, as well as other related fees, on the Report of Sales and Royalty Remittance (Form MMS-2014).

Royalty oil must be placed in marketable condition at no cost to MMS. Questions on marketable condition should be directed to MMS' points of contact identified in this letter.

You must deliver all royalty oil to MMS from all your royalty bearing wells that are measured at the facility measurement points (FMPs) listed on the enclosure. In addition, you will make reasonable efforts to notify MMS of leases that, during the period of in-kind status, began producing oil measured at these FMPs. Royalty oil from your newly producing leases will be added to RIK volumes at existing delivery points upon mutual consent of MMS' designee and MMS. The MMS will timely notify you whether such new production will be taken in-kind and will make reasonable efforts to take in-kind all production behind each FMP at which RIK oil is measured.

Communication with MMS and Designee

With the exception of those properties where MMS ships their barrels, MMS will no longer notify the Designee of the daily royalty oil volumes anticipated for the following month of production. The designee will be responsible for obtaining this information from the FMP operators. The Designee, as MMS' Designated agent, will communicate directly with the FMP operator, obtain estimated volumes, and make arrangements for the delivery and transfer of royalty oil from each custody transfer point identified in Enclosure 1.

The estimated delivery volumes must be obtained from a responsible FMP operator no later than 10 business days before the first day of each month. The Designee will provide the estimated delivery volumes for each custody transfer point to MMS by noon MT the 21st of each month. When the 21st falls on a weekend or Federal holiday, the following business day applies. This process will continue for each month in accordance with the "Term" stated above. Communications with MMS' Designee must occur regarding the daily royalty oil volumes anticipated for the following month of production.

For only SPR packages 32, 45-46, 48-50, and 61 where MMS ships their barrels, you must notify MMS in writing via facsimile at 303-231-3846 or email addressed to rik.project@mms.gov of the daily royalty volumes (Avails) anticipated for the following month of production by noon MT. Enclosure 3 provides the recommended Avails form. This form is also available at http://www.mrm.mms.gov/rikweb/ExcelDocs/Oil_Production_Avails_estimate.xls. On this same form for each property, you will also provide any anticipated volume adjustments to resolve previous months' imbalances. The total volumes to be delivered to our Designee at each of the delivery points must be indicated as a volume net of anticipated production plus or minus any adjustments. MMS understands that any such estimates are not warranties of actual deliveries, but are provided to facilitate planning.

You must use reasonable efforts, consistent with industry practice, to inform MMS regarding significant changes in oil production levels. Such communication must occur as soon as practicable after you know such anticipated changes in production levels.

Operator Assignments

For leases which are being taken in kind and which you are assigning to another Operator, you must notify the Designee and MMS point of contact described under "New Lease Production" of those assignments. In addition, you must notify only MMS' point of contact described under "New Lease Production" of the effective date of the assignment (Operator change date with MMS), and identify which company assumed the existing imbalances at the time of assignment.

Volume Reconciliation

You must provide the pipeline with the volume allocation for MMS' royalty oil separately from other producers. You must send all volume allocation schedules provided to pipeline companies that address royalty oil volumes at the delivery points in Enclosure 1 to the MMS **at the same time**

they are submitted to the pipeline companies. Volume allocation schedules and imbalance statements must be submitted to the rik.project@mms.gov mailbox. Enclosure 4 provides the recommended volume allocation form. This form is also available at http://www.mrm.mms.gov/rikweb/ExcelDocs/Actual_Production_Allocation_Form.xls.

Balancing Account and Imbalances

You must take timely action to remedy potential imbalances through adjustments to royalty oil volumes delivered to MMS in the production month following the month the imbalance is created.

Imbalances between delivered and entitled volumes of royalty oil will be dually monitored by you and MMS. Such volume adjustments will be identified in your communication of royalty oil volumes anticipated **before** the month of production as described under "Communication Between Parties."

Requirements for handling routine imbalances are outlined below:

- Imbalances will be determined on the basis of the difference between the entitled royalty share of production and the actual volumes delivered. These imbalances will be maintained at a lease/agreement level and/or the FMP level.

You must make available upon request by MMS the lease imbalance statement to the Imbalance Coordinator, as described under "Operator Imbalance Statements". The lease imbalance statement must be available within 60 days after the end of the month of production unless MMS approves an alternative timeframe. We will monitor and reconcile royalty entitlements with the royalty oil deliveries you make. Your imbalance statement must specify total production, MMS' entitled share, volumes delivered, the monthly imbalance, and the cumulative imbalance. You will remedy imbalances in the production month following the month that the imbalance is identified. Routine imbalances not remedied within 90 days of the end of the production month will be resolved as follows:

- Mutually agreed upon make-up delivery schedule or

- Cash out payment based on the MMS' contract price (at the delivery point), net of transportation costs, from the lease for each month of the imbalance. Interest will accrue from the end of the month following the month of production.

In imbalance situations, cash out payment is based on the MMS' contract price net of transportation costs from the lease for each month of the imbalance.

Reconciliation will involve communication between you and the MMS. Imbalances remaining upon cessation of the RIK term or cessation of production will be settled on the basis of the MMS' contract price (at the delivery point), net of transportation costs, from the FMP or lease. You will report the imbalance volume and value on the Form MMS-2014 as either a positive or a negative for the final month of delivery. **Interest will accrue from the end of the month following the month of production.**

Reporting

You must continue to report crude oil production on the Oil and Gas Operations Report (OGOR). You must also report transportation allowances and quality bank debits/credits on the Form MMS-2014 for any royalty volumes that are delivered downstream of the FMP or where the quality bank is passed back to the operator/producer under requirements specified in the MMS regulations at *30 CFR section 206* and the MMS *Minerals Revenue Reporter Handbook,* please see our website at http://www.mrm.mms.gov/ReportingServices/PDFDocs/RevenueHandbook.pdf.

You will not be required to report royalties for the RIK properties listed in Enclosure 1 on the Form MMS-2014 for the term during which MMS takes royalty in-kind, with the exception of properties noted as Royalty Relief and Section 6 leases (unless being taken in-kind), Net Profit Share, and any retrograde or free condensate not delivered to the MMS. You must continue to report these non-RIK properties on the Form MMS-2014 per the MMS regulations.

Audit Rights

MMS may audit your records in accordance with *30 CFR section 206* relevant to volumes and qualities of royalty oil produced, measured, delivered, and if applicable, transported.

MMS' Point of Contact

Copies of all correspondence between the Operator and MMS should be kept on file by the Operator. Points of contact for the MMS are listed below:

- Volume Allocation Schedules, Operator Imbalance Statements, and Minimum Royalty Obligations:
  Ms. Bernie Muniz
  Telephone: 303-231-3854; Fax: 303-231-3846
  E-mail: Bernadette.Muniz@mms.gov

- Volume Avails:
  Ms. Carol Smothers
  Telephone: 281-987-6856; Fax: 303-445-4246
  E-mail: Carol.Smothers@mms.gov

- New Lease Production:
  Ms. Donna Hogan (BON, EI, POS, SGC)
  Telephone: 303-231-3148; Fax: 303-231-3846
  E-Mail: Donna.Hogan@mms.gov or

Mr. Allen Vigil (Mars, Grand Isle, HLS, HLS-SB, HOOPS, Santa Ynez)
Telephone: 303-231-3098; Fax: 303-231-3846
E-Mail: Allen.Vigil@mms.gov or

Ms. Tiffany Duval (LLS & TXG) or
Telephone: 303-231-3620; Fax: 303-231-3846
E-Mail: Tiffany.Duval@mms.gov

Ms. Amanda Martinez (HLS)
Telephone: 303-231-3480; Fax: 303-231-3846
E-Mail: Amanda.Martinez@mms.gov

- Electronic Funds Transfer:
  Mr. David Barnes
  Telephone: 303-231-3034; Fax: 303-231-3501
  E-mail: mailto:David.Barnes2@mms.gov

- Marketable Condition and Gathering Upstream of the FMP Questions:
  Mr. Roman Geissel
  Telephone: 303-231-3226; Fax: 303-231-3473
  E-mail: Roman.Geissel@mms.gov

- MMS RIK Website: http://www.mrm.mms.gov/rikweb/Default.htm

We acknowledge that you and the MMS have given proper notice when using the telephone number or fax number provided to communicate with us. Any telephone communication regarding volumes must be confirmed by e-mail or fax no later than 1 business day after telephone communication occurs. We further agree to make arrangements to receive such communications regarding oil scheduling issues during normal business hours. You and the MMS should communicate with one of the points of contact to answer any further questions.

The Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) requires us to inform you that we collect this information to document fulfillment of royalty obligations on minerals removed from leases on Federal lands. This information collection is approved by the Office of Management and Budget and is titled "30 CFR Part 208—Sale of Federal Royalty Oil; Sale of Federal Royalty Gas; and Commercial Contracts (OMB Control Number 1010-0119, expiration date February 28, 2009)." We use this information to maintain and audit lease accounts. Responses are **mandatory** to obtain a benefit.

Proprietary information is protected in accordance with standards established by the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1733), the Freedom of Information Act (5 U.S.C. 552(b)(4)), and the Department regulations (43 CFR 2). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a current valid OMB Control Number. Public reporting burden is estimated to average 1 hour per response, including the time for reviewing instructions, gathering and maintaining data, and completing and reviewing the data. Direct comments regarding the burden to estimate, or any other aspect of this information collection to the Information Collection Clearance Officer, Minerals Management Service, Mail Stop 4230, 1849 C Street NW, Washington, DC 20240.

Sincerely,

Pamela Rieger

Pamela Rieger
Acting Manager, Crude Oil Front Office
Royalty In Kind

<u>Enclosures:</u>

Enclosure 1	July 2008 RIK Properties
Enclosure 2	Summary of Nomination Due Dates
Enclosure 3	Oil Production Avails Estimate
Enclosure 4	Actual Operator Delivery Allocation
Enclosure 5	Oil Imbalance Statement