July 13, 2007

Department of the Interior
Minerals Management Service
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VIA FAX: 703-787-1546
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ATTN: Rules Processing Team (Comments)
RIN 1010-AD33

RE: Proposed Rule – Ultra-Deep Gas Wells and Deep Gas Wells on OCS Oil and Gas Leases; Extension of Royalty Relief Provisions to OCS Leases Offshore of Alaska (72 Fed. Reg. 28396, May 18, 2007).

Dear Sir or Madam:

As representatives of the Nation's natural gas and oil industry, the National Ocean Industries Association, the American Exploration & Production Council, the Independent Petroleum Association of America, the International Association of Drilling Contractors, the Natural Gas Supply Association, and the US Oil & Gas Association appreciate the opportunity to respond to your request for comments on the proposed rule. Our six national trade associations represent thousands of companies, both majors and independents, engaged in all sectors of the U.S. oil and natural gas industry, including exploration, production, refining, distribution, marketing, equipment manufacture and supply, and other diverse offshore support services. Either directly or indirectly, we are all working to explore for and produce hydrocarbon resources from the Nation's Outer Continental Shelf (OCS) in an environmentally sensitive manner. The proposed regulation, therefore, is of particular importance to us.

The proposed rulemaking implementing sections 344 and 346 of the Energy Policy Act of 2005 (EPACT) would modify the current deep gas royalty relief regulations. The current regulations provide royalty suspension volumes of 15 and 25 billion cubic feet (BCF) for new wells drilled and completed at depths exceeding 15,000 and 18,000 feet respectively, in water depths of less than 200 meters. The proposed rule would extend the relief to leases in waters up to 400 meters deep, and would add a third tier of royalty relief providing a suspension volume of 35 BCF for new wells drilled and completed at 20,000 feet or deeper. In addition, the proposal would extend discretionary royalty relief to leases in the Alaska OCS region.

The undersigned associations strongly support deepwater, deep gas, and discretionary royalty relief. These tools assist the Minerals Management Service (MMS) in fulfilling its mandate to provide for the expeditious exploration and development of the energy resources on the OCS and to provide for conservation of the resource by ensuring that as much of the energy in a particular area as practicable is harvested. By enacting sections 344 and 346 of EPACT, Congress intended to provide additional royalty relief for the production of ultra-deep gas, to extend the deep gas relief already being awarded in waters 200 meters and shallower to waters 400 meters and shallower, and to include the Alaska region in the OCS waters eligible for royalty relief. We commend the MMS for attempting to implement the EPACT mandate by extending royalty relief to waters in the Alaska region and by proposing a third tier of royalty relief for ultra-deep gas wells, but we do not believe this proposed rule achieves those goals. We have several concerns about the proposed rule's treatment of production of natural gas that has been achieved by sidetracking or by drilling secondary wells to greater depths on a lease already producing from another deep gas reservoir. Furthermore, we strongly oppose the agency's proposal to apply a price threshold of $4.47/MMBtu to the new royalty relief volumes required by EPACT, since this threshold effectively nullifies the royalty relief measures of the Act. Finally, we strongly urge the agency to amend its current regulations regarding deepwater and deep gas royalty relief to include waters off Alaska.

Background

The natural gas market is in a state of transition. In 2004, the North American natural gas market consumed 27.6 trillion cubic feet (TCF). This level will increase 1% per year, and by 2015 will reach approximately 32 TCF. The United States accounts for 80% of this total consumption today, though its share will decrease to 74% by 2030 as Canadian consumption outpaces U.S. growth in demand for natural gas.

As America's natural gas needs are increasing, the production from traditional supply sources is declining. The increased demand and declining production requires that the industry seek resources in places that have not been as economic or as attractive in the past. One of these areas is the potential for deep gas on the Gulf of Mexico continental shelf. The MMS Gulf of Mexico Regional Office has reported that while 80% of Gulf gas comes from shallow water, "shallow water gas production is in a steep slide."

While the shallow waters of the offshore Gulf of Mexico have been an area of substantial exploration, sediments located at depths greater than 15,000 feet below the sea floor are relatively unexplored. Only 11% of wellbores drilled at all depths of water between 1993 and 2005 were completed to a depth of 15,000 feet or more. These numbers are startling when you consider that the MMS estimates that there could be up to 55 TCF of recoverable natural gas below this depth.

The numbers reflect the unique challenges presented by production of deep and ultra-deep gas, which, in many ways, are more difficult to overcome than those presented by deepwater production. These challenges include high pressures and temperatures, corrosive environments, salt intrusions, and poor seismic images. Compounding these technical challenges is the associated high cost environment. The projects require significantly more geological and geophysical data acquisition and manipulation, unconventional rig specifications, innovative well construction techniques, and increased costs for support facilities. While drilling costs for conventional on the shelf shallow depth wells average between $6 million and $7 million, drilling one deep gas exploratory well can result in costs ranging from $10 million to well over $100 million.

The additional tier of relief for ultra-deep wells mandated by Congress is particularly important. Many companies believe that the real targets of opportunity lie beneath the 20,000 foot depth. Large targets are always developed first, and the government needs to encourage exploration to discover those deeper targets. The difference in cost to drill an 18,000 foot well and a 20,000 foot well is dramatic. These regions remain frontier areas in many ways, and unless significant relief is offered for production in this potentially important province, the ultra deep gas frontier will remain largely untapped.

If implemented correctly, this incentive can spur industry to overcome the many technical challenges involved in deep shelf drilling, so that the heretofore untapped deep gas pools may be harvested. Deep gas is one of the few short-term options available to help stem our current domestic natural gas production decline and deliver significant new production through infrastructure that is already in place.

Proposed Rule

We strongly object to several provisions in the proposed rule, and urge the MMS to change them. First, we urge that ultra-deep wells be granted the relief intended by Congress, and not be subject to arbitrary limitations simply because they are sidetracks or secondary wells. Second, we urge the agency to adopt a reasonable price threshold for the new rule, rather than the threshold proposed that would effectively terminate all royalty relief. Finally, we urge MMS to amend current and proposed deepwater and deep gas royalty relief regulations to apply to the Alaska region.

Ultra-Deep Wells and Sidetracks on Leases with Existing Deep or Ultra-Deep Wells

Congress stated clearly and unequivocally in subsection 344(a)(1) of EPACT that the rule MMS adopts must grant royalty suspension volumes of not less than 35 BCF for natural gas production from ultra-deep wells in less than 400 meters of water. Notwithstanding this explicit statement of congressional intent, the proposed rule relies on a convoluted interpretation of subsection 344(a)(2) to give itself discretion to grant no royalty relief at all for an ultra-deep well or sidetrack if a deep well or ultra-deep well exists on the lease. The rule fails to explain why the existence of a reservoir at 15,000 feet in any way reduces the cost or risk of drilling an ultra-deep well with a target depth of 22,000 feet. Similarly, the rule does not explain why an ultra-deep well producing from a reservoir on the east side of a lease reduces the cost or risk of drilling an ultra-deep well to produce from a different reservoir on the west side of the lease.

MMS has failed to provide any rationale for its decision to deny granting 35 BCF of royalty relief for a second well on a lease. The agency has chosen instead to unilaterally and arbitrarily thwart Congress' expressed intent to incentivize ultra-deep production by denying royalty relief for ultra-deep wells on leases with existing deep wells or ultra-deep wells regardless of the situation that exists on the lease.

The proposed rule would in many cases provide less royalty relief than is currently available under the existing rules. The rule would result in wells drilled at greater depths earning the same or less of an incentive or no incentive at all. Additionally, the rule would lead to wells drilled between 200 and 400 meters possibly earning less of an incentive than wells drilled in less than 200 meters. Under the existing rule, a lessee with an existing well drilled to a depth of 15,000 feet would receive an additional 10 BCF of suspension volume for an ultra-deep well drilled on the lease. However, under the proposed rule, for most leases, the lessee will receive no additional royalty suspension volume for drilling a second, ultra-deep well on a lease that already has a well drilled to 15,000 feet.

In the few instances where the proposed rule would provide an incentive for a deep sidetrack or second well on a lease, the proposed rule is still nonsensical. As an example, if a company drilled a well to 15,000 feet under the old rule and received a suspension volume of 15 BCF, and then drilled a new well under this rule to 18,000 feet, the company would receive an additional 10 BCF. However, if that same company drilled a new well that was deeper, to 20,000 feet, it would not get the additional 10 BCF, but instead would get no suspension volume at all for that well. Hence, the rule is actually a disincentive to drill to deeper depths. This interpretation of the statute runs counter to the will of Congress.

Price Threshold

The price threshold of $4.47/MMBtu proposed for all new royalty relief provisions prescribed by EPACT is contrary to the intent of the legislation. This is substantially less than the price threshold applicable to royalty suspension volumes under the existing rule. Since that rule was adopted in 2004, the costs of drilling deep gas and ultra-deep gas wells have gone up exponentially. However, rather than raising the threshold to respond to the fact that it costs more for companies to make the investment into these frontier areas than it did before, the MMS has instead gone in the opposite direction by proposing an extremely low threshold. In selecting such an artificially low threshold for deeper wells that cost more, the agency is not only defying logic, but is also functionally repealing the section and ensuring that the relief will never be granted, thereby once again thwarting the will of Congress. Furthermore, in practice, this would lead to less relief or no relief for wells drilled to deeper depths and for wells drilled between 200 and 400 meters of water than would be allowed for wells drilled in less than 200 meters of water.

The agency's explanation for the dramatically lower price threshold is that, unlike the existing rule, the royalty relief prescribed in section 344 of EPACT has no sunset provision. That is an indefensible justification for such a low threshold. The price thresholds must be set through economic modeling to establish the price at which lessees no longer need an incentive to drill deep or ultra-deep gas wells. Frustration over the ability to establish a sunset for royalty relief hardly meets that standard and is simply further evidence that, through this proposed rule, the MMS is seeking to undermine Congress' intent to provide new incentives for deep and ultra-deep gas production.

Royalty Relief for the Alaska Region

Section 346 of EPACT extended the Secretary's authority to provide royalty relief to the waters of the Alaska region. There was an immediate positive impact to this action, as the lease sale held after the law passed generated greater participation and higher bonus bids than previous offshore Alaska sales. However, that immediate reaction may be stopped in its tracks by the MMS proposal here. Rather than implement that authority by amending existing royalty relief regulations and by including Alaskan waters in this new ultra-deep gas regulation, the MMS has merely proposed to extend to Alaskan waters the discretionary relief for end-of-life and marginal production. Once again, the agency has chosen to apply EPACT in such a way that Congress' action will be minimized. We urge the MMS to fully extend existing royalty relief regulations to the Alaska region, in accordance with the new authority granted in section 346 of EPACT.

In summary, we believe that the intent of sections 344 and 346 of EPACT was to spur more domestic production in order to provide energy for the American people, and we do not believe that the rule, as drafted, will achieve those goals. We ask that the MMS amend the proposed rule in response to the comments provided herein. Thank you again for considering our comments. If you have any questions or need additional information, please feel free to contact Kim Harb at (202)737-0926.

Sincerely,

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National Ocean Industries Association

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Independent Petroleum Association of America

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