EXXON COMPANY, U.S.A.
P.O. BOX 2024 • HOUSTON, TX 77252-2024

CONTROLLER'S DEPARTMENT
OWNERSHIP

W.L. STONE
REGULATORY AFFAIRS ADVISOR

December 18, 1998

Comments of Exxon Company, U.S.A. Related to Transportation Allowances for Deep Water Subsea Leases

VIA FACSIMILE (303) 275-7124

Mr. Martin C. Grieshaber
Minerals Management Service
Royalty Management Program
P.O. Box 25165
MS 9200
Denver, Colorado 80225-0165

Dear Mr. Grieshaber:

On November 16, 1998, the MMS hosted a workshop at its Regional Office in New Orleans, Louisiana to discuss deep water lease developments involving subsea well completions. Specifically, the MMS solicited input for developing criteria to distinguish between "gathering" and "transportation" in the deep water environment for the purpose of determining allowable deductions for calculating royalty value. The workshop was a good first step toward the ultimate goal of providing fair and equitable treatment to both the government and the federal lessee in the deep water OCS. Exxon commends the MMS for this initiative and is confident that this important goal can and will be accomplished.

In response to the MMS' invitation, the American Petroleum Institute ("API"), through participating member companies, presented a panel of industry technical experts that discussed the significant technical and operational distinctions between traditional shallow water operations and those in the deep water. In addition, the API presented a panel of legal experts that discussed the various reasons why the operational circumstances unique to deep water exploration render the classification of all sub-sea movement as "gathering" unreasonable. Exxon Company, U.S.A. ("Exxon") supports the API's presentation and recommendations made at the workshop. At the conclusion of the workshop, the MMS invited written comments from interested parties. As a federal lessee with substantial deep water lease holdings, Exxon is an interested party in this process and welcomes this opportunity to submit comments. Exxon further supports the written comments and recommendations that API is submitting to the MMS on these issues.

As the MMS recognizes and as was made evident by API's presentation at the workshop, fundamental differences exist between traditional mineral exploration and production in the shallow water OCS, which the 1988 regulations were designed to address, and that in the deep water. Simply stated, the technological and operational realities of the present deep water subsea production environment will not always fit neatly within the MMS' historical royalty valuation regulations, promulgated nearly eleven years ago. The MMS has recognized that the 1988

regulations should not be strictly applied in the deepwater context as evidenced by the following comment in the MMS' 1997 report entitled *Deepwater in the Gulf of Mexico: America's New Frontier*:

> Because operations and equipment used in deepwater are different from those used in shallower waters, the existing regulations, originally written for conventional, shallow-water operations, cannot be directly applied to proposed deepwater operations in many cases.

The realities of the deep water subsea environment compel a re-examination of the distinction between gathering and transportation for subsea production under the existing regulations. Costs for installation and operation of subsea pipelines are substantial and the distances the production is moved are great. The MMS can and should recognize that the movement of bulk production from subsea wells and/or manifolds to distant host platforms serves a transportation function and purpose and, consequently, should be eligible for a transportation allowance. Such treatment is well within the MMS' discretion. Both Congress and the courts have specifically recognized that the Department of the Interior can and should consider whether operational factors affect the applicability of a regulation.

> It is recognized that a certain amount of administrative discretion and flexibility are necessary. Oil and gas are found under a great variety of types of terrain and localities. Many different and highly technical factors may be controlling in different cases. Legislative rules and standards which would be fair and equitable in one case might well prevent any operations at all in another. Therefore, the Secretary of the Interior must have administrative discretion to deal with particular problems in particular areas as they arise.

California Co. v. Seaton 187 F.Supp. 445, 449 n. 1 (D.D.C. 1960)(quoting House Report No. 2238, U.S. Code Cong. & Adm. News, 1954, p. 2696).[1]

Indeed, the MMS has in a previous instance exercised its discretion to grant a transportation allowance upon a finding that a movement of bulk oil production actually served a transportation function. *See Exxon Company, U.S.A.*, MMS-VSD-OG: 93-0075 (December 29, 1994). This decision unquestionably establishes that the MMS has the flexibility to apply the 1988 regulations based on the function of the movement.

Exxon and others operating in the deep water face unique operational circumstances that render the treatment of all subsea movements as gathering unreasonable and unfair. The great distances moved in subsea transportation provide a benefit to the MMS by enhancing the value of the production. Movement of even bulk production a great distance enhances the value of the royalty oil and/or gas production. The federal lessor, as beneficiary of the transportation service

[1] While *California Co. v. Seaton* addressed onshore leasing under section 17 of the Mineral Leasing Act, the Secretary is afforded the same discretion regardless of whether the lease in question is located onshore or offshore.

of the royalty oil and/or gas, should share the cost of this transportation service by permitting a reasonable transportation allowance.

Exxon appreciates this opportunity to comment on this critical initiative.

Sincerely,

W. L. Stone