DEPARTMENT OF THE INTERIOR

Bureau of Land Management

43 CFR Part 3100

[WO-610-02-4110-24 1A; Circular No. 2644]

RIN 1004-AC00

Promotion of Development, Reduction of Royalty on Stripper Wells

AGENCY: Bureau of Land Management, Interior.

ACTION: Final rule.

SUMMARY: This final rule amends 43 CFR 3103.4-1 relating to waiver, suspension, or reduction of rental, royalty, or minimum royalty. The purpose of this amendment is to establish conditions under which an operator or an owner of a stripper oil well property can obtain a reduction in the royalty rate. This action is necessary in order to encourage operators of Federal stripper oil properties to place marginal or currently uneconomical shut-in oil wells back in production and to provide the economic incentive to increase production by reworking such wells, drilling new wells, and/or by implementing enhanced oil recovery projects. It contains procedures for operators to follow in determining whether a property qualifies and in calculating a royalty rate. It also contains a form with which to notify the Minerals Management Service (MMS) of participation in this program.

EFFECTIVE DATE: September 10, 1992.

ADDRESSES: Inquiries or suggestions should be sent to: Director (610), Bureau of Land Management, room 501 L Street Building, Department of the Interior, 1849 C Street, NW., Washington, DC 20240.

FOR FURTHER INFORMATION CONTACT: Erick Kaarlela, (202) 653-2127.

SUPPLEMENTARY INFORMATION: A proposed rule for royalty reduction of stripper oil properties was published in the **Federal Register** on March 11, 1992 (57 FR 8605), with a 30-day comment period. Comments were received from 71 sources, which included 6 industry associations, 41 industrial entities, 10 individuals, and 14 Government entities.

The majority of the comments stated that the proposal was beneficial. Fifty-three—over two-thirds of the respondents—supported the proposed rule. Five of the comments opposed the rule. The remainder primarily requested clarifications.

Several correspondents stated that they did not understand the calculations used to establish the qualifying production rate. However, several other comments stated that the calculations and procedures were simple to understand. No change is made in the final rule, but, to help alleviate confusion, additional guidance concerning the calculations and procedures will be provided at workshops the Bureau of Land Management (BLM) and MMS will conduct upon final implementation of this rule.

Many comments suggested that the proposed rule be expanded to include stripper gas wells. The Department is currently considering a similar royalty rate reduction for stripper gas well properties. However, stripper gas wells are not part of this rule.

Several comments expressed uncertainty whether the proposed rule was applicable to Indian leases. This rule applies only to Federal properties. Indian leases are not considered Federal properties for purposes of this rule, and Indian leases are not covered.

Several comments noted that the notification procedures for discontinuing the royalty reduction when oil prices reach $28 per barrel in section 3103.4-1(d)(4) were vague. We agree, and therefore the rule has been amended to provide that BLM and MMS will do the calculations and notify the affected parties if and when this price provision becomes applicable.

Several comments expressed confusion on the notification process for royalty rate calculations. The rule has been amended by adding as an appendix a sample MMS Form Identification Number MMS-4377, Stripper Royalty Rate Reduction Notification, which is to be used for this notification, and providing the appropriate address to which it should be sent.

One comment stated that the description of eligible wells in section 3103.4-1(c)(2) was not specific enough. The rule has been amended to make it clear that only wells integral to production can be counted.

Several comments indicated misunderstanding of what constitutes an injection well, as provided in section 3103.4-1(c)(4) and particularly the use of the term "fluid" in this context. "Fluid" for purposes of this regulation includes both gas and liquid and the provision has been expanded by inserting "including reservoir pressure maintenance operations" at the end of the provision.

Several comments expressed confusion concerning the term "oil well" versus "completion" as described in section 3103.4-1(c)(3). The final rule has been changed to clarify this by redefining "oil well" as an oil completion.

Several comments expressed uncertainty as to the requirements for qualification and time frames for subsequent qualification periods. The final rule has been amended at section 3103.4-1(d)(3)(i)(B) to clarify the definition of qualifying properties and the use of subsequent qualifying periods.

Several comments stated that the definition of oil well should match that of State regulatory agencies. In the interest of national uniformity, these comments are rejected. One comment stated that the definition of oil well (completion) was too restrictive and that marginal wells producing casinghead gas where the energy equivalent exceeds that of oil would not qualify under the proposed rule. Section 3103.4-1(c)(3) has been amended to include oil completions that produce less than 60 MCF of gas per day.

Some comments asked whether new wells drilled on the property would benefit from the reduced royalty rate. The intent of the rule is that all wells on a stripper well property are to be included in any royalty reduction. Reduced royalty rates are not for individual stripper oil wells but for stripper oil well properties.

Several comments asked the types of lease to which the proposed rule applies. The rule applies to every lease regardless of the royalty schedule attached to the lease. Section 3103.4-1(c)(1) has been amended to make this clear.

Several comments requested clarification of the term "producing/injection day." If a completion produces oil or injects fluids for any portion of a day, it is counted as a whole producing day. Section 3103.4-1(d)(2) has been amended to make this point clear.

Several comments suggested either an increase or a decrease in the 15-barrel threshold stated in section 3103.4-1(c)(1). Many pointed to definitions in State law or the now-repealed crude oil Windfall Profits Tax Act. The threshold is appropriate and conforms to the latest relevant congressional enactment, the Omnibus Budget Reconciliation Act of 1990, which defined marginal wells for tax purposes as those producing less than 15 barrels per day. Therefore, the 15-barrel threshold is retained in the final rule.

Several comments stated that the 5-year test period was too short for the royalty rate reduction to be effective, while another suggested that it is unnecessarily long. The 5-year period is sufficient to see whether the royalty reduction results in additional oil

production or an increase in activity. Any shorter period would unduly reduce the incentive to develop additional reserves, or engage in costly enhanced recovery. Therefore, no change was made.

Several comments questioned MMS and BLM capabilities to administer this program. The BLM and MMS are cooperating closely in the administration of the royalty rate reduction program. The MMS will have principal monitoring responsibilities. The MMS is analyzing the impacts and outlining the internal processing of the applications that it will receive. Additionally, the personnel and system resource impacts have been identified. The majority of monitoring to be done by the MMS will use existing computerized financial processing and accounting systems. The MMS and the BLM understand their respective roles and responsibilities and are confident that the program will be successfully administered.

Several comments addressed mixed ownership in properties and how this would be handled under the rule. Although all eligible wells on the property will be used in considering whether the property qualifies for royalty rate reduction, only Federal lands within a qualifying property will be eligible for the royalty reduction. Section 3103.4–1(d)(3)(ii) has been amended to clarify this issue.

A comment suggested that total production referred to in section 3103.4–1(d)(2) should include production used on the lease. The provision for calculation of total production has been amended to make it clear that it refers to all production regardless of its disposition.

Another comment was concerned that the proposal would extend to properties producing significant quantities of gas. Applicable wells include only those classified as oil wells and those producing less than 60 MCF of gas per day. However, the royalty rate reduction is only applicable to oil production. Well classifications can change during the life of a well, and BLM will review for proper well classification and production rates during the program.

One comment suggested that the rule allow for the use of Form MMS–4054 (Oil and Gas Operations Report) in lieu of Form MMS–3160 for determining the property average daily production rate. The final rule has been amended to allow the use of either Form MMS–3160 or Form MMS–4054, whichever is appropriate.

Several comments suggested that the notification and filing requirements need to be further clarified. The final rule includes specific notification instructions in section 3103.4–1(d)(3)(iii)(B) and a notification form to facilitate the filing of notices by the operators.

Some comments asked whether condensate production from oil wells, which is normally included in the oil volume as reported on Form MMS–3160, must now be excluded and reported separately. Condensate production will continue to be considered part of the oil volume for reporting purposes on Form MMS–3160. However, only oil is eligible for the royalty rate reduction.

One comment opposed this type of incentive for only a limited or special segment of the oil and gas industry, and suggested that the incentive should apply to all Federal oil properties. A royalty rate reduction for stripper oil properties is warranted in order to encourage the greatest ultimate recovery of oil from those properties. Section 39 of the Mineral Leasing Act allows royalty reduction only in cases where it is necessary to promote development or where leases cannot be successfully operated at the current royalty rate. There has been no demonstration that royalty reduction is necessary for all Federal leases, regardless of their rate of production, for these purposes.

One comment asked if the reduced royalty applicable to the Federal leases within communitization agreements or unit participating areas would be based on the qualifying status of the entire unit or communitization agreement as a property. This is correct. The property may include Indian and/or non-Federal lands for qualification purposes, but the reduced royalty only applies to the Federal leases in those agreements. Section 3103.4–1(d)(3)(ii) has been amended in the final rule to make this clear.

Several comments were received on the royalty rate formula stated in section 3103.4–1(d)(3)(ii). One comment suggested amending the formula by including oil price and operating costs differentials. This recommendation is not adopted in the final rule, because it would be overly complex and administratively cumbersome.

One comment questioned why the proposed rule counted injection wells in calculating the qualifying production rate. Injection wells are included in these calculations because, like producing oil wells, injection wells are an integral part of production operations and are used to enhance oil recovery. Therefore, they are appropriately included when computing the royalty rate.

One comment questioned the procedure for calculating applicable daily property production rates through "rounding down," exemplified in section 3103.4–1(d)(ii). Truncating decimals is an appropriate procedure, because it is consistent with the objective of providing an incentive and will be insignificant in the overall results.

One comment asked the rationale for reducing the royalty rate 0.8 percent for each barrel below 15 barrels of oil per day. The 0.8 percent represents a straight line per unit rate of decline of production from 12.5 percent to 0.5 percent; i.e., 11.7 percent is paid on 14 barrels, 10.9 percent is paid on 13 barrels, and so on. A gradual straight line reduction in royalty rate is simple to administer and should discourage manipulation of the qualifying production volumes.

One comment asked why the royalty rate was proposed in section 3103.4–1(d)(3)(iii)(C) to be capped at a reduced rate as determined from the initial qualifying period. The royalty rate will not increase beyond the rate established in the qualifying period, regardless of the amount of future production, in order to provide a continuing incentive to operators to increase investment in their oil properties and to obtain additional oil production over the entire life of the program.

One comment asked about the possibility of manipulation of lease operations in order to obtain the benefits of a royalty rate reduction. Manipulation of lease operations is possible. In coordination with MMS, BLM will be monitoring production and investigating anomalies. Lessees found to have manipulated production figures will be dropped from the program as provided in section 3103.4–1.(d)(3)(iv).

One comment asked why there is no regulatory language limiting the program to 5 years. The intent of the rule is not to limit this program to 5 years but merely to review it after 5 years. However, a provision has been added to the final rule in section 3103.4–1.(d)(3)(iv) allowing the Secretary to terminate the royalty reduction program at any time after 5 years.

Several comments questioned why the threshold for royalty rate reduction is set at $28 a barrel. This amount is an appropriate economic cutoff for the royalty rate reduction; it was used in the Omnibus Budget Reconciliation Act of 1990 tax revisions for marginal wells that had similar objectives.

Several comments asked why we did not address the deficiencies in the current royalty rate reduction process found at 43 CFR 3103.4–1 instead of proposing an across-the-board royalty rate reduction. Streamlining the current

process was considered, but the method adopted in the final rule will provide more of an incentive to operators to continue to produce these stripper oil properties by allowing them to make a profit and not just break even as required by the current regulations.

Several comments requested clarification of the term "routine operational and economic factors" as used in section 3103.4–1(d)(3)(iv). The Department interprets these as normal activities related to oil field operations and clearly not being conducted for the purpose of manipulating production. There is no need for further clarification of this provision, as the words used are used in their common, everyday meaning.

Several comments were received from State agencies about the possible Federal and State revenue losses that will result from the proposed royalty rate reduction. These comments typically reflected concern that the royalty rate reduction will merely generate a large initial Federal and State royalty loss with little offsetting royalty and tax gain from a projected subsequent increase in production. The comments also indicated the related concern that administrative costs and problems will be greater than anticipated and that these costs will be passed on to the States. The following are examples of these concerns. One agency calculated the most favorable combined Federal and State revenue loss at a substantial $20 million and did not consider offsetting this with Federal and State tax gains. Similarly, another predicted that the combined royalty loss will be around $29 million because it does not expect offsetting royalty and tax revenues from production increases. It also predicted that the costs of administering the program will be much larger than expected. A third State official stated that the projected increase in crude oil production as a result of the royalty reduction will not occur as predicted, so that the royalty reduction will fail to produce tax and royalty increases to help offset the initial loss.

Likewise, another State office stated that the projections of production increases from the royalty rate reduction were too optimistic and predicted less tax and revenue offsets to the initial royalty loss. It noted, for example, that a substantial part of the royalty reduction in one State will go to a few old, large oil fields that cannot be expected to increase oil production over what is currently, being produced.

The Department of the Interior recognizes that there will be some royalty losses to Federal and State Governments and estimated these losses to determine their possible magnitude. The Secretary chose to use royalty reduction specifically in order to increase recovery of the oil and gas resource to benefit the public interest rather than to maximize revenues to the Federal and State governments, and is fully authorized to do so by Section 39 of the Mineral Leasing Act, which was amended in 1946 to increase the Secretary's discretion in this regard. The Department estimated there to be a likely Federal gain from the royalty reduction program of $3.3 million, the States' loss to be $6 million and the benefit to the industry, largely from increased production, to be $49.1 million. The accuracy of these estimates is dependent on the production response of the industry, but the estimates are believed to be reasonable based on the results of simulating a similar royalty reduction for the Federal portion of the New Mexico reservoirs in the Department of Energy's (DOE) Tertiary Oil Recovery Information System (TORIS) model. The difference in impact on the State and Federal governments is not a product of any feature of the rule. The net State losses, from their share of the reduced Federal royalties, are not offset to the same extent as Federal losses, because State tax rates are generally lower than Federal rates. Furthermore, the indirect benefits associated with increased production, such as continued or increased employment in local communities, will help offset losses.

In the face of this disagreement over estimates between the comments and Department, the estimates have been re-examined. After further review, we find our estimates reasonable and find no reason to revise them. There is a risk that the losses will come in higher (or lower) than our estimates, but we view this as an acceptable risk in attempting to stimulate the production of Federal stripper oil leases and ensure that the maximum amount of economically recoverable oil is obtained from the reservoir.

One comment suggested that the abandonment rate described in the proposal was not significant enough to justify the proposed relief. The abandonment rate alone may not serve as an accurate indicator of the economy of the industry because many wells are shut-in while awaiting abandonment and are not counted as abandoned: There are 6,000 shut-in wells and 3,000 temporarily abandoned wells on Federal lands as of September 30, 1991, accounting for over 25 percent of all wells on Federal lands. The increases in recoverable reserves and production indicated by the DOE's "TORIS" model demonstrate that development would be promoted through this relief.

One comment questioned the statement in the preamble of the proposed rule that money currently spent in abandoning wells can instead be used toward production, noting that operators will eventually need to abandon wells and will retain funds therefor. It is true that the reduction will not eliminate the ultimate need to abandon the well. However, it will allow for increased cash flow at the present time by avoiding simultaneous abandonment of many wells and by generating revenue from additional production.

One comment stated that the Department proposes to count all wells "drilled in the earth" in determining the eligibility of a property. The rule provides for counting only those wells that produced or that had fluid injected into them during the qualifying or subsequent 12-month period.

Some comments stated that the proposal to use historical information to determine eligibility would allow operators who are currently economically healthy to be eligible for relief. There may be some isolated cases that can fall into this category, but it is unlikely that there would be a significant change in production in the brief time from the qualifying period to the present. Furthermore, the use of the qualifying period is administratively simple, can be implemented without any new administrative mechanism, and discourages manipulation.

One comment stated that on the one hand, the proposal served to discourage, not encourage, increased production, while on the other hand, it also locks in relief to properties that may have future production increases such that they no longer meet initial qualification production levels. Operators would not likely reduce their production and subsequent revenues to obtain a lower royalty rate, because the use of a linear sliding scale minimizes any gains from lower royalties, and the cost of such manipulation of production would outweigh those small royalty gains. Additionally, a property will enjoy the benefit of the relief even when its production rose above the stripper level. The rationale for this relief is to encourage investment to promote development and sustain increased production.

One comment stated that the rule provided no justification for allowing the lessee to retain the reduced rate for 6 months after the market has reached $28.00/bbl, as provided in section

3103.4–1(d)(4). A 6-month period is necessary to allow the lessee to adjust operations to take into account the higher royalty rate.

One comment stated that the royalty reduction would not minimize the necessity of drilling new wells. The proposed rule did not imply that new wells may not be needed for extension of current reservoirs or the development of new reservoirs, but rather proposed a royalty reduction that will allow existing wells to have extended production lives, and will minimize the need to drill replacement wells in existing reservoirs.

One comment expressed concern that some major producers who have de-emphasized their investment in domestic exploration and production would receive substantial benefits under the proposed royalty reduction rate. The proposed royalty reduction rate will provide incentives for current domestic producers to increase production as well as an incentive for a continued emphasis on domestic exploration and production. The analysis undertaken by the Department of Energy found the royalty reduction will stimulate a 29 percent increase in production from stripper wells on Federal lands.

One comment suggested that relief to Federal leaseholders alone in unfair to private stripper well operators. It is beyond the Department's authority to provide relief to private holdings. The relief provided to Federal lessees will not affect the competitive position of any other producer, the production from Federal stripper well properties not being large enough to affect the world price of oil or other costs of production.

One comment noted that lessees would be entitled to relief even if they chose to shut-in or abandon wells. The Department never intended to prevent all abandonment, but the role provides an incentive to producers for more complete recovery of remaining reserves.

One comment noted that the use of the 12-month period ending July 31, 1991, as the initial qualifying period in section 3103.4–1(d)(3)(i)(B) may permit lessees to use shut-in wells to determine their eligibility even if they currently would not meet the definition of well properties. The number of properties in which such shut-ins have occurred is not significant in comparison to the benefits afforded by using historical data.

One comment stated that the average cost savings per property would be insufficient to promote development. Another stated that other factors, such as pricing and environmental concerns, have a greater impact on the operator's decision to continue production. The Department's estimate, based on DOE's TORIS Model, is that there will be an increase of 4.7 million barrels in the oil produced per year. While this rule does not address all of the relevant factors, it will have a very significant impact.

One comment noted that the rule does not assert that all Federal stripper well properties qualify for relief under the standards of Section 39. The class of eligible wells defined in this rule reasonably approximates the class in which there is a substantial probability that recoverable reserves will be produced that otherwise would not be produced because of the margin of profitability at the market price and current royalty rates that have prevailed over the last 5 years. Therefore, the relief provided by the rule encourages the greatest ultimate recovery and promotes development of marginal properties, so that this rule is consistent with the statute. Further, timely achievement of this increased recovery would not be possible if royalty reduction requests for these well properties are processed on a property-by-property basis under the existing regulations, because many of the operators may have to shut-in wells before all such requests could be prepared, analyzed, and approved.

One comment questioned the Department's ability to detect manipulation due to the current MMS audit procedures focusing on larger producing properties. The strategy for detecting manipulation does not depend on royalty audit, but it will be focused on identifying anomalies in production levels.

Two comments stated that the finding in the regulatory preamble is insufficient to support the exercising of the Secretary's authority under section 39 of the Mineral Leasing Act (MLA), as amended. One comment questioned the Department's authority for granting royalty relief simultaneously to all stripper well properties. The royalty rate reduction is necessary to promote development of the substantial majority of stripper oil well properties that cannot economically be fully developed at the current royalty rate and market price. As noted in the preamble of the proposed rule, stripper well production is important to maintaining United States production, which has been declining during the last 5 years. Also, there has been an increase in the number of shut-in and abandoned wells. In light of this, and the modeling of the Department of Energy, the Department estimates that the royalty rate reduction will increase production from stripper well leases by 4.7 million barrels of oil per year over the test period. These findings meet the requirements in Section 39 of the MLA, which allows the Secretary to grant royalty rate reductions "for purposes of encouraging the greatest ultimate recovery of * * * oil * * * and in the interest of conservation of natural resources * * * whenever in his judgment it is necessary to do so in order to promote development * * *."

One comment challenged the adequacy of the Secretary's findings to support "nationwide" royalty rate reductions, citing the Interior Board of Land Appeals (IBLA) decision in *Peabody Coal Co.*, 93 IBLA 317 (1986), for the proposition that there must be a showing of "a reasonable probability operation would cease or development, recovery, or conservation of the resources would be jeopardized." 93 IBLA at 327. The rule does not comprise a nationwide royalty rate reduction, but rather provides for reductions targeted on properties with marginal production in which the economics of operating at today's oil prices while paying full royalties dictate abandonment before technically recoverable resources have been produced. There is a reasonable probability that recovery would be jeopardized or operations cease, based on actual experience and projections of the DOE TORIS model. The correspondent's interpretation of *Peabody* was rejected by the Interior Board of Land Appeals in *State of Wyoming*, 117 IBLA 316, 322, affirmed U.S. Dist. Ct. (Wyo.) No. CV–0097–B, filed December 16, 1991, in which IBLA stated:

> The State has also urged that the Department has consistently interpreted 30 U.S.C. 209 (1988) to allow a royalty reduction to promote development *only when the development could not otherwise economically occur.* * * * Neither the statute nor the regulations limit the Secretary's discretion to this criterion. Nor did we hold in *Peabody* or any other Board decision that the *only* circumstance authorizing royalty reduction to promote development is when development cannot otherwise economically occur. To so hold would render the section 209 language "whenever * * * necessary * * * to promote development" meaningless. As noted in Solicitor's Opinion, M–36920, 87 I.D. at 73, this language was added to section 209 "as an *alternative* to finding that the lease 'cannot be successfully operated' " and gave the Secretary "*greater* discretion in granting relief." (Emphasis added.)

A comment suggested that it may be in the national interest to allow wells to remain shut-in to await better economics to resume production. The comment also faulted the Department for not showing what percentage of Federal leases are at risk of permanent

loss of production or the "break point" for economic survival of a lease. The comment further accused the Department of seeking the reduction to test the effect of royalty reduction without a rational basis at this time for determining the amount of reduction "necessary" for development. The comments are not adopted in the final rule. The national interest is not served by shutting in wells prematurely. Either such wells are left unplugged with the attendant risk to the environment, or they are permanently plugged making re-entry a proposition far too expensive for stripper well production rates. Leaving wells shut-in for long periods of time increases the risk of damaging the reservoir and fresh water zones because of possible casing deterioration or other factors, as well as possibly making it cost prohibitive to re-enter either to resume production or to plug and abandon the well permanently. The proposed rule did show that an appreciable percentage of producing Federal leases (15,500 of 23,000) were stripper wells at risk of permanent loss of production under current market conditions. The breakpoint for such stripper properties varies with the level of production, and therefore the Secretary has decided to adopt a sliding scale for determining the appropriate royalty at each level of production.

A comment suggested that the Secretary is limited to reducing royalties on a property-by-property basis upon application of the lessee and a specific showing of hardship or need, because otherwise the power to reduce royalties would infringe the responsibility of Congress to establish minimum royalty rates. For this proposition, the comment relied on provisions of the original section 17 of the Mineral Leasing Act concerning stripper wells that have since been repealed. The comment also relied heavily on the legislative history of a 1982 amendment of section 30 creating a royalty reduction mechanism for relinquished leases. The reduction is approved on the terms of a 1946 amendment of section 39 authorizing reductions the Secretary determines to be necessary to promote development. Neither provisions long since repealed nor provisions added to another part of the law 35 years later provide guidance, much less govern, with respect to the meaning of the 1946 language of section 39. Section 39 itself does not limit the Secretary to lease-by-lease determinations. Nor, as suggested by the comment, should the existing regulations establishing one mechanism for royalty rate reduction be read to limit the Secretary to that mechanism alone, when the Secretary finds a determination for a class or group of leases to be appropriate in the interest of maximizing ultimate recovery from those leases. In exercising discretionary authority under section 39, the Secretary is not bound to observe the minimum royalties specified in statute. *Solicitor's Opinion, Reduction of Production Royalties Below Statutory Minimum*, M-36920, 87 I.D. 69 (1979).

Determination

After consideration of the comments received, it is determined that a royalty reduction on oil from low production leases is necessary to promote development, encourage the greatest ultimate recovery of oil, and serve the interest of conserving natural resources. The national interest would be served, in a time of increasing dependence on imported fuel and a weak domestic oil industry, by greater production from present Federal oil leases of the oil that it is technically feasible to produce. A significant number of leases with production averaging less than 15 barrels per well-day contain wells that have been shut in or abandoned over the last 5 years from which additional oil could have been recovered. The expected cumulative effect of premature abandonments and foregone investments in enhanced recovery or new drilling on stripper well properties will diminish United States production 4.7 million barrels below what can be achieved by adoption of this rule. At the low market prices for crude oil that have prevailed for the last 5 years and that are expected in the next few years, the current royalty rate does not permit a profit margin on low production wells that makes it economical to maximize oil recovery. In addition, the incentive to produce incremental oil declines as the average daily production falls.

This determination is based on an analysis of the DOE's Tertiary Oil Recovery Information System modeling of certain reservoirs with stripper oil properties undertaken at the request of the Department of the Interior. The modeling indicated that there will be an increase in production of 4.7 million barrels per year if this royalty reduction initiative is adopted. Accordingly, establishing sliding scale royalty reduction rates, progressively reducing the royalty rate as average production declines below 15 barrels a day, will delay the abandonment of stripper wells, secure additional production therefrom, and increase the level of production from stripper properties by creating incentives for additional drilling and enhanced recovery programs. This determination is consistent with Congress' decision in the 1990 Omnibus Budget Reconciliation Act to afford tax relief to operators of stripper well properties. Furthermore, timely action to prevent premature abandonment, with the attendant risks of damage to reservoirs and costs of re-entry, requires immediately offering relief to all properties producing less than 15 barrels per well-day rather than relying on property-by-property determinations.

The principal author of this final rule is Joe Lara of the Division of Fluid Minerals, assisted by the staff of the Division of Legislation and Regulatory Management, BLM, and the MMS.

It is hereby determined that this final rule does not constitute a major Federal action significantly affecting the quality of the human environment, and that no detailed statement pursuant to section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)) is required. The BLM has determined that this final rule is categorically excluded from further environmental review pursuant to 516 Departmental Manual (DM), chapter 2, appendix 1, Item 1.10, and appendix 5, Item 5.4.B(6), and that the rule would not significantly affect the 10 criteria for exceptions listed in 516 DM 2, appendix 2. Pursuant to the Council on Environmental Quality regulations (40 CFR 1508.4) and environmental policies and procedures of the Department of the Interior, "categorical exclusions" means a category of actions which do not individually or cumulatively have a significant effect on the human environment and which have been found to have no such effect in procedures adopted by a Federal agency and for which neither an environmental assessment nor an environmental impact statement is required.

The Department of the Interior has determined under Executive Order 12291 that this document is not a major rule. A major rule is any regulation that is likely to result in an annual effect on the economy of $100 million or more, a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions, or significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets. Further, the Department has determined under the Regulatory Flexibility Act (5 U.S.C. 601, *et seq.*) that it will not have a significant economic

impact on a substantial number of small entities.

The Department certifies that this final rule does not represent a governmental action capable of interference with constitutionally protected property rights. The rule does not allow or require the taking of any property without due process. Therefore, as required by Executive Order 12630, the Department of the Interior has determined that the rule would not cause a taking of private property.

The information collection requirement(s) contained in § 3103.4-1 have been approved by the Office of Management and Budget under 44 U.S.C. 3501, *et seq.* and assigned clearance numbers 1004-0145 and 1010-0090.

The Department has certified to the Office of Management and Budget that these proposed regulations meet the applicable standards provided in sections 1(a) and 2(b)(2) of Executive Order 12778.

List of Subjects for 43 CFR Part 3100

Land Management Bureau, Public Lands—Mineral resources, Oil and gas production, Mineral royalties.

For the reasons stated in the Preamble, and under the authorities cited below, part 3100, group 3100, subchapter C, chapter II of title 43 of the Code of Federal Regulations is amended as set forth below:

Dated: August 4, 1992.

Richard Roldan,

Deputy Assistant Secretary of the Interior.

PART 3100—ONSHORE OIL AND GAS LEASING; GENERAL

1. The authority citation for part 3100 is revised to read as follows:

Authority: 30 U.S.C. 181, *et seq.*, 30 U.S.C. 351-359.

Subpart 3103—Fees, Rentals and Royalty

2. Section 3100.0-9 is added to read as follows:

§ 3100.0-9 Information collection.

(a)(1) The collections of information contained in § 3103.4-1(b) have been approved by the Office of Management and Budget under 44 U.S.C. 3501 *et seq.* and are among the collections assigned clearance number 1004-0145. The information will be used to determine whether an oil and gas operator or owner may obtain a reduction in the royalty rate. Response is required to obtain a benefit in accordance with 30 U.S.C. 181, *et seq.*, and 30 U.S.C. 351-359.

(2) Public reporting burden for the information collections assigned clearance number 1004-0145 is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing the burden, to the Information Collection Clearance Officer (783), Bureau of Land Management, Washington, DC 20240, and the Office of Management and Budget, Paperwork Reduction Project, 1004-0145, Washington, DC 20503.

(b)(1) The collections of information contained in § 3103.4-1(c) and (d) have been approved by the Office of Management and Budget under 44 U.S.C. 3501 *et seq.* and assigned clearance number 1010-0090. The information will be used to determine whether an oil and gas lessee may obtain a reduction in the royalty rate. Response is required to obtain a benefit in accordance with 30 U.S.C. 181, *et seq.*, and 30 U.S.C. 351-359.

(2) Public reporting burden for this information is estimated to average ½ hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing the burden, to the Information Collection Clearance Officer, Minerals Management Service (Mail Stop 2300), 381 Elden Street, Herndon, VA 22070-4817, and the Office of Management and Budget, Paperwork Reduction Project, 1010-0090, Washington, DC 20503.

3. Section 3103.4-1 is amended by redesignating paragraphs (c) and (d) as paragraphs (b)(3) and (e) respectively, revising paragraph (b)(1), and adding new paragraphs (c) and (d) to read as follows:

§ 3103.4-1 Waiver, suspension, or reduction of rental, royalty, or minimum royalty.

* * * * *

(b)(1) An application for the above benefits on other than stripper oil well properties shall be filed in the proper BLM office. It shall contain the serial numbers of the leases, the names of the record title holders, operating rights owners (sublessees), and operators for each lease, the description of lands by legal subdivision and a description of the relief requested.

* * * * *

(c)(1) A stripper well property is any Federal lease or portion thereof segregated for royalty purposes, a communitization agreement, or a participating area of a unit agreement, operated by the same operator, that produces an average of less than 15 barrels of oil per eligible well per well-day for the qualifying period.

(2) An eligible well is an oil well that produces or an injection well that injects and is integral to production for any period of time during the qualifying or subsequent 12-month period.

(3) An oil completion is a completion from which the energy equivalent of the oil produced exceeds the energy equivalent of the gas produced (including the entrained liquid hydrocarbons) or any completion producing oil and less than 60 MCF of gas per day.

(4) An injection well is a well that injects a fluid for secondary or enhanced oil recovery, including reservoir pressure maintenance operations.

(d) Stripper oil well property royalty rate reduction shall be administered according to the following requirements and procedures.

(1) An application for the benefits under paragraph (a) of this section for stripper oil well properties is not required.

(2) Total oil production (regardless of disposition) for the subject period from the eligible wells on the property is totaled and then divided by the total number of well days or portions of days, both producing and injection days, as reported on Form MMS-3160 or MMS-4054 for the eligible wells to determine the property average daily production rate. For those properties in communitization agreements and participating areas of unit agreements that have allocated (not actual) production, the production rate for all eligible well(s) in that specific communitization agreement or participating area is determined and shall be assigned to that allocated property in that communitization agreement or participating area.

(3) Procedures to be used by operator:

(i) Qualifying determination.

(A) Calculate an average daily production rate for the property in order to verify that the property qualifies as a stripper property.

(B) The initial qualifying period for producing properties is the period August 1, 1990, through July 31, 1991. For the properties that were shut-in for 12

consecutive months or longer, the qualifying period is the 12-month production period immediately prior to the shut-in. If the property does not qualify during the initial qualifying period, it may later qualify due to production decline. In those cases, the 12-month qualifying period will be the first consecutive 12-month period beginning after August 31, 1990, during which the property qualifies.

(ii) Qualifying royalty rate calculation. If the property qualifies, use the production rate rounded down to the next whole number (e.g., 6.7 becomes 6) for the qualifying period, and apply the following formula to determine the maximum royalty rate for oil production from the Federal leases for the life of the program.

Royalty Rate (%) = 0.5 + (0.8 × the average daily production rate)

The formula-calculated royalty rate shall apply to all oil production (except condensate) from the property for the first 12 months. The rate shall be effective the first day of the production month after the Minerals Management Service (MMS) receives notification. If the production rate is 15 barrels or greater, the royalty rate will be the rate in the lease terms.

(iii) Outyears royalty rate calculations.

(A) At the end of each 12-month period, the property average daily production rate shall be determined for that period. A royalty rate shall then be calculated using the formula in paragraph (d)(3)(ii) of this section.

(B) The new calculated royalty rate shall be compared to the qualifying period royalty rate. The lower of the two rates shall be used for the current period provided that the operator notifies the MMS of the new royalty rate. The new royalty rate shall not become effective until the first day of the month after the MMS receives notification. Notification shall be received on Form MMS-4377 and mailed to Minerals Management Service, P.O. Box 17110, Denver, CO 80217. If the operator does not notify the MMS of the new royalty rate within 60 days after the end of the subject 12-month period, the royalty rate for the property shall revert back to the royalty rate established as the qualifying period royalty rate, effective at the beginning of the current 12-month period.

(C) The royalty rate shall never exceed the calculated qualifying royalty rate for the life of this program.

(iv) Prohibition. For the qualifying period and any subsequent 12-month period, the production rate shall be the result of routine operational and economic factors for that period and for that property and not the result of production manipulation for the purpose of obtaining a lower royalty rate. A production rate that is determined to have resulted from production manipulation will not receive the benefit of a royalty rate reduction.

(v) Certification. The applicable royalty rate shall be used by the operator/payor when submitting the required royalty reports/payments to MSS. By submitting royalty reports/payments using the royalty rate reduction benefits of this program, the operator certifies that the production rate for the qualifying and subsequent 12-month period was not subject to manipulation for the purpose of obtaining the benefit of a royalty rate reduction, and the royalty rate was calculated in accordance with the instructions and procedures in these regulations.

(vi) Agency action. If a royalty rate is improperly calculated, the MMS will calculate the correct rate and inform the operator/payors. Any additional royalties due are payable immediately upon notification. Late payment or underpayment charges will be assessed in accordance with 30 CFR 218.102. The BLM may terminate a royalty rate reduction if it is determined that the production rate was manipulated by the operator for the purpose of receiving a royalty rate reduction. Terminations of royalty rate reductions will be effective on the effective date of the royalty rate reduction resulting from the manipulated production rate (i.e., the termination will be retroactive to the effective date of the improper reduction). The operator/payor shall pay the difference in royalty resulting from the retroactive application of the unmanipulated rate. Late payment or underpayment charges will be assessed in accordance with 30 CFR 218.102.

(4) The royalty rate reduction provision for stripper well properties shall be effective as of October 1, 1992. If the oil price, adjusted for inflation by BLM and MMS, using the implicit price deflator for gross national product with 1991 as the base year, remains on average above $28 per barrel, based on West Texas Intermediate crude average posted price for a period of 6 consecutive months, the benefits of the royalty rate reduction under this section may be terminated upon 6 months' notice, published in the **Federal Register**.

(5) The Secretary will evaluate the effectiveness of the stripper well royalty reduction program and may at any time after September 10, 1997, terminate any or all royalty reductions granted under this section upon 6 months notice.

(6) The stripper well property royalty rate reduction benefits shall apply to all oil produced from the property.

(7) The royalty for gas production (including liquids produced in association with gas) for oil completions shall be calculated separately using the lease royalty rate.

(8) If the lease royalty rate is lower than the benefits provided in this stripper oil property royalty rate reduction program, the lease rate prevails.

(9) The minimum royalty provisions of § 3103.3-2 apply.

(10) Examples.

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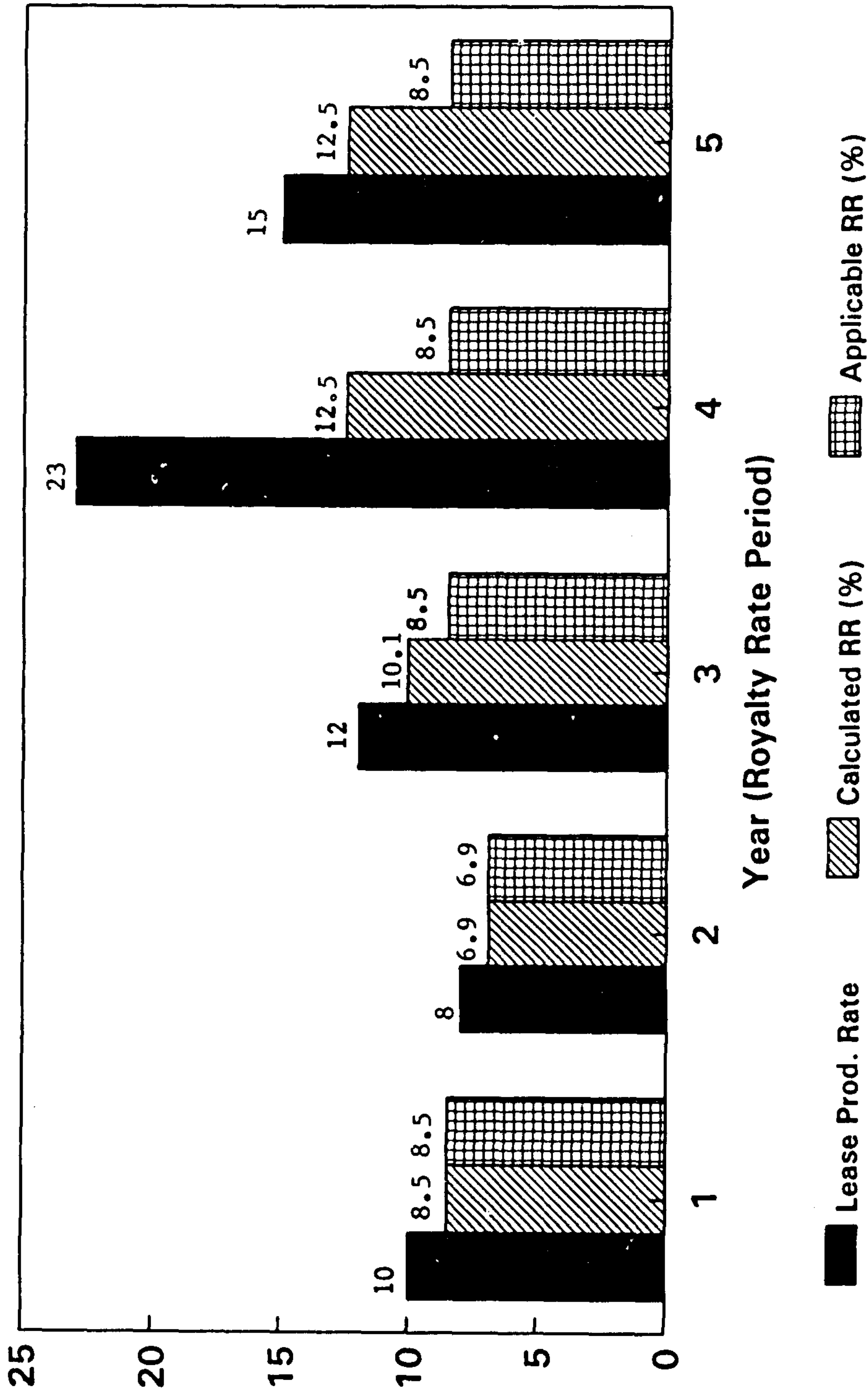

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Explanation, Example 1

1. Property production rate per well for qualifying period (August 1, 1990–July 31, 1991) is 10 barrels of oil per day (BOPD).

2. Using the formula, the royalty rate for the first year is calculated to be 8.5 percent. This rate is also the maximum royalty rate for the life of the program.

$8.5\% = 0.5 + (0.8 \times 10)$

3. Production rate for the first year is 8 BOPD.

4. Using the formula, the royalty rate is calculated at 6.9 percent. Since 6.9 percent is less than the first year rate of 8.5 percent, 6.9 percent is the applicable royalty rate for the second year.

$6.9\% = 0.5 + (0.8 \times 8)$

5. Production rate for the second year is 12 BOPD.

6. Using the formula, the royalty rate is calculated at 10.1 percent. Since the 8.5 percent first year royalty rate is less than 10.1 percent, the applicable royalty rate for third year is 8.5 percent.

$10.1\% = 0.5 + (0.8 \times 12)$

7. Production rate for the third year is 23 BOPD.

8. Since the production rate of 23 BOPD is greater than the 15 BOPD threshold for the program, the calculated royalty rate would be the property royalty rate. However, since the 8.5 percent first year royalty rate is less than the property rate, the royalty rate for the fourth year is 8.5 percent.

9. Production rate for the fourth year is 15 BOPD.

10. Since the production is at the 15 BOPD threshold, the royalty rate would be the property royalty rate. However, since the 8.5 percent first year royalty rate is less than the lease rate, the royalty rate for the fifth year is 8.5 percent.

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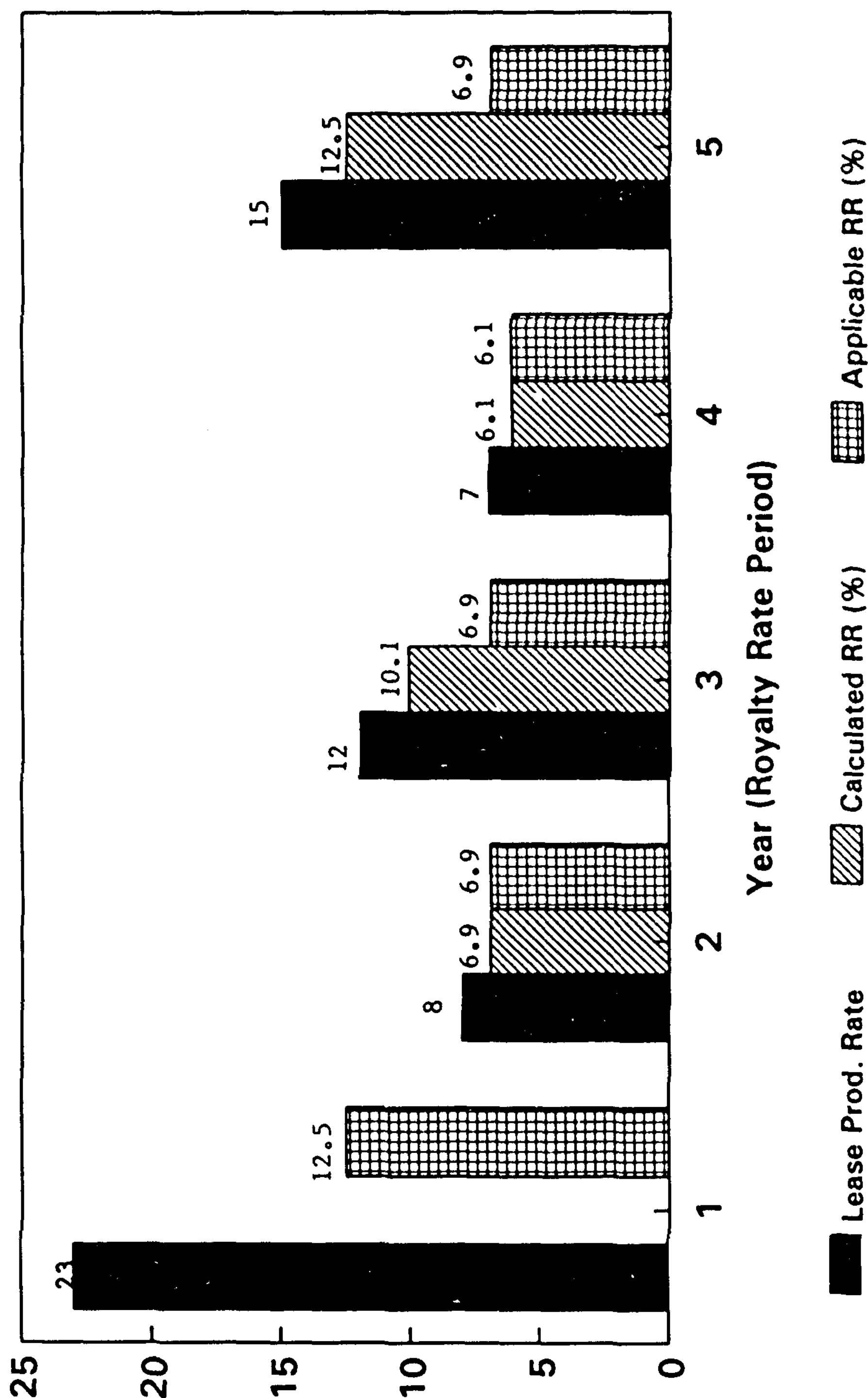

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Explanation, Example 2

1. Property production rate of 23 BOPD per well (for the August 1, 1990–July 31, 1991, qualifying period prior to the effective date of the program) is greater than the 15 BOPD which qualifies a property for a royalty rate reduction. Therefore, the property is not entitled to a royalty rate reduction for the first year of the program.

2. Property royalty rate for the first year is the rate as stated in the lease.

3. Production rate for the first year is 8 BOPD.

4. Using the formula, the royalty rate is calculated to be 6.9 percent for the second year. This rate is also the maximum royalty rate for the life of the program.

6.9%=0.5+(0.8×8)

5. Production rate for the second year is 12 BOPD.

6. Using the formula, the royalty rate is calculated at 10.1 percent. Since the 6.9 percent second year royalty rate is less than 10.1 percent, the applicable royalty rate for third year is 6.9 percent.

10.1%=0.5+(0.8×12)

7. Production rate third year is 7 BOPD.

8. Using the formula, the royalty rate is calculated at 6.1 percent. Since the 6.1 percent third year royalty rate is less than the qualifying (maximum) rate of 6.9 percent, the royalty rate for the fourth year is 6.1 percent.

6.1%=0.5+(0.8×7)

9. Production rate for the fourth year is 15 BOPD.

10. Since the production is at the 15 BOPD threshold, the royalty rate would be the lease royalty rate. However, since the 6.9 percent second year royalty rate is less than the lease rate, the royalty rate for the fifth year is 6.9 percent.

Appendix:

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U S DEPARTMENT OF THE INTERIOR

STRIPPER ROYALTY RATE REDUCTION NOTIFICATION

NOTE: Reduced Royalty Rate is not effective until the month after this notification is received by the Minerals Management Service. See 43 CFR Part 3100 for complete instructions.

OPERATOR NAME: ______________________ DATE SUBMITTED ______________

OPERATOR NUMBER: ______________________

PERSON TO CONTACT ______________________ ______ ______ ______

AREA CODE | TELEPHONE NUMBER | EXTEN.

LEASE NUMBER(S)	AGREEMENT NUMBER \1	QUALIFYING OR CURRENT PERIOD \2	QUALIFYING ROYALTY RATE	CURRENT ROYALTY RATE \3	EFFECTIVE DATES

NOTE: THIS NOTIFICATION MUST BE SUBMITTED TO MMS AND ALL PAYORS ON THE LEASES.

\1 Include agreement number for any lease located in an agreement. All leases in the agreement must be listed separately.

\2 Initial qualifying period August 1, 1990, through July 31, 1991, or current period. If the property does not initially qualify, subsequent qualifying period would be the latest 12-month period before the property qualifies (i.e., a 12-month rolling average).

\3 Current period royalty rate must be compared to qualifying period royalty rate and the lower of the two rates will be the royalty rate for the subsequent year, when notification is received by MMS.