



United States Department of the Interior

MINERALS MANAGEMENT SERVICE

Washington, D.C. 20240

SEP 28 2000

Dear Operator/Lessee:

The Minerals Management Service (MMS) has elected to take crude oil royalties as “royalty in kind” (RIK) from one or more Federal leases or unit agreements (properties) in the Gulf of Mexico for which you are the Operator or Lessee. The enclosure lists those properties and other relevant information. This RIK project is designated as the Gulf Oil Sale 1, or GOS1, and begins with oil production for November 1, 2000.

This letter provides the terms, procedures, and conditions under which MMS as the Lessor will take Royalty Oil in kind under the Outer Continental Shelf Lands Act of 1953 (43 U.S.C. § 1353) and the royalty provisions in the Federal leases associated with the properties. For the purposes of this letter, Royalty Oil means the Federal lease production multiplied by the lease royalty rate. The volumes of Royalty Oil taken by MMS will be consistent with any and all grants of royalty relief.

Term

Under GOS1, MMS will take all Royalty Oil from the properties listed in the enclosure for a 6-month term beginning November 1, 2000, and ending April 30, 2001. We will provide a courtesy termination notice 30 days prior to the end of the term. If we terminate this project before April 30, 2001, we will provide at least a 30-day written notice of termination.

Royalty Oil Delivery

As the Operator, you must deliver all Royalty Oil from the selected properties to the market centers identified in the enclosure, including Royalty Oil from newly producing wells on the properties or newly producing properties added to commingling agreements. You will be assumed to be in exclusive control and possession of Royalty Oil prior to delivery. The MMS or its designee will have custody, possession, and responsibility for Royalty Oil beyond the delivery point. Delivery must be at reasonable times and intervals and will occur at the same frequency that oil is produced and transported from the property.

Royalty Oil must be placed in marketable condition at no cost to the Lessor, even if the activities required to meet this condition are performed downstream of the royalty measurement point. Marketable condition means the condition generally acceptable to purchasers in the field or area. Questions regarding marketable condition should be directed to one of the Lessor’s points of contact on page 5 of this letter.

Unless otherwise specified, all Royalty Oil will be physically delivered by the Lessee or Operator to the delivery points at MMS' expense; that is, we will reimburse you for reasonable, actual transportation costs incurred for delivery of Royalty Oil to the market centers identified in the enclosure, downstream of the MMS-approved Facility Measurement Point (FMP). Transportation beyond the delivery point is the responsibility of the Royalty Oil purchaser. For reimbursement for transportation costs, you must report a transportation allowance on the Report of Sales and Royalty Remittance (Form MMS-2014) against each specific lease for the production you move downstream of the FMP. See "Reporting" section for more details regarding reporting requirements.

Fulfillment of Royalty Obligations

Delivery of 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. However, the rights, duties, and obligations that currently exist among the Lessee, Operator, and MMS for crude oil avoidably lost prior to the FMP or oil used on or for the benefit of the lease under 30 CFR Part 202 remain in effect.

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

Lessor Obligation to Take

We agree to take 100 percent of the Royalty Oil delivered to the delivery point for our account or our designee's account. Using customary industry practices, we will exercise reasonable efforts to minimize imbalances with you and other Lessees.

We may communicate with you to make arrangements for the timely and accurate custody transfer of Royalty Oil from the delivery point(s). The Lessee will **not** incur royalty-related penalties because of our failure to take delivery of oil volumes as communicated by the Operator.

Communication with Lessor

No later than 10 calendar days before the first day of each month, you must notify MMS (or our designee if instructed) of the daily Royalty Oil volumes anticipated for the following month of production, adjusted for the imbalances as described in the following section. You may make other arrangements for timely notification only if acceptable to us. We understand that such an estimate is not a warranty of actual deliveries to be made but is provided to facilitate planning and balancing. You also must use reasonable efforts, consistent with industry practice, to inform us as soon as practical regarding significant changes in oil production levels and/or royalty shares anticipated for GOS1 properties.

Balancing Account and Imbalances

Variances in production levels are expected to be the cause of most imbalances. For monthly deliveries during the term of GOS1, the Operator and MMS will work together to minimize the imbalances. We will monitor production and Royalty Oil volumes delivered using information provided by the Operator and other data.

Operators must handle imbalances as follows:

- You must determine imbalances monthly based on the difference between the royalty share of production and the actual volumes delivered. Imbalances must be maintained at the accepted royalty measurement point for each lease or agreement.
- You must provide the lease imbalance statement to MMS no later than 45 days after the end of each month of production, unless we approve an alternative timeframe for submission of the statement.
- Deliveries for the month following the month when the imbalance statement is due must be increased or decreased as necessary to provide for volumetric off-set of the monthly imbalance.
- Net imbalances remaining at the end of the GOS1 term must be settled as provided in the following section.

Final Imbalance Reconciliation

- We will reconcile final imbalances as soon as practicable. Reconciliation will involve communication between the Operator and MMS, and the Lessee, if necessary. We will issue a final reconciliation to the Operator through orders appealable under 30 CFR parts 243 and 290. Upon GOS1 termination, you as the Operator must issue a final oil imbalance statement to us to facilitate final reconciliation. (See Lessor's points of contact on page 5 of this letter.)
- The final imbalance will be settled through cash payment. The price used to determine the cash payment will be based on MMS regulations at 30 CFR part 206. See "Reporting" section below for reporting final imbalances.

Reporting

You must continue to report crude oil production to MMS on the Oil and Gas Operations Report (OGOR) under current requirements and frequencies as specified in MMS regulations and the MMS *PAAS Reporter Handbook*. You must not report royalty due or payments for Royalty Oil on Form MMS-2014 for the term of GOS1, except for transportation allowances, gravity and quality adjustments, or final imbalances as indicated in the following paragraph. Payments for Royalty Oil under GOS1 will be made by the Royalty Oil purchaser. Reporting does not change for non-RIK leases.

For the final month of delivery, you must report any remaining imbalance volumes on Form MMS-2014 as either a positive value for underdelivered volumes or a negative value for overdelivered volumes. For settlement of overdelivered volumes, you may take a credit against current royalties due on the same property for the net volume overdelivered during the GOS1 term. You may receive a refund for the overdelivered volumes if you are no longer responsible for paying royalties on the property. You must allocate and report the imbalances separately for each applicable lease or agreement. Interest will accrue from 60 days after the final month of delivery.

You must report transportation allowances, gravity adjustments, or quality adjustments as a separate entry for each applicable lease or agreement on Form MMS-2014. Gravity and quality adjustments must be based on actual adjustments incurred between the lease or agreement and the delivery point.

Lessor's Designee

If MMS chooses to act through a duly authorized designee, we will provide you with prior written notification, including the person to contact. (In most cases, the designee will be the Royalty Oil purchaser, that is, the winning bidder.) Notification will describe specific duties that the designee will perform on our behalf. We also will provide written notification to you when the designee is no longer authorized to act on our behalf for the purposes described in this letter. You may communicate with the designee as specified in the notification. You will not be required to direct communications to both MMS and its designee. For the purposes of this letter, if we notify you that we will use a designee in the contract, references to MMS will refer to its designee. When acting on our behalf, the designee will agree in writing to comply with all provisions of this letter that are applicable to MMS.

Audit

We may audit your records regarding all information relevant to volumes and qualities of Royalty Oil produced, measured, delivered, and, if applicable, transported. We reserve the right to examine your financial records for the subject properties related to any transportation allowances prior to the delivery point.

Lessees, Operators, and revenue payors must maintain all records of transactions mentioned in the above paragraph for a period of 7 years from the day on which the relevant transaction occurred unless MMS notifies the record holder of an audit or investigation. When notified that an audit or investigation is planned, you must maintain the records until you are released in writing from the obligation to maintain the records.

Lessor's Points of Contact

Copies of all correspondence between the Operator and MMS should be kept on file by the Operator. Operators and Lessees should communicate with one of the following points of contact to answer any further questions.

Imbalance statements:

MMS RIK Project Team
 P.O. Box 25165, MS 3131
 Denver, CO 80225 Fax: 303-231-3219
 Email: rik.project@mms.gov

Notification of daily Royalty Oil volumes:

Use the RIK Project Team email or fax number above, or call one of the following team members:

| <u>RIK Team Member</u> | <u>Telephone</u> |
|------------------------|------------------|
| Ms. Crystel Tobar | 303-231-3126 |
| Mr. Ron House | 303-231-3075 |
| Ms. Deborah Gilmore | 303-231-3076 |

COTR:

Ms. Theresa Walsh Bayani
 Telephone: 303-231-3043; Fax: 303-231-3219

Reporting Issues:

Mr. Andy Sandoval
 Telephone: 303-231-3777; Fax: 303-231-3700

Electronic Funds Transfer:

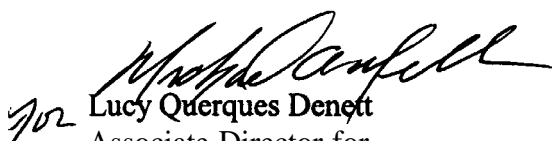
Ms. Kathy Jarrett
 Telephone: 303-231-3669; Fax: 303-231-3501

Paperwork Reduction Act

The Paperwork Reduction Act of 1995 requires us to inform you that the information collections are necessary to facilitate reconciliation of imbalances among the Operator, Lessee, and MMS and to document fulfillment of royalty obligations on minerals removed from leases on Federal lands. The information collections are approved by the Office of Management and Budget and are titled Directed Third Party Communication Between Operators and Purchasers of RIK (OMB 1010-0126, expires February 28, 2003) and Production Accounting and Auditing System Oil and Gas Reports (OMB 1010-0040, expires August 31, 2001). We estimate the communication burden of reconciling imbalances is 1 hour per month, and the burden for reporting electronically is

30 minutes per property per month. Comments on the accuracy of this estimate or suggestions for reducing this burden should be directed to the Information Collection Clearance Officer, Minerals Management Service, 1849 C Street, NW, MS 4230, Washington, DC 20240. Proprietary information submitted to the U.S. Department of the Interior 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 Departmental 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 currently valid OMB number.

Sincerely,


702 **Lucy Querques Denett**
Associate Director for
Royalty Management

Enclosure