



United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, D.C. 20240

SEP 22 1998

Dear Operator:

Our records indicate that your company is the operator and/or owns operating rights for at least one Federal oil and gas lease or approved Federal agreement in the State of Wyoming from which the United States will take crude oil royalties-in-kind (RIK) beginning on October 1, 1998. This project is one of the Minerals Management Service's (MMS) RIK pilot projects, which are intended to examine the feasibility of taking both oil and gas royalties-in-kind under different conditions in various parts of the country.

The crude oil under the RIK pilot projects is not the preference for small refiners under 30 U.S.C § 192, so the MMS regulations in 30 CFR Part 208 do not apply. Therefore, this letter outlines the procedures for the Operators of such properties during the course of the Wyoming pilot project. Our authority is 30 U.S.C. § 192 and the royalty provisions contained within Federal leases. This letter establishes the terms and conditions under which the United States (Lessor) will take crude oil in-kind during the Wyoming project, and under which the designated operator or operating rights owner (Operator), as representative of the Lessee, will make crude oil (Royalty Oil) available to the United States and/or its purchaser or marketing agent. For purposes of this letter, Royalty Oil is defined as that portion of lease/agreement production equal to the lease royalty rate.

Royalty-in-Kind Applicability

The Operator must make all Royalty Oil available to Lessor's purchaser/agent for the entire term(s) of publicly announced Wyoming RIK projects. The term of the first Wyoming RIK project is from October 1, 1998, through March 31, 1999. Operators of properties selected for Wyoming RIK projects must deliver all Royalty Oil produced from such properties during the project term(s), including Royalty Oil from newly producing wells on these properties.

Royalty Oil Delivery

The Operator must deliver Royalty Oil to the Lessor's purchaser/agent at the Delivery Point, defined as the flange connecting the tank battery to the pipeline or truck outlet for each pilot project property operated. Title to Royalty Oil passes to the Lessor's purchaser at this flange.

The Operator must deliver Royalty Oil to the Lessor's purchaser/agent only upon movement of production from the tank battery into the pipeline or truck outlet (that is, in sales situations). For high-volume properties that generally are directly connected to pipelines, such delivery of Royalty Oil may be as frequent as daily. For lower levels of production and/or those not directly connected to pipelines, such delivery of Royalty Oil occurs when the Operator chooses to sell/move crude oil from the tank battery, an activity that may occur as infrequently as monthly, or even less often. For crude oil

produced during the term of the Wyoming pilot project but remaining in tank batteries as inventory at the end of the project term, royalties will be due to MMS when such crude oil is actually sold/moved from the lease.

Royalty Oil must be delivered in marketable condition, that is, in a condition generally acceptable to purchasers in the field or area. The Operator must perform any necessary dehydration, separation, or other field processing currently required to place production in marketable condition under regulations applicable to royalty in-value under 30 CFR Part 206 at no cost to the Lessor. Questions regarding potential differences in marketable condition among different purchasers should be directed to the Contracting Officer's Technical Representative (COTR) at the address/number on the last page of this letter under Lessor Point of Contact.

Fulfillment of Royalty Obligations

Operators represent and act on behalf of the Lessees of their properties. 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 Lessees' royalty obligation to the Lessor. However, the rights, duties, and obligations that currently exist between the Lessor, Lessee, and Operator for crude oil avoidably lost prior to the Delivery Point under 30 CFR Part 202 remain in effect.

For properties where the Lessee has applied for a royalty rate reduction, Operators may use the proposed royalty rate in the interim before the Bureau of Land Management approves the reduction. If the application is denied, Operators therefore must revert to using the prior royalty rate, and any imbalances must be settled at project termination as discussed below. For properties with variable royalty rates that depend on factors not known at the time of delivery of Royalty Oil, Operators must base their deliveries on their best estimate of the royalty rate. The Operator must then increase or decrease deliveries in the subsequent month to resolve imbalances once the correct royalty rate is determined.

All rent and/or minimum royalty obligations on any property in the Wyoming pilot project remain the responsibility of the Lessee. If royalties paid by the Lessee on the in-value volumes do not meet the minimum royalty obligation on a pilot property, the Lessee may contact MMS for any amount due. MMS records will reflect the amount of royalties paid by the purchaser/agent. Any amounts not paid timely will be billed to the Lessee. Interest will be charged when the minimum royalty payment is received. Where the Lessee is unable to fully recoup an advance rental paid on a lease, the Lessee may request a refund from MMS.

Lessor Obligation to Take

For the entire term of any publicly announced Wyoming RIK pilot project, the Lessor through its purchasers/agents will take 100 percent of the Royalty Oil delivered to it at the Delivery Point. The Lessor's purchasers/agents, through customary industry practice in nominating and scheduling transportation services, will minimize the occurrence of imbalances with Operators. To facilitate timely

takes of Royalty Oil from trucked properties, Lessor's purchasers/agents are contractually required to communicate with Operators, with the expectation that arrangements can be made for joint movement of crude oil from these properties.

Operators will incur no liabilities if the Lessor's purchaser/agent fails to take 100 percent of the Royalty Oil, a situation governed by the terms of the Lessor's contract with the purchaser/agent.

Reporting

Operators must continue to conduct production reporting under current requirements, formats, and frequencies. Reporting of crude oil revenues and values for Wyoming pilot properties on the MMS Form 2014 or other similar form is not required of Operators, Lessees, or existing payors for the term of the project, except under the provisions described on the next page under Volume Reconciliations at Project Termination. Reporting requirements for production and royalties for natural gas produced from Wyoming pilot properties will not change.

Communication with Royalty Oil Purchaser/Agent

No later than 10 working days before the first day of each term of the Wyoming pilot project, the Operator must notify the Royalty Oil purchaser/agent by facsimile transmission of the daily Royalty Oil volumes and crude oil qualities anticipated for the first month of the pilot project term. MMS understands that any such estimate is not a warranty of actual deliveries to be made but is provided to facilitate planning for transportation and marketing of Royalty Oil by its purchaser/agent. The Operator must also communicate to Lessor's purchaser/agent the expected royalty percentage of production to be delivered.

The Operator must use reasonable efforts, consistent with industry practice, to communicate by facsimile transmission to Lessor's purchaser/agent regarding significant changes in crude oil production levels and/or royalty rates anticipated for pilot project properties. Such communication must occur as soon as practicable after the Operator knows of such anticipated changes in production levels. The Operator must notify both the Lessor and Lessor's purchaser/agent in the event of shut-in of Wyoming pilot properties.

Communication with Transporter

No later than 10 days before the first day of each term of the Wyoming pilot project, the Operator must inform the transporter of pilot property production that the royalty portion of production from pilot properties will be taken by the Lessor's purchaser/agent. The Lessor's purchaser/agent must also communicate this information to the transporter.

Imbalances During the Project Term

For routine imbalances occurring during any month of the project, the Operator and Lessor's purchaser/agent must work together as soon as practicable to arrange for increased or decreased

deliveries in the subsequent month to resolve the imbalances. Imbalances resulting from variable royalty rates are expected to be the cause of most routine imbalances.

Volume Reconciliations at Project Termination

After each term of the Wyoming pilot project, MMS analysts will reconcile production and revenue reports with additional data, including Bureau of Land Management and pipeline data. Reconciliations will involve communication between Lessor, Operator, and Lessor's purchaser/agent. MMS will conduct such reconciliation separately for each month of the project. MMS also will identify net imbalances (that is, imbalances netted over the entire term of the project). Any necessary balancing must occur based on the results of this reconciliation to settle any remaining imbalances. MMS will issue final reconciliations through orders appealable under 30 CFR Parts 243 and 290.

Except as noted below, for settlement of underdeliveries, Lessees must settle in cash for the net volume underdelivered from a lease over the project term. For net volume settlements of underdeliveries, Lessees of pilot properties must use the values for each month's production using MMS regulations at 30 CFR Part 206, averaged over the Wyoming pilot project term and applied to the net underdelivered volume. However, if MMS believes that the Operator has systematically and/or significantly underdelivered at times of high prices, MMS may require final settlement on the separate monthly imbalances identified. In such cases, value would be calculated based on MMS regulations at 30 CFR Part 206 for each month identified by MMS as significantly underdelivered.

For settlement of overdeliveries, Lessees may take a credit against current royalties on the same property for the net volume overdelivered during the project term. For net volume settlements of overdeliveries, Lessees of pilot properties must use the values for each month's production using MMS regulations at 30 CFR Part 206, averaged over the Wyoming pilot project term and applied to the net overdelivered volume. Lessees may receive a refund for the overdelivered volumes in two circumstances: (1) the property for which an overdelivery has been identified continues to be taken in-kind after the first project term; or (2) the Lessee no longer is responsible for paying royalties on the project.

Interest

Interest is due by either the Federal Government, Operators, or Lessees for underdeliveries or overdeliveries incurred during the Wyoming pilot program.

Audit Rights

Lessor may audit Operators' records regarding all information relevant to volumes and qualities of Royalty Oil produced, stored, used on lease, field processed, measured, and transferred. Except as noted below, for the term of the Wyoming pilot project, Lessor relinquishes the right to audit the financial records of Operators or Lessees of pilot project properties for revenue and valuation information pertinent to those properties. However, if final reconciliation indicates an imbalance

needing valuation using the provisions of 30 CFR Part 206 (see above), MMS reserves the right to examine financial records of Lessees of Wyoming pilot properties.

Assignability

If operating responsibility is changed to another party during the term of the Wyoming pilot project, all of the rights and responsibilities outlined in this document transfer to the new Operator.

Lessor Point of Contact

Copies of all correspondence between Operator and Lessor's purchaser/agent should be kept on file by the Operator. Additional information may be obtained from the contact at the address below, including address, point of contact, and telephone numbers of the Lessor's purchaser/agent by pilot property. Points of contact for the Lessor are as follows:

COTR:

Mr. Robert Kronebusch
Telephone: 303-275-7113; FAX: 303-275-7124

Production Reporting Issues:

Ms. Mary Williams
Telephone: 303-231-3403; FAX: 303-231-3700

Revenue Reporting Issues:

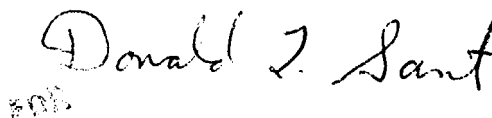
Mr. Larry Barker
Telephone: 303-231-3157; FAX: 303-231-3189

Electronic Funds Transfer:

Mr. Dave Menard
Telephone: 303-231-3574; FAX: 303-231-3501

Operators should communicate with the above points of contact to answer any further questions.

Sincerely,



Lucy Querques Denett
Associate Director for
Royalty Management