

**Comments Received in Response
to F.R. Notice of July 16, 1998**

American Petroleum Institute (API)

The API recommended a two step analysis in determining whether an allowance was appropriate: 1) what activity is encompassed by transportation, and; 2) what is the amount of the transportation allowance?

Specific comments on the first step were:

"When subsea systems are utilized as the primary development system for lease/unit development, the treatment of subsea production to achieve pipeline quality may be impossible at the lease/unit."

"The common thread running through almost every transportation allowance characterization is ~~the physical movement of the hydrocarbon off the lease or unit.~~"

"The selection of subsea systems for lease/unit development is principally driven by economics. . . . Consequently, the royalty settlement point is at a remotely located surface platform because it is more technically practical and economically feasible. If a surface platform type system were utilized for lease/unit development, movement of production away from the lease would clearly be deemed transportation. The fact that a different development system was utilized for economic reasons should therefore not preclude production movement away from the lease/unit from being deemed transportation in subsea development situations."

Similar, if not identical reasoning was used by other commenters.

In regard to the second step in the analysis, the API commented that the allowance should be based upon the commercial value of the service. For example, a reasonable value would be that paid in the same field or area by parties not affiliated with the pipeline.

Chevron

Specific comments submitted by Chevron were:

"We strongly believe that MMS should grant a transportation allowance for the movement of ~~any bulk production~~ to a measurement or treatment point off the lease, provided the allowance covers only the cost of moving the royalty bearing substances contained in the bulk stream."

"Retaining the existing distinction between gathering and transportation will unfairly limit transportation allowances in more and more instances. MMS may just as easily avoid sharing in the cost of moving the non-royalty bearing substances by limiting bulk

transportation allowances to the cost allocable to moving the royalty bearing components only. At the same time, ~~having to bear the full cost of moving the non-royalty bearing portion of the bulk stream would also encourage lessees to locate treatment and measurement facilities as close to the lease as possible.~~

Office of the City Attorney of the City of Long Beach

The City of Long Beach's comments were more specific to the allowances for oil movement included in the rule. They did state that the only transportation costs which should be deductible are those incurred in moving crude from ~~a lease to the nearest market center~~. For California, that would be limited to the movement of crude to Los Angeles.

Conoco

Conoco's comments followed the rationale set forth by API. Specifically, Conoco stated:

"Assuming that platforms could be economically built in deep water, the cost of moving the bulk oil via these sub-sea pipelines would routinely be considered as "transportation" under MMS regulations and thus a "transportation allowance" would be applicable.

Conoco's position is that a "transportation allowance" should also be allowed for the ~~sub-sea movement of deep water oil under the same conditions that would apply if these pipelines were defined as "transportation" under the MMS regulations.~~

The Law Offices of Lobel, Novins & Lamont

The comments, submitted on behalf of the California State Controllers Office (SCO), allowed that the gathering in deep water does not directly affect California's current federal royalty interests. The commenter did state that, "However, any modification of the gathering definition that would confuse the gathering/transportation distinction does affect California."

Additionally, the SCO recommended that in reviewing any requests, the MMS consider the relief already provided under the Deep Water Royalty Relief Act.

Exxon Company, U.S.A.

The Exxon comments were similar in nature to those of the API. ~~Exxon states, "The distinction between "gathering" and "transportation" should pivot on whether the movement is away from the lease and should not be dependent on the technology used."~~

All movement offshore is an from the lease

Independent Petroleum Association of America

Domestic Petroleum Council

The commenter stated that the extent to which industry employs the subsea technology depends on the way MMS responds to requests for allowances when production is moved - often over significant distances - from the lease to the structure where separation or treatment occurs.

The commenter discusses the regulatory history of gathering and discusses the CNG subsea case,

the RVD's Exxon Grand Isle decision, and the IBLA's Shell Auger and Exxon Shute Creek decisions.

The specific recommended action was:

"In order to remedy the current discriminatory situation, IPAA and DPC urge the MMS to exercise its administrative discretion by issuing, on an expedited basis, an interpretive rule applicable to its existing regulations and, with retroactive effect, providing that a ~~transportation allowance will be granted the lessee when production from a subsea completion is moved away from the lease to a structure where separation or treatment is performed. The allowance should be available for production moving from a subsea completion in any depth.~~

Marathon Oil Company

Marathon's comments reiterated previous comments concerning economics being a driving factor in deep water production situations.

Marathon's recommendations were somewhat different however.

~~"Marathon recommends that gathering be defined as any movement of production to an accumulation point off the lease premises or an adjacent lease. Transportation is any movement of production off the lease premises or an adjacent lease."~~

Also, when calculating the transportation allowance for an unregulated pipeline, flowline, or facility, the lessee should be allowed to apply for, and the secretary allowed to grant, a higher rate of return for pipelines in more than 200 meters of water. A higher rate of return should be allowed in order to recognize and compensate lessees for the additional risk in the fabrication, installation, operation, and maintenance of deep water pipelines."

Montana Department of Revenue

Montana's concern is that any changes to the gathering definition should not have an impact on the federal leases in their state where the royalty rates are generally less than 5%.

Oryx

Oryx believes that the movement of production from subsea completions should be allowed regardless of the type of production.

Their recommendation was as follows:

"MMS should develop a standard test for determining what is "transportation" and what is "gathering". Oryx believes that any movement of production away from the producing lease, unit, or communitized area constitutes "transportation". Gathering would be limited to the movement of production to a central accumulation or treatment point on the lease, unit, or communitized area."

Shell Oil Company

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Shell's comments restate the two⁴ analysis described in the API comments. FERC tariffs and jurisdictional issues are also discussed. Shell states: "What is clear is that subsea transportation from the subsea manifold to the surface platform is a valuable transportation service off the lease which adds value to the production."

Texaco

Texaco believes that the definition of gathering should be changed to address the movement of production from subsea facilities long distances before reaching an offshore platform. Texaco states: "Movement at great distances from a sub-sea manifold to a production treating platform should be classified as transportation and not gathering." Texaco believes that "an adjustment for fair value of transportation services is merited."

MEETING AGENDA
with MMS DIRECTOR QUARTERMAN
July 24, 1998

Sales to Joint Venture Affiliates

Background

Current Activities

August 3, 1998 Decision Meeting

*Do we need requirement in rule
for notification of 10-~~50~~% ownership?*

*Coal bed methane gathering
definition.*

Subsea Tie-ins Team

Background

Current Status

New Orleans Meeting Summary

Option Paper Development

Issues

Future Activities

Subsea Tie-ins

Fall 1997 - CNG Director's Decision - IBLA appeal

Team formed - Eric P. (GOUR), Sam Fraser (Herndon), Jim Morris (RVD), PMI

Data gathering (Number) (Past decisions/guidance)

Issues discussions (Deep Water - All depths) (Distance of Movement) (Measurement location)

Options development (Pros + Cons)

(Single Well - multiple streams) (On lease/off lease)

(a couple more weeks)

Circulate for review

Any guidance based on meetings w/ Congress?

Recommendations

IBLA deadline (Mid September for Solicitor) on CNG.

Dow L. Campbell
Attorney



539 South Main Street
Findlay, OH 45840-3295
Direct No. 419/421-4121
Main No. 419/422-2121
Facsimile 419/427-3681
E-mail: DLCampbell@MarathonOil.com

July 31, 1998

**Via Facsimile: (303) 231-3385
& Overnight Mail**

Mr. David S. Guzy, Chief
Rules & Procedures Staff
Royalty Management Program
Minerals Management Service
Building 85, Denver Federal Center
Denver, Colorado 80225

**Re: Establishing Oil Value for Royalty Due on Federal Leases
(63 FR 38355, July 16, 1998)**

Dear Mr. Guzy:

Marathon appreciates the opportunity to submit the enclosed comments on MMS' recently published further supplementary proposed rule for establishing oil value for royalty due on federal leases.

Notwithstanding Marathon's request that MMS modify its proposal as set forth in these comments, the implementation of a federal royalty-in-kind program remains the best long-term solution to the complexities and uncertainties that exist in any valuation process.

If you have any questions, please contact me.

Sincerely,

A handwritten signature in cursive script that reads 'Dow L. Campbell'.

Dow L. Campbell

Enclosure

19-0000:

cc: The Office of Information and Regulatory Affairs
Office of Management and Budget
Attention: Desk Officer for the Department of the Interior
725 17th Street, NW
Washington, D.C. 20503

To illustrate the problem caused by MMS' proposed "first exchange" rule, MMS should consider the situations illustrated by the two attached charts. In the example illustrated by Chart No. 1, entitled "Tracing Situation: MMS Theory", the MMS' latest tracing proposal would be relatively straight-forward to apply for royalty valuation purposes. Clearly, the final disposition of the offshore lessee's exchanged production can be traced to an arm's-length sale at an onshore market center. In this instance, the federal lessee would only be required by the "first exchange" rule to analyze two transactions: (1) the initial exchange of 55,000 barrels at Empire, Louisiana and (2) the subsequent arm's-length sale of those 55,000 barrels at Cushing, Oklahoma.

However, most of the exchange transactions which occur in the crude oil marketplace today are far more complex than this particular example. As a result, the effort required of the federal lessee to apply MMS' current tracing proposal to actual exchange situations is a much more burdensome task than that envisioned by MMS. To demonstrate this point, Chart No. 2, entitled "Tracing Situation: Marketplace Reality," illustrates a typical situation involving an exchange of lease production pursuant to a single exchange agreement. Under MMS' proposed "first exchange" rule, the federal lessee of this particular offshore lease would first have to analyze the initial exchange of 78,000 barrels at Empire, Louisiana, of which only a portion is actually attributable to the lessee's offshore lease. The lessee would then be required to analyze 37 subsequent transactions and several pipeline shipments covering the disposition of over 4,000,000 barrels at Cushing, Oklahoma in order to determine how much, if any, was sold at arm's length. It is beyond question unreasonable to require a lessee to perform this burdensome analysis on an ongoing basis for each of its federal leases.

Marathon urges MMS to adopt the use of lease-based benchmarks as a fair and reasonable method for valuing lease production exchanged at or near the lease. A lease-based benchmark system, using arm's-length transactions at the lease, would eliminate the extreme burden of tracing downstream transactions. If MMS insists on including a tracing requirement in its final valuation rule, the requirement should be written in a way so as to apply only to the type of situation illustrated by Chart No. 1; that is, tracing of lease production would be required when the arm's-length sale involves only the further disposition of the aggregated volumes covered by the initial exchange agreement.

DEEPWATER GATHERING VS. TRANSPORTATION

MMS specifically asks for comments regarding the definition of "gathering" as it applies to deepwater developments. MMS is correct when it states that in the case of deepwater developments, especially those involving subsea completions with no platform, bulk or unseparated production is often moved many miles before it first surfaces and is treated on a platform. This situation was not an issue when the current regulations were promulgated in 1988, but technological advances since that time have made it a concern which must be addressed in any proposed oil valuation rule. Recent technological advances in subsea completions have made it possible for oil companies to produce oil and gas from reserves which would not otherwise be economically feasible. As a result, the federal government's royalties have increased substantially.

The current definitions of "gathering" and "transportation" address the common onshore and offshore production scenarios where production is metered and treated in the field or on a local platform. However, deepwater developments and subsea completions are entirely different. In the case of subsea completions, the production can travel for miles before ever reaching a platform. Such costs should be treated as transportation, not gathering.

Marathon recommends that gathering be defined as any movement of production to an accumulation point on the lease premises or an adjacent lease. Transportation is any movement of production off the lease premises or an adjacent lease.

Also, when calculating the transportation allowance for an unregulated pipeline, flowline, or facility, the lessee should be allowed to apply for, and the Secretary allowed to grant, a higher rate of return for pipelines in more than 200 meters of water. A higher rate of return should be allowed in order to

Author: John Russo at -MMS-DENVER-GH-2

Date: 8/11/98 6:47 AM

Priority: Normal

From: Martin Grieshaber at -MMS-DENVER-GH-1

Subject: Re: Paper for Review

----- Message Contents -----

I read the paper, I think I am on option 1 action 2 with the exception that I wouldn't distinguish the cases on whether they are shallow water or deep water, rather I distinguish them on the distance. That means shallow water situations would be handled similarly for similar distances. You all said it clearly in the background section "the current regulations did not anticipate movement of this type" and again in the cons for option 1 action 1 "did the MMS actually expect not to share in costs of moving bulk production 60+ miles?". Key word needs to be "distance", not water depth. We are not arbitrary and capricious if we make our decisions on distance, because that was not an issue in shallow water. As I said, if there are similar situations in shallow water we should apply the same criteria and philosophy.

Let me know what you think.

Reply Separator

Subject: Paper for Review

Author: Martin Grieshaber at -mms-denver-gh-1

Date: 8/5/98 10:31 AM

Attached is a paper scheduled to be presented to the MMS Quality Council on August 20, 1998. The paper's topic is Subsea Tie-ins (Gathering v. Transportation).

The paper is the WordPerfect document subcrevu.wpd. The attachments are all included in the Paperport document subsea-1.max.

Please provide comments to me by next Monday (August 11). Comments on a preferred recommendation would also be appreciated.

Thanks,

Marty

Author: Hugh Hilliard at -MMS-DOI
Date: 8/13/98 4:16 PM
Priority: Normal
TO: Martin Grieshaber at -MMS-DENVER-GH-1
CC: Todd McCutcheon at -MMS-DENVER-GH-1
Subject: Comments on Subsea Tie Back paper

----- Message Contents -----

Sorry it took me a while to get to this.

Two comments:

1. Page 3, discussion of deep water vs. all water depths. This section needs to distinguish better between NEW leases, for which the DWRRA provides an automatic royalty holiday, and EXISTING leases, for which the holiday is only for leases where the lessee can show the holiday is needed to make the leases economic.

2. more conceptual comment: one way of looking at this issue is whether the movement is really intended to transport the oil or is it intended primarily as a less expensive way (compared to building a platform at the lease site) of bringing the production up to the surface. If the purpose is primarily to inexpensively to bring oil to the surface, and the movement closer to the trunkline pipeline (or in some cases possibly further away from its ultimate destination) is just an incidental benefit, then the argument for deducting the costs is not as strong.

Although we don't want to discourage cheaper ways of producing oil and gas, we also don't want the choice of methods to be influenced by whether one method will allow more of the costs to be deductible.

I would suggest consideration of a "primary purpose" test (as part of new regulations, perhaps) as a way of determining whether or not a transportation allowance should be granted.

Another alternative would be some type of apportionment between the two purposes (perhaps, as you consider in the paper, by allowing a transportation allowance only for the royalty-bearing substances and perhaps only to the extent that the subsea tieback moves the production closer to its destination).

A third approach that takes this conceptual view into account would be to allow a deduction for what it would have cost to transport the production had they built a platform on the lease site (though this is probably more difficult to administer).

The distance factors discussed in the paper are another way to get at this conceptual distinction--the greater the distance, the more the movement tends to look like transportation rather than a production-related expense.

I guess my bottom line is that for all of the options discussed, I think discussion of the PURPOSE of the sub sea tie back helps to make the policy considerations clearer.

Issue: Marketable condition product that is moved several miles to royalty measurement point.

Grand Isle - Exxon
Point Arguello - Chevron/Mobil

Eric - control of allowances
companies request

Do we want to propose a solution that changes the way industry does business and development on a property that has a negative impact on the environment.

More subsea v. platforms
Does agency have a preference

Never have told companies that should set platform or drill wells (caissons)

Scope

Eric

Want What?

More control

FERC tariffs acceptable? Don't worry about.

Criteria: Crossing lease line
Not auditing

Primary function criteria for MMS purposes.

Could see leaving as is - 3 cases not bad.

Sam

Don't feel that deepwater is driver.

What is legal basis for lease line?

Present situation
- Audit and make decisions (Eric)

What has changed since '88?

Deeper water
Movement of bulk longer distances.

Using measurement point "as critical point" is not as important.
Measurement not at sales point.

Deeper water RRR should take into consideration in future.

Subsea Tie-ins (Gathering v. Transportation)

BRIEFING DOCUMENT FOR THE MMS Quality Council

Note: The information within this document does not necessarily contain the views of the Minerals Management Service (MMS). Rather, it is an attempt to describe background information, alternatives, and articulate comments supporting or opposing alternatives. Thus, even where this document appears to make a statement of fact, that fact may reflect a perspective of an interested party in supporting or opposing an option rather than what MMS believes to be the actual facts surrounding the gathering/transportation issue or agency regulations. Nothing herein should be perceived or cited as a statement of MMS's opinion or its position on the facts.

August 19, 1998

Subsea Tie-ins or Deep Water Gathering Allowances

As companies move into deep water in the Gulf of Mexico, they have started developing fields using subsea facilities. The operators move production by pipeline from the subsea manifold to a pre-existing platform in shallower water, where it undergoes separation, dehydration, and treatment before continuing to shore. The pipeline tiebacks can be of substantial length. Industry uses this scenario to reduce the cost of deep water development and to prolong the productive life of offshore facilities originally built to develop other fields.

Background

On October 16, 1997, the Minerals Management Service (MMS) Associate Director for Policy and Management Improvement (PMI), denied a CNG Producing Company appeal (MMS-96-370-OCS) of a determination by the Chief, Royalty Valuation Division. The decision denied an allowance for the transportation of production from Outer Continental Shelf (OCS) Green Canyon Block 116 (GC116) to South Timbalier Block 300A (ST300A). CNG requested an allowance for the transportation of bulk production approximately 25 miles from a subsea manifold in 2,040 feet of water on the GC116 lease to production measurement, separation, dehydration and treatment facilities located on the ST300A offshore platform. CNG appealed to the Interior Board of Land Appeals. The statement of reasons from the MMS solicitor is due on or about September 15, 1998, thus providing urgency to a decision on what actions MMS plans regarding this issue.

The current regulations and definitions did not specifically anticipate movement of this type and the resulting impact on the regulations. MMS management determined that further investigation was appropriate.

A team, under PMI leadership, was established in November 1997. The team's members are Eric Primeaux - Offshore Minerals Management (OMM)/Gulf of Mexico Region (GOMR); Sam Fraser - OMM/Herndon; Jim Morris - Royalty Management Program (RMP)/Lakewood; Martin Grieshaber (initially Greg Smith) - PMI/Lakewood; and Todd McCutcheon - PMI/Lakewood.

The team was tasked with several items, including:

- Investigate subsea tie-ins in general (how many, physical hookups, distances from well to tie-in facilities, revenue impacts, etc.),
- Analyze the differences between gathering and transportation - what are the effects under the current regulations and how should subsea tie-ins be regulated in the future, and

- Provide a recommendation/decision paper to the MMS Quality Council whether transportation allowances should be granted to these tieback projects, and if so, what the structure of these allowances should be.

The team initially met at the GOMR office in December 1997. The team agreed to limit the scope to the Outer Continental Shelf. Importantly, the team decided to investigate all movement of bulk production (oil and gas) downstream off the lease - not just movement from subsea tie-ins. The team recognized the need for several pieces of additional data before moving on to the second and third bullets above.

The GOMR staff identified at least 47 subsea wells, 27 of which are producing. For the month of December 1997, the wells produced from 0 - 158,926 barrels of oil; 1148 - 5,684,421 Mcf of gas; and 0 - 55,602 barrels of water. The bulk production from all these wells flows to existing platforms where the production is separated and the oil, gas, and water are measured. The length of the pipeline from the subsea well to the platform varies significantly, as does the water depth. Eleven of the 27 wells are in water depths that would qualify as deep water (greater than 656 feet). Data specific to these wells is summarized in Attachment 1. The GOMR also identified two pipeline systems that move bulk production from offshore to onshore where separation and measurement occurs.

The team reviewed data from the Royalty Valuation Division concerning any regulatory determinations made for the identified wells. The purpose of the review was to assure the consistency of application of the regulations regarding MMS guidance, particularly when determining whether production movement was gathering or transportation. RVD's review identified three projects related to the subsea wells on Attachment 1:

- LL&E's Garden Banks 235 (See Attachment 2),
- CNG's Green Canyon 116 (See Attachment 3), and
- Shell's Mississippi Canyon (MC) 807 (See Attachment 4).

Attachment 1 indicates that the movement in the Shell MC 807 case was 1.0 miles. Shell has asked for a determination concerning the movement of the production from MC 807 Platform A to West Delta 142 (>60 miles). In all instances, RVD concluded that the movement was gathering.

Additional investigation identified that allowances for transportation were claimed on several of the leases identified on Attachment 1. Without further investigation, no conclusion can be made regarding the accuracy of the allowance claims. The allowances being reported may be for legitimate transportation and unrelated to the issue decided by the MMS.

The team met again in the GOMR offices on July 21, 1998. Discussions at this meeting centered on the topics listed under the Options Discussion occurring later in this paper. Numerous options were also developed.

The team decided to expand the scope of its inquiry. During the discussions about the data

compiled by the GOMR and what criteria should be used in developing options, the team identified several critical issues needing serious consideration prior to making a recommendation on the allowableness of deductions for transporting production from subsea tie-ins. Based upon the team's decisions on these critical issues, the scope was expanded to the larger transportation versus gathering question. The team felt that proposing a solution to the subsea tie-ins issue would not simplify or clarify outstanding ambiguities and questions on the larger issue. The team did develop an option for this smaller issue. A summary of the discussions on the critical issues follows.

Critical Issues Discussion

Prior to deciding which option may be the best course of action, decisions concerning the scope of potential changes must be made. For purposes of discussion here, the term lease is used synonymously with lease/unit. The team's decisions are summarized below.

Deep Water v. All Water Depths

Should the MMS consider changing its gathering definition for only deep water (≥ 656 feet), or should the definition be changed for all situations, regardless of water depth? An argument can be made that the circumstances are different and require different guidelines. However, changes to the definition that would be applicable to all water depths, would impact all companies - not just those with the resources to develop deep water prospects.

Deep Water Royalty Relief (DWRR) results in a royalty holiday when the MMS concludes that the royalties that would have to be paid for a field make the development uneconomic. When estimating the potential royalties, the MMS includes a transportation allowance in the calculation. In this calculation, larger allowances mean smaller potential royalties, that is, a smaller difference between the field's value with and without royalties. Data from one deep water royalty relief case indicates that permitting an allowance for gathering would increase the transportation costs from \$0.45/ Mcf to \$0.50/Mcf.

Much of the deep water will probably be developed under royalty holiday, so gathering allowances would be less important in deep water than in shallow water. However, allowances for gathering would reduce the royalties for the pioneering deep water projects that were too early to benefit from the royalty holiday of the DWRR.

The problems related to differentiating between transportation and gathering are not solely a deep water issue, in fact, they occur universally. The team decided to expand the issue to all water depths.

Distance of Movement

Is the distance that bulk production is moved prior to initial treatment a factor that should be considered in any proposed definition changes? In and of itself, this is not a critical factor. The team wondered what criteria - without appearing arbitrary and capricious - would MMS use if a

distance cutoff had to be developed. The team questioned whether companies moving production across several leases had to pay right-of-way fees? The answer is yes, and they are collected by the GOMR.

Measurement

Should the gathering definition be tied to the location of the approved measurement point? What effect do accurate allocation measurements have on the royalty equation? The MMS/RMP currently uses the approved measurement point as one of its factors in determining the marketable condition of the production. However, there appears to be no correlation between the measurement point approved by the MMS and the point at which the production is in marketable condition. Approximately 55-60% of the oil in the GOM is measured for royalty purposes offshore. The remaining 40-45% of the oil is measured at an onshore point approved under the regulations and the companies claim an allowance for transportation prior to that point. The MMS determines the appropriate location of the approved measurement point. Since there are examples of on lease and off lease measurement of marketable production, as well as, at least one example of off lease measurement of bulk production, the location of the measurement point doesn't appear to be critical in the gathering/transportation determination.

Single Well Gathering v. Accumulated Well Stream Movement

Is there a difference between the movement of bulk production from one well and the movement of bulk production from several wells to the initial point of treatment? Several well streams may be "gathered" to a central tie-in at which point bulk production is moved to a facility for initial treatment. The team discussed the question of whether some of the possible gathering/transportation solutions themselves would create more problems. For example, if a solution would promote development including more subsea wellheads and manifolds as opposed to platforms, what environmental affects would there be? Does MMS have a preference, or does the MMS let the companies continue to make these decisions as we have historically? To the team's knowledge, the MMS has never forced development one way or the other. The team decided that the movement of bulk production should be treated consistently whether it comes from one well or several wells. Attachment 5 provides a visual example of this situation.

Valuation Point Different Than Accumulation Point Or Initial Treatment Point

Currently, a transportation allowance is permitted for movement away from the lease to the point of valuation off the lease. Have we ever had a situation where the approved measurement point and the valuation point were different but still on the same lease and a company claimed an allowance? The team's members were not aware of the existence of this situation.

Movement On Lease As Opposed to Movement Beyond the Lease Boundaries

Is there a difference between movement of bulk production or marketable production on a lease as opposed the movement of the same production off the lease? As far back as 1936, the Department of the Interior has maintained that the lessee bears the responsibility of placing the production in marketable condition. This interpretation was upheld in the California v. Udall

decision in 1961. The R. E. Yarbrough and Co. Decision at IBLA 90-481 (1992) states the following:

Recent litigation has confirmed that the "Marketable Condition Rule" requires valuation of gas production without deduction of the costs of gathering and compressing the gas necessary to place the gas in marketable condition. Mesa Operating Ltd. v. U.S. Department of the Interior, 931 F.2d 318, 325. (1991).

As supported by numerous other cases, the lessee bears the responsibility of gathering under the marketable condition rule.

The standard OCS lease form provides: "The lessee shall pay a fixed royalty as shown on the face hereof in amount or value of production saved, removed, or sold from the leased area." The standard lease form also provides that; "The value of production shall be the estimated reasonable value of the production as determined by the Lessor, due consideration . . . and other relevant matters."

The current valuation regulations (30 CFR § 206.104 for oil; 30 CFR §§ 206.152 and 206.153 for gas) provide that MMS shall allow a deduction for the reasonable actual costs incurred by the lessee for transportation of production to a point (e.g. sales point or value determination point) off the lease.

The team discussed the possibility of crafting a gathering (or transportation) definition that clearly stated that any movement on the lease of bulk production or marketable production was gathering. The movement of bulk production off the lease could be dealt with on a case-by-case basis. The movement of marketable production off the lease would be transportation. No firm decision was made on this concept.

Definitions Discussion

Also germane to this issue is a discussion of the definitions and meanings of the two terms - gathering and transportation.

The MMS and the Federal Energy Regulatory Commission (FERC) have historically had different meanings for the term gathering. Also, the Royalty Enhancement Act of 1998 (Act) - House Resolution 3334 (H.R. 3334) - has proposed separate and different expanded definitions for many of the terms used frequently in gathering and transportation discussions. Finally, the MMS undertook a Federal Gas Valuation Negotiated Rulemaking (REGNEG) effort completed in 1995. The committee composed of state, industry, and government representatives proposed new criteria for distinguishing between gathering and transportation.

MMS

The current MMS regulations promulgated in 1988 define gathering as:

Gathering means the movement of lease production to a central accumulation and/or

treatment point on the lease, unit or communitized area, or to a central accumulation or treatment point off the lease, unit or communitized area as approved by the BLM or MMS OCS operations personnel for onshore and OCS leases, respectively.

MMS received several comments on the definition prior to the rule's publication. The commenters proposed removing the phrase "or to a central accumulation or treatment point off the lease, unit or communitized area as approved by the BLM or MMS OCS operations personnel for onshore and OCS leases, respectively." The commenters stated that the phrase was unclear and that it should be removed from the definition. Several industry commenters recommended limiting gathering to the lease or unit area so a transportation allowance may be obtained for all off-lease movement.

The term transportation is not defined in the regulations. The 1988 regulations provide for an allowance for the reasonable actual costs of transporting the product. An unwritten definition would be - any movement not determined to be gathering is transportation.

When analyzing the movement of production, the MMS's Royalty Management Program uses additional information to distinguish between gathering (no allowance) and transportation (allowance). The two main criteria used historically are: 1) the location of the approved measurement point; and 2) whether the production is in marketable condition.

FERC

The Federal Energy Regulatory Commission (FERC) uses a "primary function test" when making a factual determination regarding its jurisdiction of pipelines. Pipelines used for the production and gathering of natural gas are exempted from FERC jurisdiction by the Natural Gas Act. The primary function test is a case-by-case consideration of all the facts and circumstances rather than the strict application of previously determined standards. The FERC has identified certain relevant considerations, including:

- 1) the diameter and length of the facility;
- 2) the location of compressors and processing plants;
- 3) the extension of the facility beyond the central point in the field;
- 4) the location of wells along all or part of the facility;
- 5) the geographical configuration of the system; and
- 6) the operating pressure of the line.

The analysis of these factors provides FERC with a basis for determining whether the function of the facility (pipeline) is for transmission (jurisdictional) or gathering (nonjurisdictional).

Additionally, the MMS recently commented on a Notice of Inquiry from the FERC concerning the criteria used to determine whether gas facilities in the OCS fell within their jurisdiction. A copy of the MMS response is included as Attachment 6.

H.R. 3334

H.R. 3334 - proposes changing several definitions. The proposed new definitions are as follows:

GATHERING. --The term "gathering means the movement of lease production to a central accumulation point on the lease, unit, or communitized area approved by the Secretary.

TRANSPORTATION: TRANSPORT. --Each of the terms "transportation" and "transporting" means any movement (including associated activities to facilitate movement such as compression and dehydration) of royalty oil or royalty gas. Such terms include any movement of royalty oil or royalty gas downstream of the delivery point, including movement described in this paragraph. Such terms may include--

(A) the movement of unseparated, bulk production away from the lease premises to a point distant from the lease premises: and

(B) the movement of separated, identifiable production downstream of a well on the lease premises to any point that is not on, and is not adjacent to, the lease premises, unit, or communitized area, as approved by the Secretary.

MERCHANTABLE CONDITION; MARKETABLE CONDITION.--Each of the terms "merchantable condition" and "marketable condition" means the condition of oil or gas that is sufficiently free of impurities to meet the requirements of or is accepted by the transporter of production from that lease premises, royalty oil, or royalty gas. Whether or not lease production is in merchantable condition shall not affect the responsibility for the bearing of costs of gathering or transportation, as provided by this Act.

DELIVERY POINT.-- The term "delivery point" means--

(A) for a lease premise for which a production measurement meter is approved in accordance with applicable laws before the date of this Act--

(i) subject to clause (ii), the existing approved meter location, or

(ii) subject to clause (ii), a delivery point requested by a lessee and approved in accordance with subparagraph (B); or

(B) for a lease premise for which no production measurement meter is approved before the date of this Act, that point on or near the lease premises, approved by the appropriate agency in accordance applicable laws and regulations, where lease production can be measured and reported in a manner that is practical, economical, and verifiable, except that such a point may be at a location off the lease premises where, if necessary, production can be allocated back to the lease premises.

REGNEG

Page 70 of the final report of the REGNEG committee states the following:

"E. TRANSPORTATION VS. GATHERING

Final Recommendation

The lessee may deduct from value, as a transportation allowance, the cost of moving royalty bearing substances (identifiable, measurable oil and gas, including gas that is

not in need of initial separation) from the point at which it is first identifiable and measurable to the sales point or other point where value is established. The lessee may not deduct from value the cost of gathering. Gathering is defined as the movement of an unseparated, bulk production stream to a point on or off the lease, where the production stream undergoes initial separation into identifiable oil, gas, or free water.

In reaching consensus, the committee agreed that for movement to be considered transportation, the gas must be an identifiable and measurable substance and that the current marketable condition requirement should not be the basis for determining between gathering and transportation.”

Additionally, in its clarifying criteria, the committee stated:

- “ • Movement of deep water bulk production would be considered for transportation but only as an exception, on a case-by-case basis.”

Public Comments

On Thursday, July 16, 1998, the MMS published in the Federal Register a Further Supplementary Proposed Rule concerning Establishing Oil Value for Royalty Due on Federal Leases. Based upon comments previously received, the MMS asked for specific comments on whether the definition of gathering should be modified to address the movement of bulk, unseparated production long distances from deep water leases. The comment period closed July 31, 1998.

The comments may be summarized as follows:

- Industry fully supported allowances for the movement of oil from subsea tie-ins. The general consensus being that the regulations did not contemplate this development; the movement is an economic decision that benefits everyone, and; if a platform were employed, the MMS would permit an allowance.
- States were concerned that any changes could ultimately impact the revenues received by them.
- Several alternatives for a new interpretation of gathering were provided.

Specific responses from twelve commenters are provided in Attachment 7.

Options

There are many options representing possible solutions. The team found it useful to identify different actions appropriate to the implementation of each option.

Option 1: Status Quo

Action 1: Continue using the current regulations. Let the IBLA determine whether the decision in the CNG case is correct. When making future gathering/transportation determinations, assure that no contradictions with past decisions occur.

Implementation: None.

Pros

- No regulatory changes required.
- Implies that the regulations are flexible enough to handle future development.
- Consistency with past application.
- No loss of revenues.

Cons

- Continual litigation over issue.
- Regulatory change may be forced by IBLA decision.
- Could impact deep water development, lower bids on tracts.
- Did the MMS actually expect not to share in costs of moving bulk production up to 60+ miles?
- Fairness question.

Action 2: Allow a deduction for the costs allocable to only the royalty bearing substances. This action implements the Exxon Grand Isle decision (see Attachment 8). Exxon was given a transportation allowance for the movement of the royalty bearing portion of the bulk production stream moved from offshore leases to its facility onshore. RVD used its discretionary authority when making the Grand Isle decision. Exxon moved the bulk stream to its onshore facility for economic reasons. If the production had been separated offshore, Exxon would have been eligible for an allowance.

The basis for this action would be as follows:

- The responsibility of placing production in marketable condition is the lessee's.
- The standard OCS lease provides the Secretary with the authority to consider other relevant matters when determining value - including production movement exceptions.
- The Secretary may allow a deduction for the royalty bearing portion of bulk production being moved to a facility where the production is placed in marketable condition.

Implementation: Case by case for the future. The MMS should reevaluate the decisions in the CNG, Shell, and LL&E cases as they are similar to the Grand Isle case.

Pros

- Provides deep water allowance.
- Within Secretary's authority.
- Consistent with past decisions.
- Agrees with REGNEG recommendation.

Cons

- Arbitrary and capricious? - why different than shallow water?
- Reduces revenues.
- Doesn't resolve the issue, inconsistencies will continue.

Action 3: The MMS develops a set of criteria (an MMS Primary Function Test) to be used in determining whether the movement of production on the OCS is gathering or transportation.

Implementation: Not necessarily regulatory but could be.

Pros

- Could include water depth and distance guidelines.
- Would provide an allowance in cases not currently accepted.
- Flexible - can be adjusted easily.
- Provides more certainty than current regulations.
- More consistency.

Cons

- Difficult to set criteria for all circumstances.

Option 2 Maintain Current Regulatory Structure With Increased Control

Action 4: The MMS calculates and publishes rates for all pipeline segments that qualify for a transportation allowance. Companies would request the calculation of rates for all new segments at which time MMS would determine whether the new segment qualified.

Implementation: Regulatory change.

Pros

- Certainty.
- Eliminates potential for litigation.

Cons

- Additional workload.
- More regulation.

Option 3 Alter the Regulations Only to Recognize the New Deep Water Technology

Action 5: Redefine gathering (or allowance for movement) based upon water depth. Deep water is defined in the royalty rate relief regulations as greater than 200 meters (=656 feet).

Implementation: Regulatory change

Pros

- Provides industry with allowance.
- Fair?
- Should prevent some litigation.
- Provides guidance which should provide surety.

Cons

- What about subsea wells or movement in 650 feet of water?
- Doesn't totally clarify the larger gathering/transportation issue.
- Changes long standing practice.
- Reduces revenues.

Action 6: Allow a deduction for movement greater than a predetermined distance.

Implementation: Regulatory change

Pros

- Provides an allowance for movement in special circumstances.
- Provides guidance which should provide surety.

Cons

- What rationale does the MMS use in determining the distance?
- Arbitrary and capricious? - Why different than shallow water?
- Revenue loss.

Option 4 Replace Current Regulations

Action 7: Develop a bright line determination - any movement on the lease is gathering, any movement from the lease line downstream is transportation. If value is determined at the lease (per the contract), then no transportation is allowed. If bulk production is moved off the lease, the MMS would allow a deduction the movement of royalty bearing substances. Under this action, the MMS would no longer care about the marketable condition of the production when allowing a deduction for movement. The costs of transportation would have to be calculated on a pro rata basis. Regardless of where it occurs, the lessee is still responsible for the costs of placing the

production in marketable condition.

Implementation: Regulatory change.

Pros

- Provides industry with allowance.
- Should prevent some litigation.
- Simplification and clarity.
- Closely resembles what MMS has approved in the Grand Isle (and other) cases.
- Conforms with industry's stated wants in their comments on the 1988 regulations.

Cons

- Revenue loss
- Somewhat more complicated calculation.
- Increases auditing burden.
- Impact on historical "marketable condition" rules?
- On large units, what was previously transportation could become gathering.
- More complicated calculations - must pro rate costs based upon on lease/off lease ratio.

Action 8: The MMS would embrace the definitions proposed in H.R. 3334. Gathering is strictly on the lease to a central accumulation point. Transportation includes movement of bulk production and movement of separated, identifiable production downstream of the well. The marketable condition of the production does not affect the responsibility for the bearing of costs of gathering or transportation.

Implementation: Regulatory change

Pros

- Reduces litigation.
- Somewhat similar to the REGNEG proposal.

Cons

- Revenue losses.
- Contradicts MMS opposition to H.R. 3334.
- Extends REGNEG proposal to include movement of water.

Subsea Wells Summary

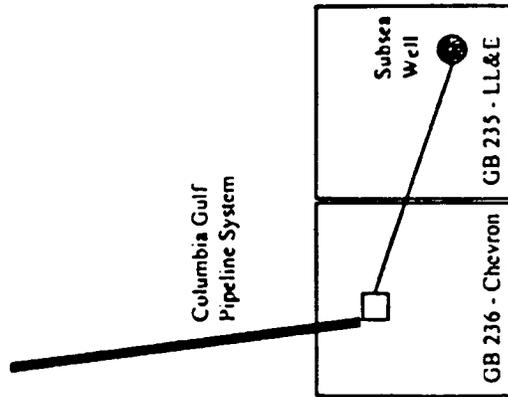
December 1997

Block	Operator	Lease	Well Name	Water Depth (Ft.)	Well Type	Oil (Bbls)	Production Gas (Mcf)	H ₂ O (Bbls)	Segment Length (Miles)	Crosses Lease Line?	In Unit?
BA 007A	Pioneer	G04558	4	120	Gas	114	35,226	14,347	2.3	No	No
• GC 116	CNG	G05904	1	2,316	Gas	2,450	70,457	12	23.4	Yes	Yes
EI 266	Shell	G16360	1	155	Gas	7,514	442,019	194	3.3	Yes	No
EI 320	Forest	G08695	3	244	Gas	0	25,942	9,191	1.5	Yes	No
EI 322	Amoco	G02113	5	242	Gas	5,797	63,201	8,415	1.3	No	No
EW 977	Walter	G15454	1	470	Gas	3	164,147	17	6.6	Yes	No
• GB 235	LL&E	G07454	3	785	Gas	0	395,399	145	6.2	Yes	No
GC 110	Shell	G05901	1	1,295	Oil	70,413	129,420	509	4.3	Yes	Yes
GI 43	Conoco	175	4	114	Gas	0	11,721	4,585	1.5	Yes	Yes
GI 43	Conoco	175	4D	114	Gas	0	33,710	0	1.5	Yes	Yes
HI 320A	Walter	G15814	1	237	Gas	0	313,912	44	3.9	Yes	No
HI 519A	Coastal	G08184	4	220	Gas	87	46,594	13,639	3.3	Yes	No
HI 587A	BP Expl.	G07349	2	467	Gas	0	41,115	55,602	5.9	Yes	No
WD 152	Oryx	G05845	1	1,367	Gas	0	55,204	0	4.4	Yes	Yes
MC 397	Enserch	G05080	A004	1,438	Gas	1,415	369,384	128	2.7	Yes	Yes
MC 397	Enserch	G05080	A009	1,438	Gas	201	99,478	138	2.7	Yes	Yes
MC 398	Enserch	G05080	B007	1,531	Gas	608	199,239	68	5.6	Yes	Yes
MC 445	Oryx	G06951	2	2,095	Gas	696	141,591	484	7.7	Yes	Yes
MC 731	Shell	G05862	A001	5,292	Gas	8,431	5,684,421	0	62.3	Yes	Yes
• MC 807	Shell	G07963	4	2,956	Oil	158,962	232,576	0	1.0	No	Yes
MP 144	OXY	G04252	5	213	Gas	0	84,871	0	1.6	Yes	No
MP 262	Walter	G10910	1	293	Gas	0	21,274	0	3.1	Yes	No
MP 290	Allied	G09727	1	272	Gas	0	8,460	0	5.1	Yes	No
SS 323	Santa Fe	G05572	2	295	Gas	5	23,251	0	1.9	Yes	No
ST 176	Newfield	G01898	C001	103	Gas	8,551	149,394	0	1.1	No	No
VK 783	Shell	G06886	4	1,494	Gas	21,281	699,350	889	12.1	Yes	Yes
WD 61	Pioneer	G03601	5	130	Gas	127	35,919	186	1.4	Yes	No

• MMS denied transportation

8/12/98 11:25 AM

TRANSPORTATION or GATHERING LL&E

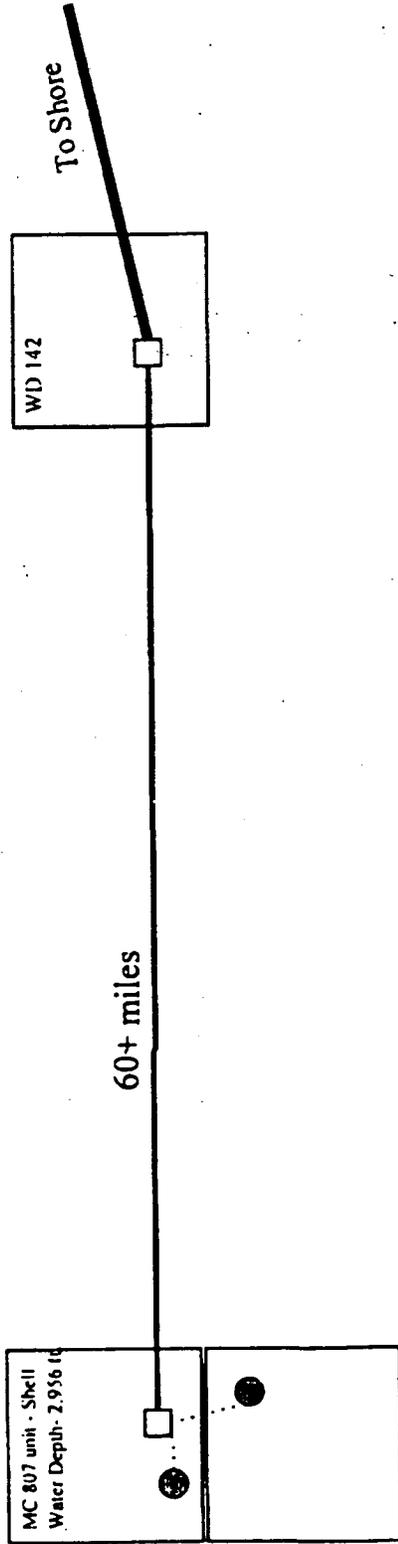


The Facts

- The well on GB 235 is a subsea completion connected by a 5.6 mile long flowline to GB 236.
- The well is located in 806 feet of water and the platform is in 685 feet of water.
- The production is measured at GB 236 for royalty purposes.
- Neither LL&E nor the MMS states where production is placed in marketable condition.

The RVD determined that the movement of the production from the subsea completion to the platform was gathering.

TRANSPORTATION or GATHERING Shell Appeal



The Facts

- Oil and gas production are initially separated on MC 807 Platform A.
- The oil is moved to shore via a separate line.
- Shell transports pipeline quality gas from MC 807 Platform A to WD 142.

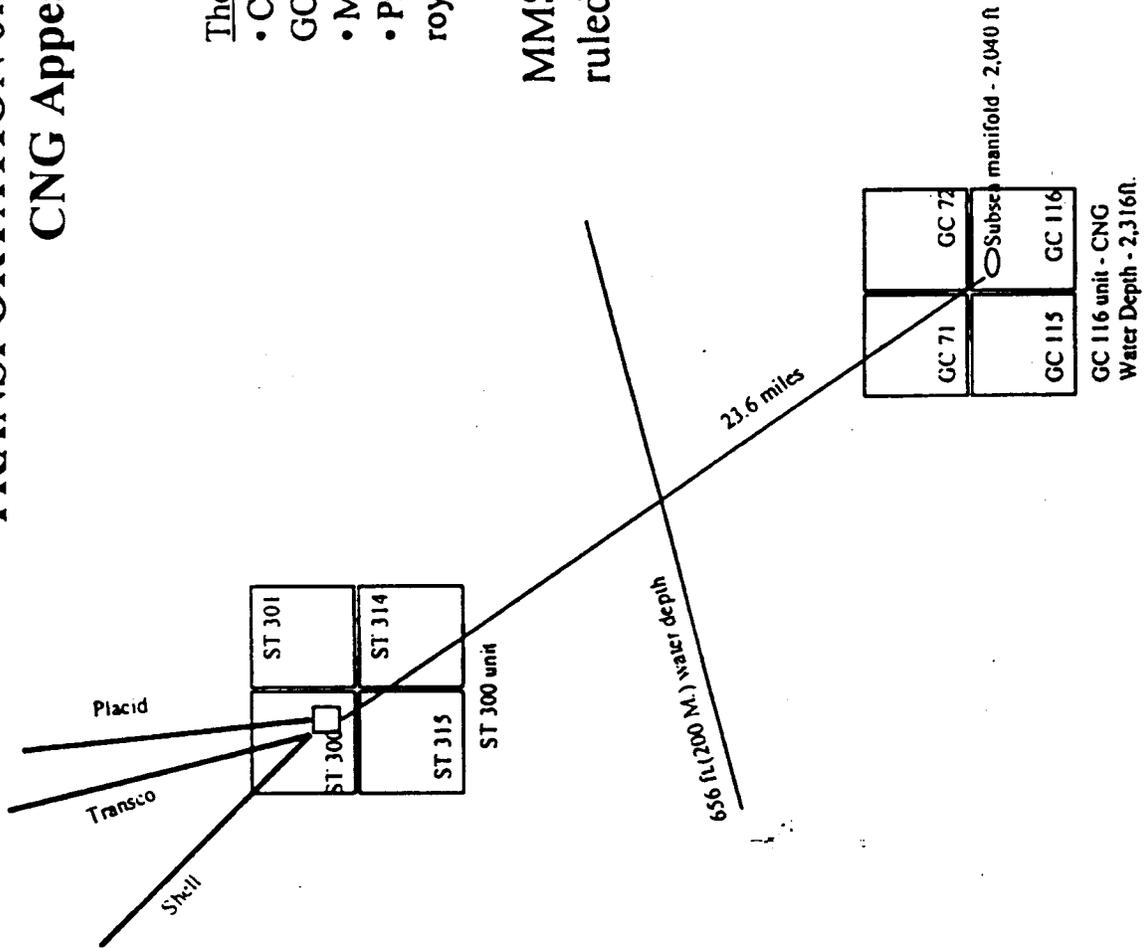
RVD decision of July 6, 1998, decided movement was gathering.

TRANSPORTATION or GATHERING CNG Appeal

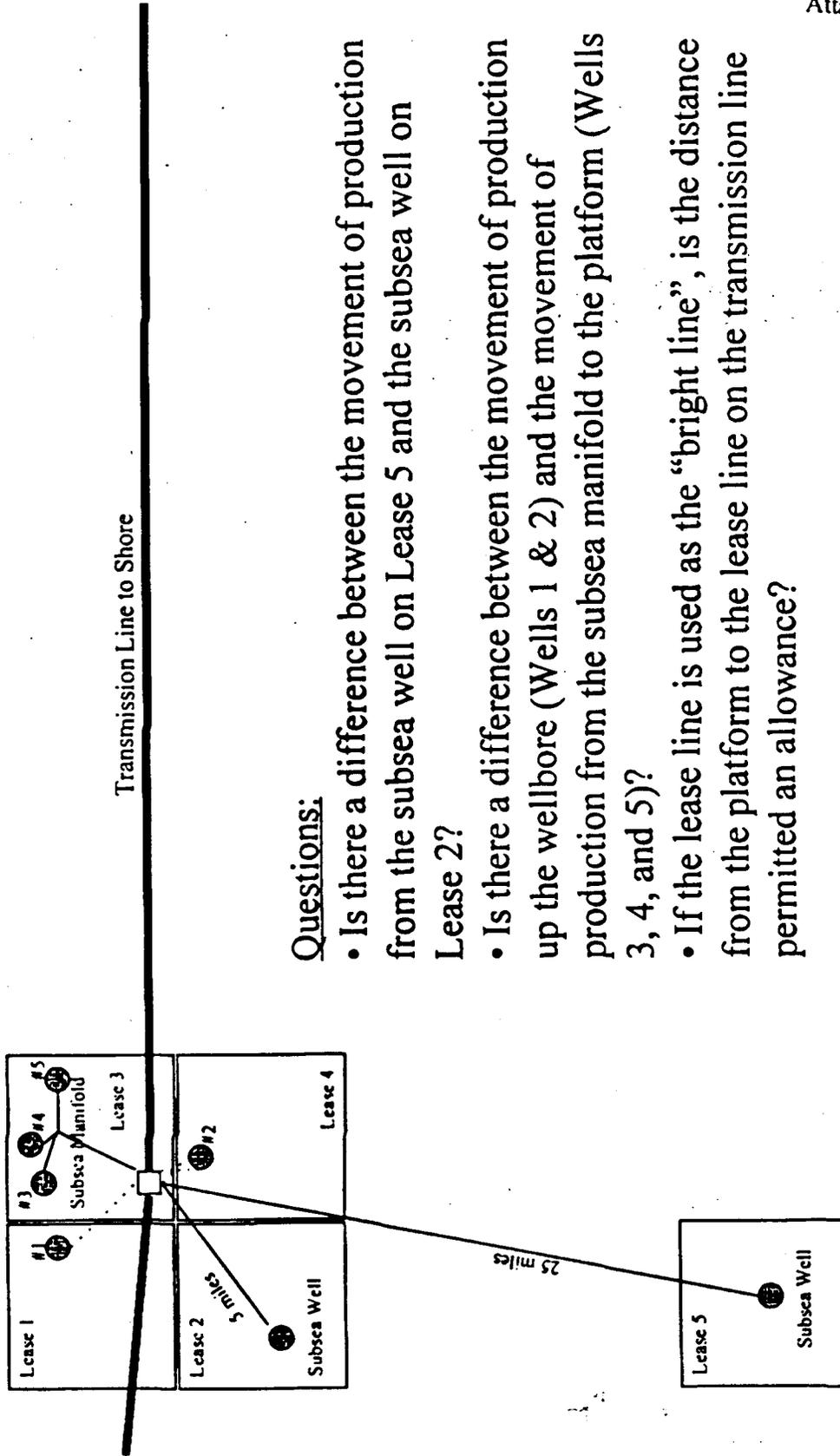
The Facts

- CNG moves bulk production 23.6 miles from GC 116 to ST 300A.
- Movement occurs along two 6-inch lines.
- Production is separated and measured for royalty purposes at ST 300A.

MMS Director's decision of October 16, 1997, ruled as gathering.



TRANSPORTATION or GATHERING?



Questions:

- Is there a difference between the movement of production from the subsea well on Lease 5 and the subsea well on Lease 2?
- Is there a difference between the movement of production up the wellbore (Wells 1 & 2) and the movement of production from the subsea manifold to the platform (Wells 3, 4, and 5)?
- If the lease line is used as the "bright line", is the distance from the platform to the lease line on the transmission line permitted an allowance?



United States Department of the Interior

MINERALS MANAGEMENT SERVICE

Washington, DC 20240

JUL 14 1998

Office of the Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Re: Notice of Inquiry into Alternative Methods for Regulating Natural Gas Pipeline Facilities and Services on the Outer Continental Shelf (OCS), Docket No. RM98-8-000

Gentlemen:

The Minerals Management Service (MMS) is the Federal agency responsible for management of the Nation's natural gas resources on the Federal OCS. Hence, any potential changes the Federal Energy Regulatory Commission (FERC) may consider based upon its review of the comments filed in the above-referenced matter could impact MMS's current policies and procedures.

MMS differentiates between the terms gathering and transportation. The purpose for this differentiation is that the costs of transportation are deductible from royalties whereas the costs of gathering are not. MMS realizes that lines characterized as gathering lines by FERC may be eligible for a transportation allowance under the MMS royalty gas valuation regulations. Additionally, with the continuing development of the Gulf of Mexico OCS, with discoveries occurring in deeper water depths, and with the more frequent use of new technologies, MMS, like FERC, recognizes the need for consistent and understandable guidelines.

MMS offers the following in response to Docket No. RM98-8-000.

A. The "Primary Function" Test.

- 1. What are the physical and operational characteristics of an OCS pipeline facility that have value in assisting the Commission in determining where gathering ends in the offshore context?**

MMS has, for royalty purposes, a much narrower definition of gathering than FERC. Our regulations define the movement of bulk production to a central accumulation and/or treatment point as gathering and the movement beyond that point as transportation. This is consistent with the definition of "Feeder lines" in the OCS Lands Act (OCSLA). Another primary factor considered by MMS in making a gathering/transportation distinction is the location of the approved measurement point for royalty determination.

- a. **What distinguishing physical and operational characteristics are unique to OCS gathering systems?**

For royalty purposes, the movement of bulk production to a point on the lease, or to a point off the lease for treatment and/or measurement is gathering.

- b. **What distinguishing physical and operational characteristics are unique to OCS transmission systems?**

When value for royalty purposes is determined at a point off the lease, the movement of measured production in marketable condition to that point is transportation.

2. **What factors, other than a pipeline facility's physical and operational characteristics, are relevant to making jurisdictional determinations in the offshore context.**

MMS has keen interest in whether a pipeline is jurisdictional. We require equal and nondiscriminatory access and rates for our lessees when royalty is paid in value and for ourselves when royalty is taken in-kind. Our purposes would be served best if the definitions used by FERC and MMS were consistent and drew a bright line between gathering facilities and transmission/transportation facilities.

3. **Are there any elements of the existing "primary function" test as it applies to OCS facilities that should be eliminated for lack of relevance, value, undue complexity, or for any other reason?**

See Question 5 below.

4. **What alternatives are there to the concept of the "primary function" test as a method of making OCS jurisdictional determinations?**

See Question 5 below.

5. **Should the Commission adopt the OUTER CONTINENTAL SHELF LANDS ACT (OCSLA)'s definition of "feeder lines" as a definition of gathering lines on the OCS?**

Yes, from a royalty collection standpoint this would provide more consistency between the rules of MMS and those of FERC. However, it would not necessarily bring about the more light-handed approach to regulation that FERC is seeking.

6. How can the Commission simplify the process of making OCS jurisdictional determinations?

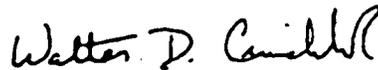
No comment.

7. How much, and to what degree of quality, is OCS gas processed at locations other than onshore or in shallow waters?

If processed means the removal of liquid hydrocarbons such as propane and butane then most processing is done onshore or in shallow waters. If processed means the operational function of separating gas from oil and condensate and the removal of impurities, then most processing is done at or near the lease. However, with the increases in deep-water production and sub-sea completions, we find that these operational functions are occurring further and further from the lease.

We thank you for the opportunity to comment on this issue. As the notice specified, enclosed are an original and 14 copies of our comments, as well as a 3½ inch diskette containing our comments. If you have any questions, or would like to discuss our comments further, please call Mr. Martin Grieshaber at (303) 275-7118.

Sincerely,



Walter D. Cruickshank
Associate Director, Policy and
Management Improvement

**Comments Received in Response
to F.R. Notice of July 16, 1998**

American Petroleum Institute (API)

The API recommended a two step analysis in determining whether an allowance was appropriate: 1) what activity is encompassed by transportation, and; 2) what is the amount of the transportation allowance?

Specific comments on the first step were:

“When subsea systems are utilized as the primary development system for lease/unit development, the treatment of subsea production to achieve pipeline quality may be impossible at the lease/unit.”

“The common thread running through almost every transportation allowance characterization is the physical movement of the hydrocarbon off the lease or unit.”

“The selection of subsea systems for lease/unit development is principally driven by economics. . . . Consequently, the royalty settlement point is at a remotely located surface platform because it is more technically practical and economically feasible. If a surface platform type system were utilized for lease/unit development, movement of production away from the lease would clearly be deemed transportation. The fact that a different development system was utilized for economic reasons should therefore not preclude production movement away from the lease/unit from being deemed transportation in subsea development situations.”

Similar, if not identical reasoning was used by other commenters.

In regard to the second step in the analysis, the API commented that the allowance should be based upon the commercial value of the service. For example, a reasonable value would be that paid in the same field or area by parties not affiliated with the pipeline.

Chevron

Specific comments submitted by Chevron were:

“We strongly believe that MMS should grant a transportation allowance for the movement of any bulk production to a measurement or treatment point off the lease, provided the allowance covers only the cost of moving the royalty bearing substances contained in the bulk stream.”

“Retaining the existing distinction between gathering and transportation will unfairly limit transportation allowances in more and more instances. MMS may just as easily avoid sharing in the cost of moving the non-royalty bearing substances by limiting bulk

transportation allowances to the cost allocable to moving the royalty bearing components only. At the same time, having to bear the full cost of moving the non-royalty bearing portion of the bulk stream would also encourage lessees to locate treatment and measurement facilities as close to the lease as possible."

Office of the City Attorney of the City of Long Beach

The City of Long Beach's comments were more specific to the allowances for oil movement included in the rule. They did state that the only transportation costs which should be deductible are those incurred in moving crude from a lease to the nearest market center. For California, that would be limited to the movement of crude to Los Angeles.

Conoco

Conoco's comments followed the rationale set forth by API. Specifically, Conoco stated:

"Assuming that platforms could be economically built in deep water, the cost of moving the bulk oil via these sub-sea pipelines would routinely be considered as "transportation" under MMS regulations and thus a "transportation allowance" would be applicable. Conoco's position is that a "transportation allowance" should also be allowed for the sub-sea movement of deep water oil under the same conditions that would apply if these pipelines were defined as "transportation" under the MMS regulations."

The Law Offices of Lobel, Novins & Lamont

The comments, submitted on behalf of the California State Controllers Office (SCO), allowed that the gathering in deep water does not directly affect California's current federal royalty interests. The commenter did state that, "However, any modification of the gathering definition that would confuse the gathering/transportation distinction does affect California."

Additionally, the SCO recommended that in reviewing any requests, the MMS consider the relief already provided under the Deep Water Royalty Relief Act.

Exxon Company, U.S.A.

The Exxon comments were similar in nature to those of the API. Exxon states; "The distinction between "gathering" and "transportation" should pivot on whether the movement is away from the lease and should not be dependent on the technology used."

Independent Petroleum Association of America
Domestic Petroleum Council

The commenter stated that the extent to which industry employs the subsea technology depends on the way MMS responds to requests for allowances when production is moved - often over significant distances - from the lease to the structure where separation or treatment occurs.

The commenter discusses the regulatory history of gathering and discusses the CNG subsea case,

the RVD's Exxon Grand Isle decision, and the IBLA's Shell Auger and Exxon Shute Creek decisions.

The specific recommended action was:

"In order to remedy the current discriminatory situation, IPAA and DPC urge the MMS to exercise its administrative discretion by issuing, on an expedited basis, an interpretive rule applicable to its existing regulations and, with retroactive effect, providing that a transportation allowance will be granted the lessee when production from a subsea completion is moved away from the lease to a structure where separation or treatment is performed. The allowance should be available for production moving from a subsea completion in any depth."

Marathon Oil Company

Marathon's comments reiterated previous comments concerning economics being a driving factor in deep water production situations.

Marathon's recommendations were somewhat different however.

"Marathon recommends that gathering be defined as any movement of production to an accumulation point off the lease premises or an adjacent lease. Transportation is any movement of production off the lease premises or an adjacent lease.

Also, when calculating the transportation allowance for an unregulated pipeline, flowline, or facility, the lessee should be allowed to apply for, and the secretary allowed to grant, a higher rate of return for pipelines in more than 200 meters of water. A higher rate of return should be allowed in order to recognize and compensate lessees for the additional risk in the fabrication, installation, operation, and maintenance of deep water pipelines."

Montana Department of Revenue

Montana's concern is that any changes to the gathering definition should not have an impact on the federal leases in their state where the royalty rates are generally less than 5%.

Oryx

Oryx believes that the movement of production from subsea completions should be allowed regardless of the type of production.

Their recommendation was as follows:

"MMS should develop a standard test for determining what is "transportation" and what is "gathering". Oryx believes that any movement of production away from the producing lease, unit, or communitized area constitutes "transportation". Gathering would be limited to the movement of production to a central accumulation or treatment point on the lease, unit, or communitized area."

Shell Oil Company

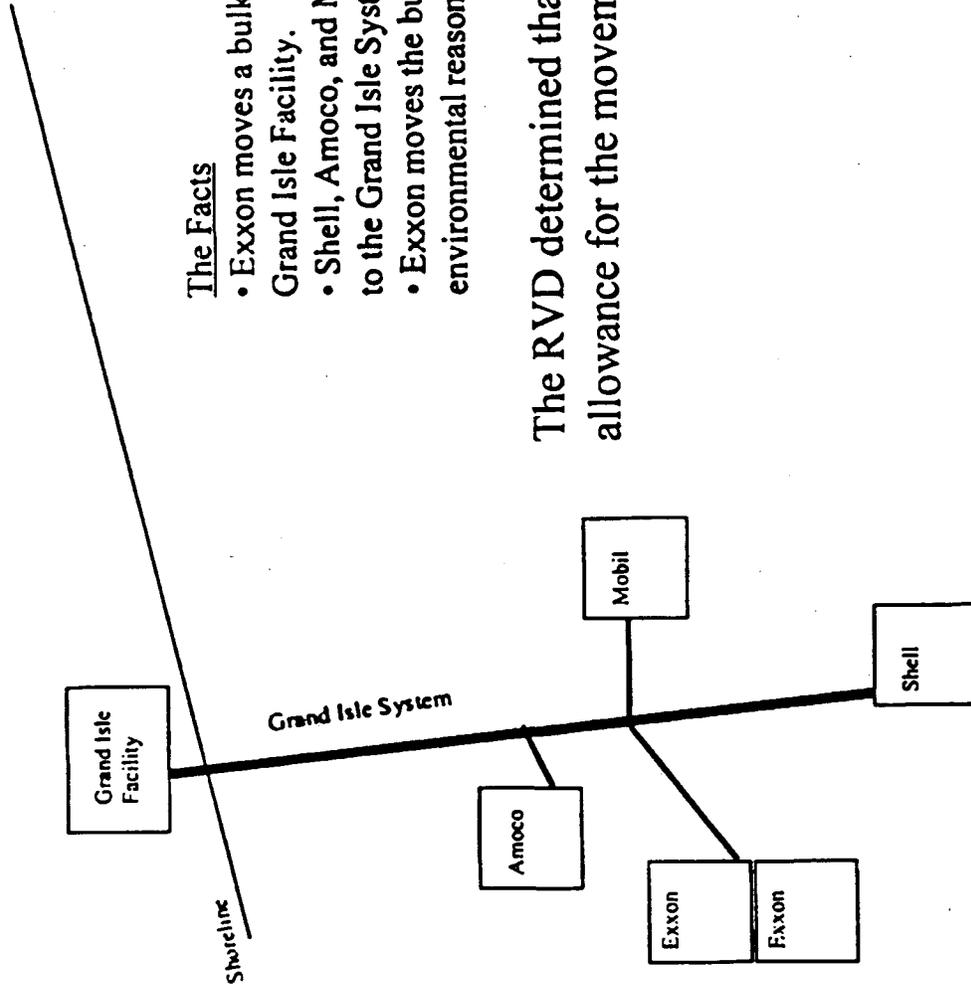
Shell's comments restate the two analysis described in the API comments. FERC tariffs and jurisdictional issues are also discussed. Shell states: "What is clear is that subsea transportation from the subsea manifold to the surface platform is a valuable transportation service off the lease which adds value to the production."

Texaco

Texaco believes that the definition of gathering should be changed to address the movement of production from subsea facilities long distances before reaching an offshore platform. Texaco states: "Movement at great distances from a sub-sea manifold to a production-treating platform should be classified as transportation and not gathering." Texaco believes that "an adjustment for fair value of transportation services is merited."

TRANSPORTATION or GATHERING

Exxon - Grand Isle



The Facts

- Exxon moves a bulk oil/water (40% water) stream to the Grand Isle Facility.
- Shell, Amoco, and Mobil, deliver marketable oil (<1% water) to the Grand Isle System.
- Exxon moves the bulk stream to shore for economic and environmental reasons.

The RVD determined that Exxon should be permitted an allowance for the movement of the oil but not the water.

Subsea Tie-ins
Gathering or Transportation
MMS Quality Council - August 20, 1998

What Has Changed? — In the past, movement to platform: short distances then moved to shore, now not the case

Why Now?
CNG - IBLA Appeal — Movement of bulk from subsea manifold 25 miles (2070') to ST 300A were measured after separation

Shell - 62 Miles of Gathering — movement of dehydrated gas from MCB07 to WD142 60+ miles to measurement — convenience of owners not a subsea issue but relevant

The Team's Work

Scenarios - Attachment 5

Options

Recommendation

meetings
gathered data
discussed issues
developed options

tries to visually summarize differences

- 4 ① Status quo ← no change royalty bearing primary test
- ② Increased control
- ③ Alter regulations — deep water/distance
- ④ Replace regulations
Bright line — lease line

Eric P.
504-736-2542

Criteria
consistency
Map out specifics

Notes on Subsea Tie-ins/Gathering and Transportation

August 28, 1998

What would distinguish from onshore?

- Water depth
- Distance
- Movement from well on sea floor
- Movement on sea floor

What are options for allowance?

- Allocation to royalty bearing substances
- On lease v. off lease
- All movement

Is there still gathering where subsea tie-ins are involved?

- On lease central accumulation
- Bulk v. initially separated

Is the approved measurement point a determining factor?

- Location

Are economics a factor?

- Deep Water Royalty Rate Relief
- The "If a platform were here, transportation would be allowed" argument

What is the function of the movement?

- Closer to shore
- Movement to valuation point

Is any regulatory control necessary?

- Notification/application/determination

Do we need to consult with our customers?

- Meetings
- Request for comments

How and who do we notify of decision?

- Dear Payor letter
- Federal Register Notice
- Payors/auditors/determiners

Last questions:

- Are the criteria able to be applied consistently without creating too many exceptions?
- What does MMS need to do about previous decisions?

4 cases

- CNG
- Grand Isle also OCS oil w/FMP onshore
- LL+E
- Shelt-Mars

Criteria under current Regs. for evaluating movement from subsea/Deepwater

- Water depth
- Distance
- FMP
- Functionality
- Marketable condition (bulk v. non-bulk) → royalty bearing products only
- Movement to shore
- Deep water royalty relief (economic automatic)
- Lease v. off base

Where's the cutoff?
Arbitrary
Not datadable

Critical

FMP
Functionality - movement to a market
Marketable condition

Options

1) Reverse GI
Deep Water/Subsea

New technology
Not anticipated
in current rules

2) FMP/Marketable condition
Criteria

If bulk; only royalty bearing product.
using Sec. discretion

CNG - Gathering but discretion

Mensa - Gathering " "

Mars - Transport. marketable condition

If movement on lease/^{not} no discretion

Author: John Russo at -MMS-DENVER-GH-2

Date: 9/17/98 8:30 AM

Priority: Normal

CC: Todd McCutcheon at -MMS-DENVER-GH-1

TO: Martin Grieshaber at -MMS-DENVER-GH-1, Deborah Gibbs-Tschudy at -MMS-DENVER-GH-4

Subject: Re[2]: Subsea Tie-ins

----- Message Contents -----

e met didn't see this until today and thus we didn't discuss. Therefore these are my comments not everyone's:

1. Consistent with my comments on this the first time, I still think if we want we can use distance as the distinguishing factor. It can be done in accordance with the furthest distance that was not "deepwater".

2. The statements re the CNG decision are confusing, on the one hand the paper says that it is consistent with other decisions and in accordance with the regulations, but the paragraph entitled "Impact" says that they are entitled to a partial allowance (like Grand Isle?), lastly the schematic says the RVD decision was that all the movement was all gathering. It seems another option that should be discussed under "options" is to modify the CNG decision to give them the same deal we gave Exxon using the same criteria and justification.

Maybe that is what you intended to say, but it wasn't that clear to me. If it wasn't what you intended to say I think you should say it.

Bye

JJR

Reply Separator

Subject: Re: Subsea Tie-ins

Author: Deborah Gibbs-Tschudy at -mms-denver-gh-4

Date: 9/14/98 2:27 PM

Lucy told me that the Audit Managers are meeting in Dallas the next two days. Perhaps Marty and I could tie-in by telecon for a short time to discuss this issue? Lucy would really like Audit's input on this issue.

Reply Separator

Subject: Subsea Tie-ins

Author: Martin Grieshaber at -mms-denver-gh-1

Date: 9/14/98 11:04 AM

Realizing that most of you were at the STRAC meeting and that the Quality Council meeting has been delayed a week, I wanted to give everyone the opportunity of reviewing and commenting on the paper one more time.

If you think we need to have a teleconference, please let me or Debbie know.

[Federal Register: October 21, 1998 (Volume 63, Number 203)]
[Notices]
[Page 56217]
From the Federal Register Online via GPO Access [wais.access.gpo.gov]
[DOCID:fr21oc98-93]

DEPARTMENT OF THE INTERIOR

Minerals Management Service

Announcement of Minerals Management Service Workshop on the
Development of Criteria To Be Used in Distinguishing Between Gathering
and Transportation in Deep Water in the Outer Continental Shelf

AGENCY: Minerals Management Service, Interior.

ACTION: Notice of meeting.

SUMMARY: The Minerals Management Service (MMS) will hold a day-long meeting with parties interested in the development of deep water leases that may involve subsea well completions. We are interested in developing specific criteria to be used in distinguishing between gathering and transportation to determine permissible deductions in calculating royalty value.

DATES: The workshop will be held on November 16, 1998, starting at 9:00 a.m., Central Time.

ADDRESSES: The meeting will be held at the MMS Gulf of Mexico Outer Continental Shelf Regional Office, 1201 Elmwood Park Blvd., New Orleans, Louisiana 70123.

FOR FURTHER INFORMATION CONTACT: Mr. Martin C. Grieshaber, Minerals Management Service, P.O. Box 25165, MS 9200, Denver, CO 80225-0165, telephone number (303) 275-7118; fax (301) 275-7124; e-mail Martin.Grieshaber@mms.gov; or Ms. Deborah Gibbs Tschudy, MMS, P.O. Box 25165, MS 3150, Denver, CO 80225-0165, telephone number (303) 275-7200; fax (303) 275-7227; e-mail Deborah.GibbsTschudy@mms.gov.

COMMENTS: Written comments on the meeting or the issues below should be addressed to Mr. Martin C. Grieshaber at the above address.

SUPPLEMENTARY INFORMATION: MMS is investigating the impact of deep water production systems on the distinction between gathering and transportation.

Current MMS regulations provide for an allowance for the actual and reasonable costs of transporting production when value for royalty purposes is determined away from the lease. No allowance is permitted for gathering (movement to a central accumulation and/or treatment point).

The new technologies involved in deep water development were not specifically contemplated in the current regulations, particularly when distinguishing between gathering and transportation.

We are interested in specific comments regarding what criteria should be used on a case-by-case basis when making the gathering/transportation differentiation for deep water leases.

Some possible criteria we would like comments on include: water depth, distance of movement, location of the approved measurement

point, marketable condition of the production, and on-lease v. off-lease movement. Specific comments are welcome on any other criteria with a bearing on the issue.

Dated: October 15, 1998.

Walter Cruickshank,
Associate Director for Policy and Management Improvement.
[FR Doc. 98-28146 Filed 10-20-98; 8:45 am]
BILLING CODE 4310-MR-M



U.S. Department of the Interior
Minerals Management Service
Office of Communications

NEWS RELEASE

FOR RELEASE: October 22, 1998

CONTACT: Anne-Berry Wade
(202) 208-3985

Barney Congdo
(504)736-2595

**MMS SCHEDULES WORKSHOP ON GATHERING AND TRANSPORTATION CRITERIA
FOR DEEP WATER SUBSEA WELLS**

The Department of the Interior's Minerals Management Service (MMS) will hold a workshop to discuss deep water lease development that may involve subsea well completions. The agency is interested in developing specific criteria to distinguish between gathering and transportation to determine allowable deductions in calculating royalty value.

The workshop is scheduled for November 16, 1998, at 9:00 a.m., central time, at the MMS Regional Office, 1201 Elmwood Park Blvd., New Orleans, Louisiana, 70123.

The MMS is considering the impact of deep water production systems on the distinction between gathering and transportation. While current MMS regulations provide an allowance for the actual and reasonable costs of transporting production when value for royalty purposes is determined away from the lease, no allowance is permitted for gathering (movement to a central accumulation and/or treatment point).

Recent deep water development technologies and their relation to gathering and transportation are not specifically outlined in current regulations. Based upon discussions with industry, the agency is seeking comments on water depth, distance of movement, location of the approved measurement point, marketable condition of the production, on-lease versus off-lease movement, and other criteria that should be used when making the gathering/transportation differentiation for deep water leases.

MMS is the federal agency that manages the Nation's natural gas, oil and other mineral resources on the Outer Continental Shelf; and collects, accounts for, and last year disbursed about \$6 billion in revenues from federal offshore mineral leases and from onshore mineral leases on federal and Indian lands.

-MMS-

MMS Internet website address: <http://www.mms.gov>
24 hour Fax-on-Demand Service: (202) 219-1703

AGENDA

Public Workshop - Deep Water Subsea Wells Gathering/Transportation Criteria New Orleans - November 16, 1998

- Opening Remarks

- Gathering and Transportation

- Comments Received

- Criteria -
 - Water Depth?
 - Distance of Movement?
 - Location of Approved Measurement Point?
 - Marketable Condition?
 - On Lease v. Off Lease Movement?
 - Other?

- Industry Panels

- Other Comments

- Questions and Answers

Common threads - physical movement of the lease or unit - movement of royalty bearing substances (Chevron) (API)

IPAA - "moved away from a lease to a structure where ~~production~~ treatment is performed."

Marathon - "Gathering be defined as a movement of production to a accumulation point off the lease premises or an adjacent lease. Transportation is any movement of production off an adjacent lease."

Oryx - "Gathering would be limited to the movement of product to a central accumulation or treatment point on the lease, unit, or communitized area."

Texasco - "Movement at great distances from a sub-sea manifold to a production-treating platform should be classified as transportation and not gathering."

Technical Panel

Subsea - Frontier/Growth Opportunity

Environmental
Infrastructure
Technology

(?) Should water depth
be subtracted from
distance moved.

Costs - significant capital costs

App. 30 Deepwater projects ($\approx 1/2$ are truly subsea)
(completions)

Tieback distances

Subsea more logical for 10-12 wells or less

Subsea's role 100-200 MBOE fields, must also consider water
depth and distance - seems to be trend.

(?) If two lines - cost
of both or just
one?

STAR

Legal Panel

Wendy D., Don Lynch, Mike Coney, Debbie Haglund, Tim Jacque

Purpose and function

Written suggestions

MMS has authority under current

Model - some automatic approval
case-by-case unwieldy

1988 Model

"treating, handling and measurement" - Coney

Today's technology not possible to initially treat a well/manifold

- central accumulation -

- bulk production moved large distances (MMS question itself)
coincidentally does treatment occur here

Function test - Debbie Haglund

Exxon decision in Grand Isle - royalty bearing production share

1) MMS authority

"how much as to whether"

2) criteria

flexibility to handle single well

manifold & daisy chain more straightforward allowance

Shell TLP case

Tim - (CNG) - water depth not critical
IPAA/Pet. Council

"Adjacent"
8 leases

Criteria notes:
N/S/E/W direction not
relevant
Also surface facilities

Don Lynch -

200 meters

Production through manifold to not adjacent lease

Daisy chain wells - movement to host not

Single well - host facility

Ideas in writing

Technology not perfect criteria

Transportation - group
Went through the criteria -

Options

- Exxon reversed
- Royalty bearing substances

Concern

Limitation to OCS

Costs - estimates for known cases

No simple method

Workshop
in CP
504-736-2541

Federal Register Notice Technology Comments on criteria case-by-case

The MMS is ~~investigating~~ ^{investigating} the impact of ~~the~~ deepwater production systems ~~and the impact~~ on the distinction between gathering and transportation.

Current MMS regulations provide for an allowance for the actual, reasonable costs of transporting production when value is determined away from the lease. No allowance is permitted for gathering (movement to a central accumulation and/or treatment point).

The new technologies inherent in deep water exploration and production do not neatly fit into the structure of the current regulations, particularly when distinguishing between gathering and transportation.

The MMS is interested in comments regarding what criteria are appropriate for making the gathering/transportation differentiation.

Possible criteria ^{the MMS would like comments on} include: water depth, distance, location of the approved measurement point, marketable condition of the production, and on lease or off lease movement.

Any other criteria that ~~may be appropriate~~ bear on the differentiation between gathering and transportation should be commented on. (Specific comments)

The MMS will be holding a ~~an~~ technical conference to hear industries' comments on this issue.

(examples)

Talking Points
Deep Water Subsea Completions Workshop
New Orleans - November 16, 1998

MMS recognizes that the old model - bulk production to surface, separation, measurement, movement downstream - doesn't readily apply in today's deep water environment. MMS also recognizes that subsea wells have existed for quite some time and in all water depths. (Maps exhibit the approximate locations)

In the Federal Register (Oil Valuation) July, 16, 1998, MMS requested comments on whether the definition of gathering should be modified to address the movement of bulk, unseparated production long distances from deep water leases. Comments summarized as follows:

- Industry fully supported allowances for the movement of oil from subsea tie-ins. The general consensus being that the regulations did not contemplate this development: the movement is an economic decision that benefits everyone, and; if a platform were employed, the MMS would permit an allowance.
- ✓ States were concerned that any changes could ultimately impact the revenues they receive.
- Several alternatives for a new interpretation of gathering were provided.

MMS agrees to a case-by-case review of past and new subsea deep water gathering/transportation scenarios.. However, MMS would like specific criteria to apply in these analyses for consistency and to provide industry with rationale.

Some considered criteria are:

- Water depth,
- Distance of movement,
- Location of the approved measurement point,
- marketable condition of the production, and
- On-lease v. Off-lease movement.

Whatever additional criteria industry proposes.

Next Steps??

**PUBLIC WORKSHOP FOR DEVELOPMENT OF GATHERING AND
TRANSPORTATION DIFFERENTIATION CRITERIA FOR DEEP WATER SUBSEA
WELLS**

The Department of the Interior's Minerals Management Service (MMS) will hold a day-long workshop with parties interested in deep water lease development that may involve subsea well completions. The MMS is interested in developing specific criteria to be used in distinguishing between gathering and transportation to determine permissible deductions in calculating royalty value.

The workshop will be held on November 17, 1998, starting at 9:00 a.m., Central time. The meeting will be held at the MMS Gulf of Mexico Outer Continental Shelf Regional Office, 1201 Elmwood Park Blvd., New Orleans, Louisiana, 70123.

The MMS is investigating the impact of deep water production systems on the distinction between gathering and transportation.

Current MMS regulations provide for an allowance for the actual and reasonable costs of transporting production when value for royalty purposes is determined away from the lease. No allowance is permitted for gathering (movement to a central accumulation and/or treatment point).

The new technologies involved in deep water development were not specifically contemplated in the current regulations, particularly when distinguishing between gathering and transportation.

The MMS is interested in specific comments regarding what criteria should be used on a case-by-case basis when making the gathering/transportation differentiation for deep water leases.

Some possible criterion the MMS would like comments on include: water depth, distance of movement, location of the approved measurement point, marketable condition of the production, and on-lease v. off-lease movement. Specific comments are welcome on any other criterion with a bearing on the issue.

There is no need to preregister, but anyone wanting to make a formal presentation should sign up upon arrival.

Eric P. 736-2541



Shell Exploration & Production Company

One Shell Plaza
P. O. Box 2463
Houston, TX 77252-2463

Larry W. Wooden
Manager Public Affairs

December 16, 1998

Mr. Todd McCutcheon
Chief, Policy & Management Improvement
Minerals Management Service
U.S. Department of the Interior
P. O. Box 25165 - MS 9200
Denver, CO 80225

Dear Mr. McCutcheon:

I am writing on behalf of Shell Oil Company and its subsidiaries and affiliates to express our support for the Minerals Management Service's subsea gathering and transportation initiative described in the notice published in the October 21, 1998 *Federal Register*. Shell commends the MMS for re-evaluating its position on subsea transportation, for as you know subsea completions are becoming an increasingly important component of industry's deepwater portfolio.

Further to our comments at the November 16, 1998 workshop, Shell endorses the substantive comments submitted by the American Petroleum Institute on this topic. In addition, we strongly encourage the MMS to expeditiously evaluate the factual information provided and to render a decision as soon as possible. We are hopeful that successful resolution of this issue will help to break the log jam and create positive momentum for the resolution of other pending royalty and operational issues.

Let me reiterate Shell's commitment to work with MMS to resolve issues in a constructive and fair fashion. We value the professionalism and dedication of MMS staff, and look forward to working cooperatively with MMS in the future to resolve this and other issues of importance to the offshore petroleum industry.

Sincerely yours,

A handwritten signature in cursive script that reads "Larry W. Wooden".



James C Pruitt
Vice President
Government Relations
Department

Texaco

1050 17th Street NW
Suite 500
Washington DC 20036

December 17, 1998

Mr. Martin C. Grieshaber
Minerals Management Service
P.O. Box 25165
MS 9200
Denver Co 80225-0165

Re: Deepwater Transportation
63 FR 56217 (October 21, 1998)

Dear Mr. Grieshaber:

On October 2, 1998, MMS announced a workshop to discuss distinctions between gathering and transportation in deepwater as they relate to permissible deductions in calculating royalty value, 63 FR 56217 (October 21, 1998). The workshop was held in New Orleans on November 16, 1998. At the workshop, the MMS requested written comments by December 16, 1998, and thereafter granted an extension until December 18, 1998 to receive comments. Texaco Inc., on behalf of itself and its affiliate, Texaco Exploration and Production Inc., appreciates the opportunity to submit these comments.

As can be judged by the attendance at the workshop and the interest expressed by the participants, this issue is of great significance to producers developing deepwater leases in the Gulf of Mexico. Three representatives of Texaco participated in two industry panels at the workshop. We urge MMS to carefully consider the workshop panel presentations. We are hopeful that the discussion will lead MMS to a workable policy based on the purpose and function of the movement of production.

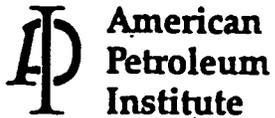
As for written comments, Texaco adopts as its own the comments filed by the American Petroleum Institute. Texaco is available for further discussion and would be pleased to provide any additional information the MMS might require on deepwater subsea transportation.

Sincerely,



36 USC 380
Official Sponsor
U.S. Olympic Team

Walter Cruickshank
Associate Director Policy and Management Improvement



American
Petroleum
Institute

1220 L Street, Northwest
Washington, DC 20005-4070
Tel 202/682-8057
Fax 202/682-8426
E-mail Leonard@api.org

V. Kenneth Leonard
Senior Manager, Upstream

December 17, 1998

Mr. Todd McCutcheon
Chief, Policy & Management Improvement
Minerals Management Service
U.S. Department of the Interior
12600 West Colfax
Suite B 440
Lakewood, CO 80215

Dear Mr. McCutcheon:

Enclosed are the two exhibits that we are using with our written comments for the MMS Subsea Initiative. Because of their bulk, I am sending them to you via Airborne rather than by fax. The comments will be faxed to you tomorrow.

Thank you,

A handwritten signature in cursive script, appearing to read 'V. Kenneth Leonard'.



1220 L Street, Northwest
Washington, DC 20005-4070
Tel 202/682-8057
Fax 202/682-8426
E-mail Leonard@api.org

V. Kenneth Leonard
Senior Manager, Upstream

Faxcover Sheet

Date: December 18, 1998

To: Mr. Todd McCutcheon 303-275-7124
Minerals Management Service

From: Ken Leonard

Please see the following letter regarding MMS' Subsea Initiative.

PAGES TO FOLLOW: Cover + 5

Please call (202) 682-8030 if there are any problems with this transmission.

4

**MMS WORKSHOP
GATHERING AND TRANSPORTATION CRITERIA
FOR DEEPWATER SUBSEA WELLS**

November 16, 1998, New Orleans

**Speaker - Dennis McLaughlin
Shell Deepwater Development Systems**

- **How does Deepwater Development Differ from Shelf?**
- **Types of Deepwater Development Systems**
- **Subsea's Role in Deepwater**
- **What is a Subsea Development System?**
- **Example Project (Mensa - Video)**
- **Subsea's Challenge**

DEEPWATER VS SHELF DEVELOPMENT

- Frontier/Growth Opportunity

- Environmental

- Infrastructure

- Technology

- Costs



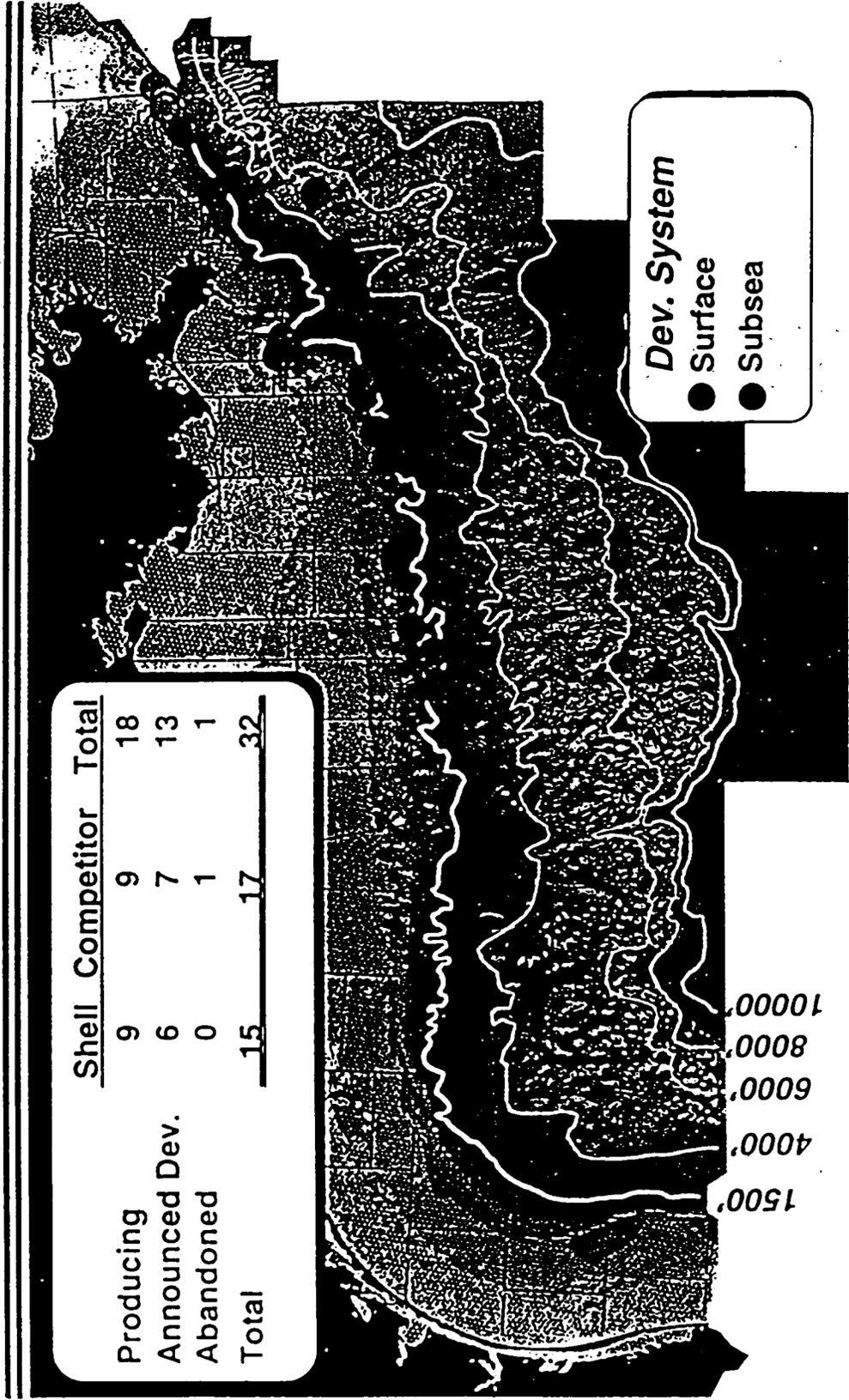
Cost Overview

Estimated Costs (\$ in millions)

Item	Shelf	Deep Water
Water Depth	200'	3000'
Wells (Based on Gen III Semi)		
Exploratory (Per Well)	\$4	\$22
Development (Subsea)	\$16	\$65
Development (Surface)	\$3	\$20
Systems		
TLP	N/A	\$500
SPAR	N/A	\$500
Subsea	\$32	\$250
Fixed Platform	\$15	N/A
Pipeline (Nominal 12")	\$10 (~12 miles)	\$80 (40-60 Miles)

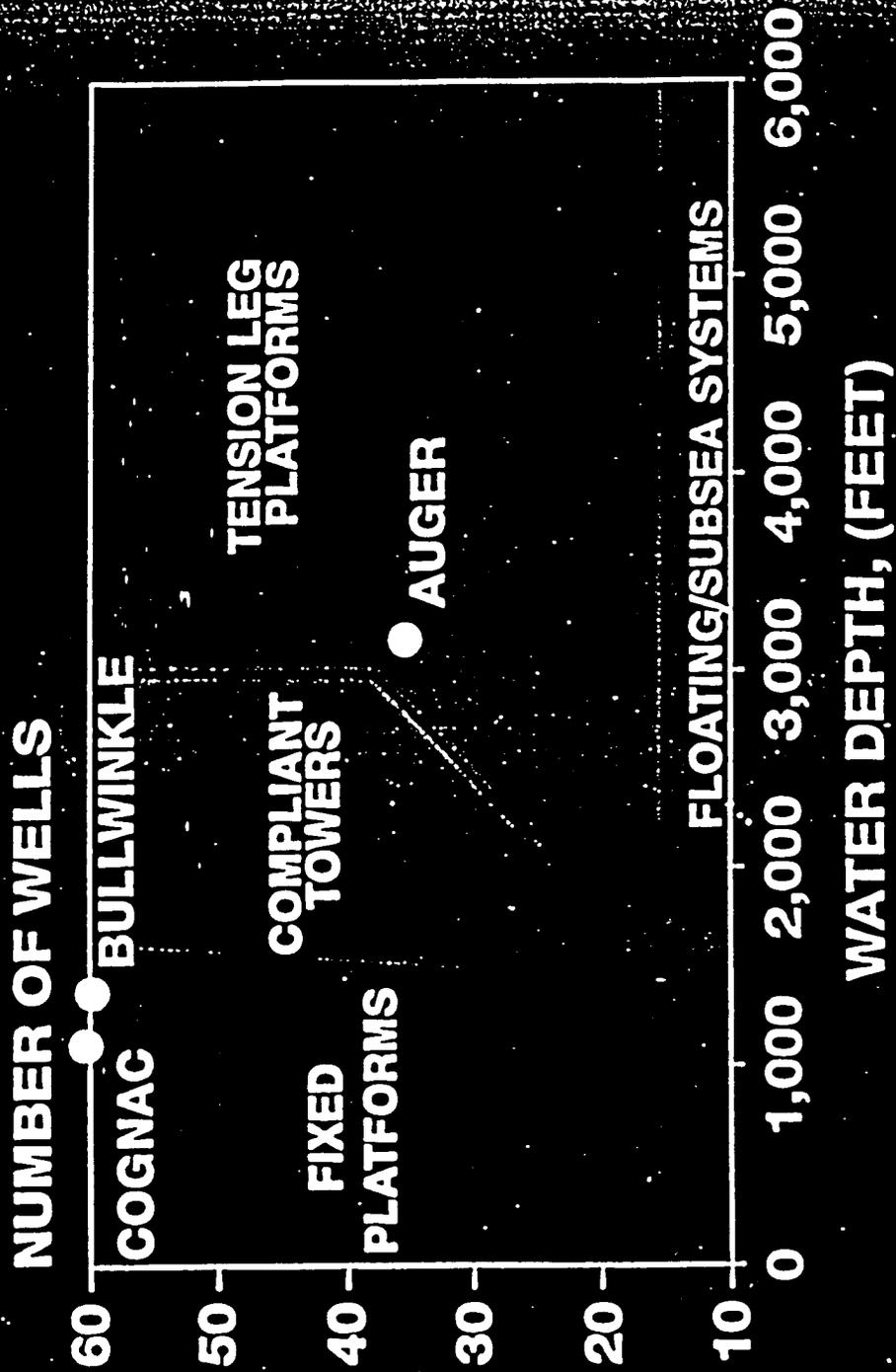


Deepwater Developments

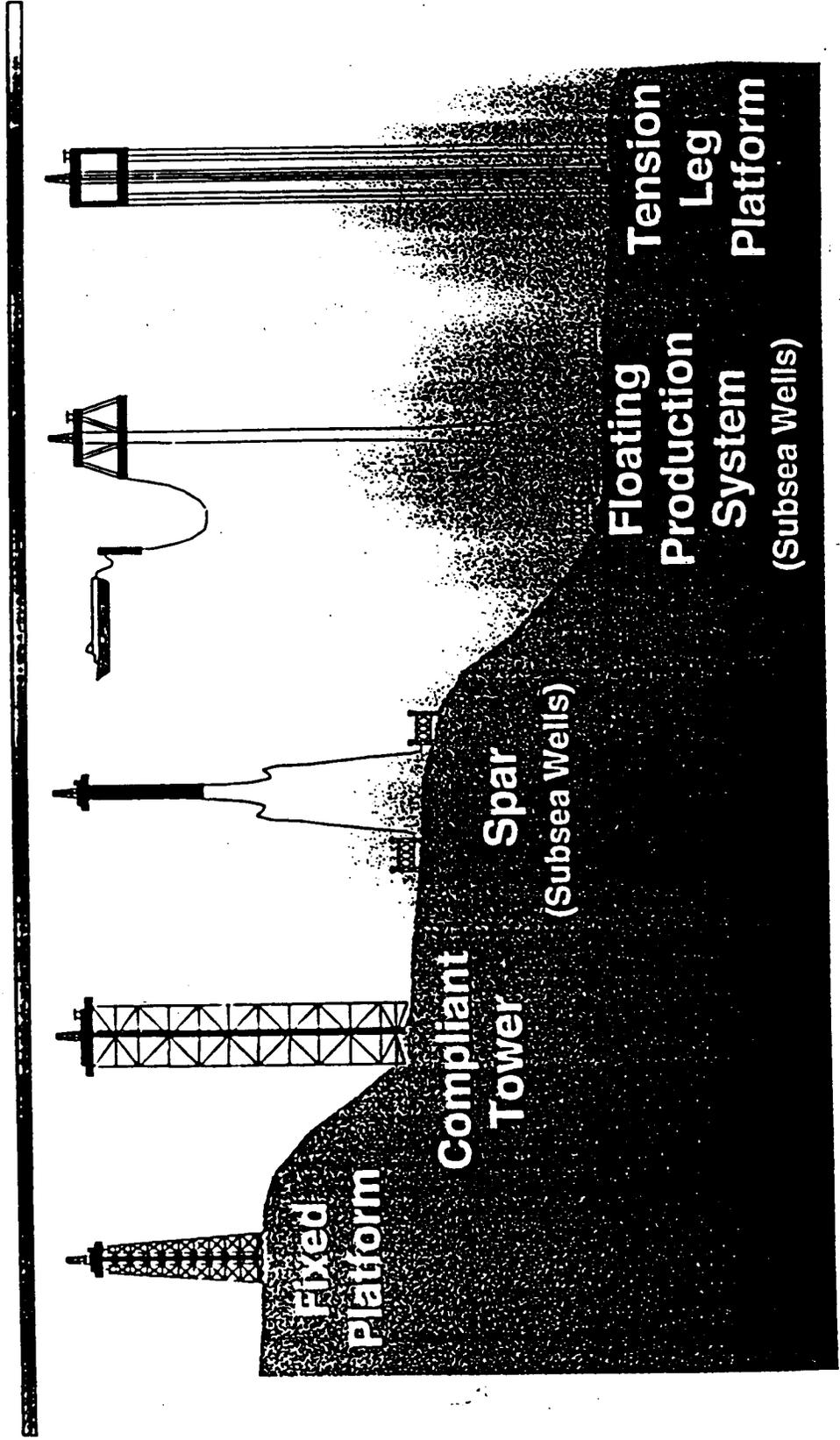


Deepwater
Gulf of Mexico

DEEPWATER SYSTEMS



Development Systems

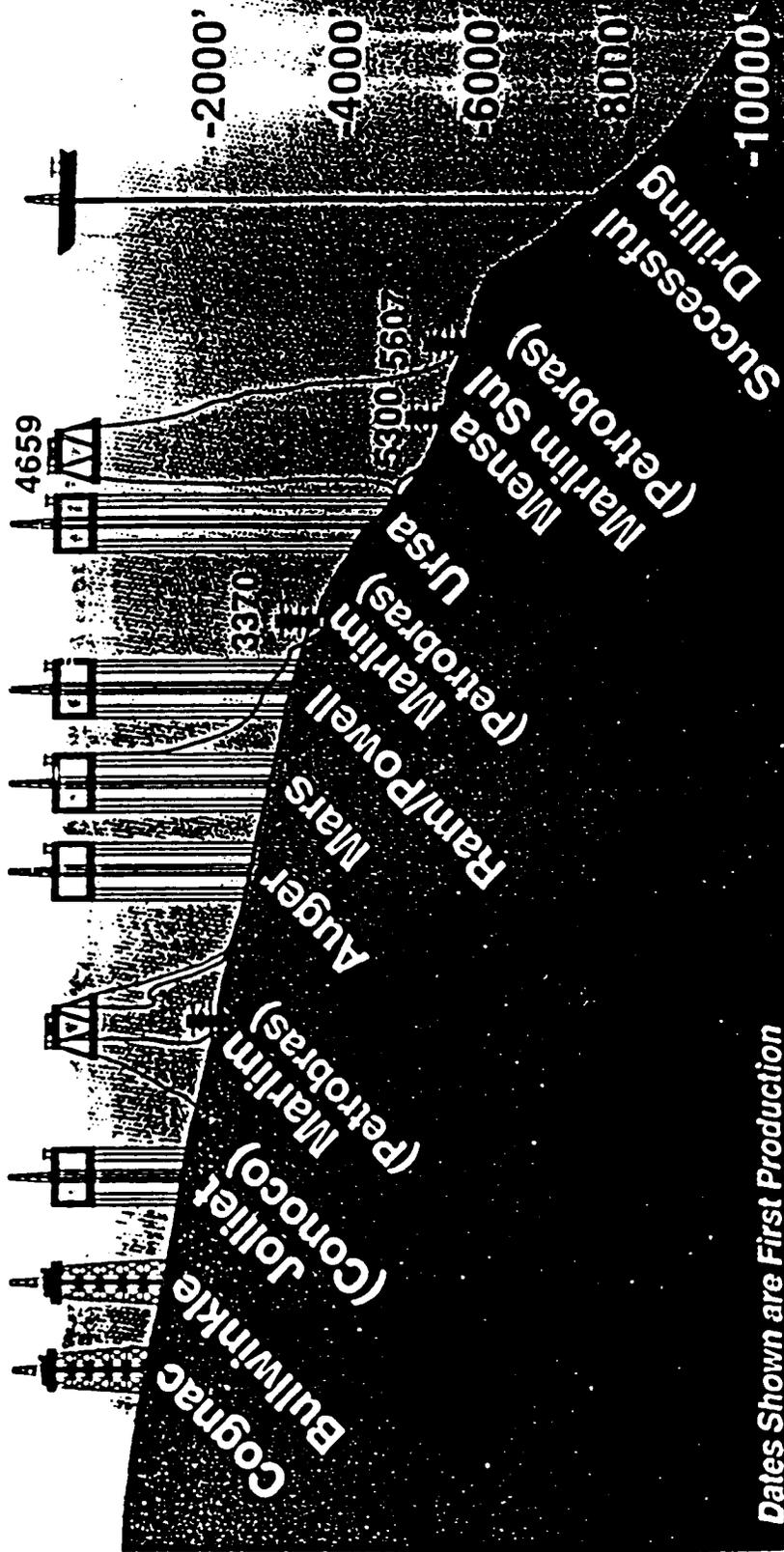




Development Milestones

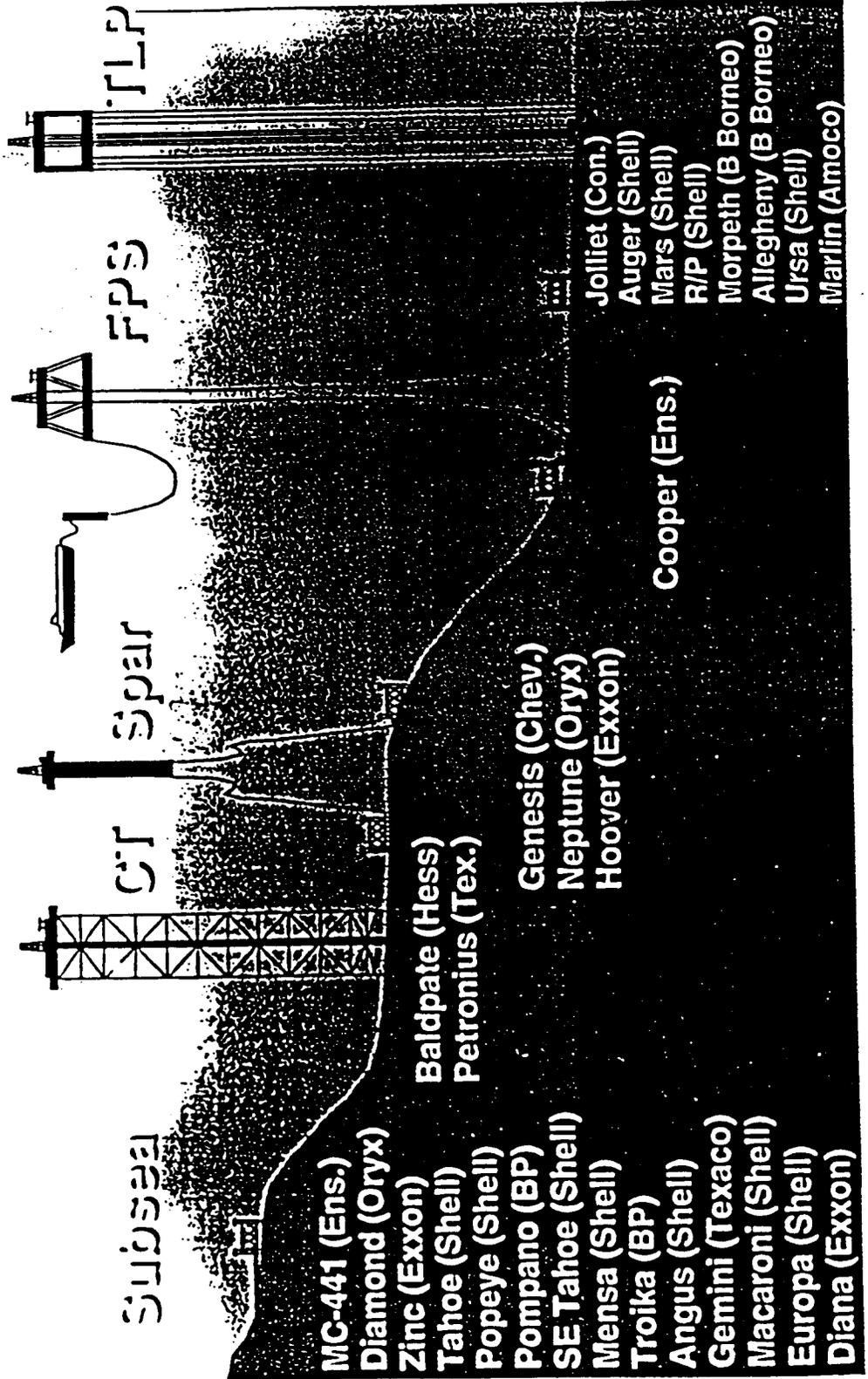


'78	'89	'93	'94	'96	'97	'95	'99	'97	'98
1025	1350	2562	2860	2940	3218	3950	3950	7718	7718



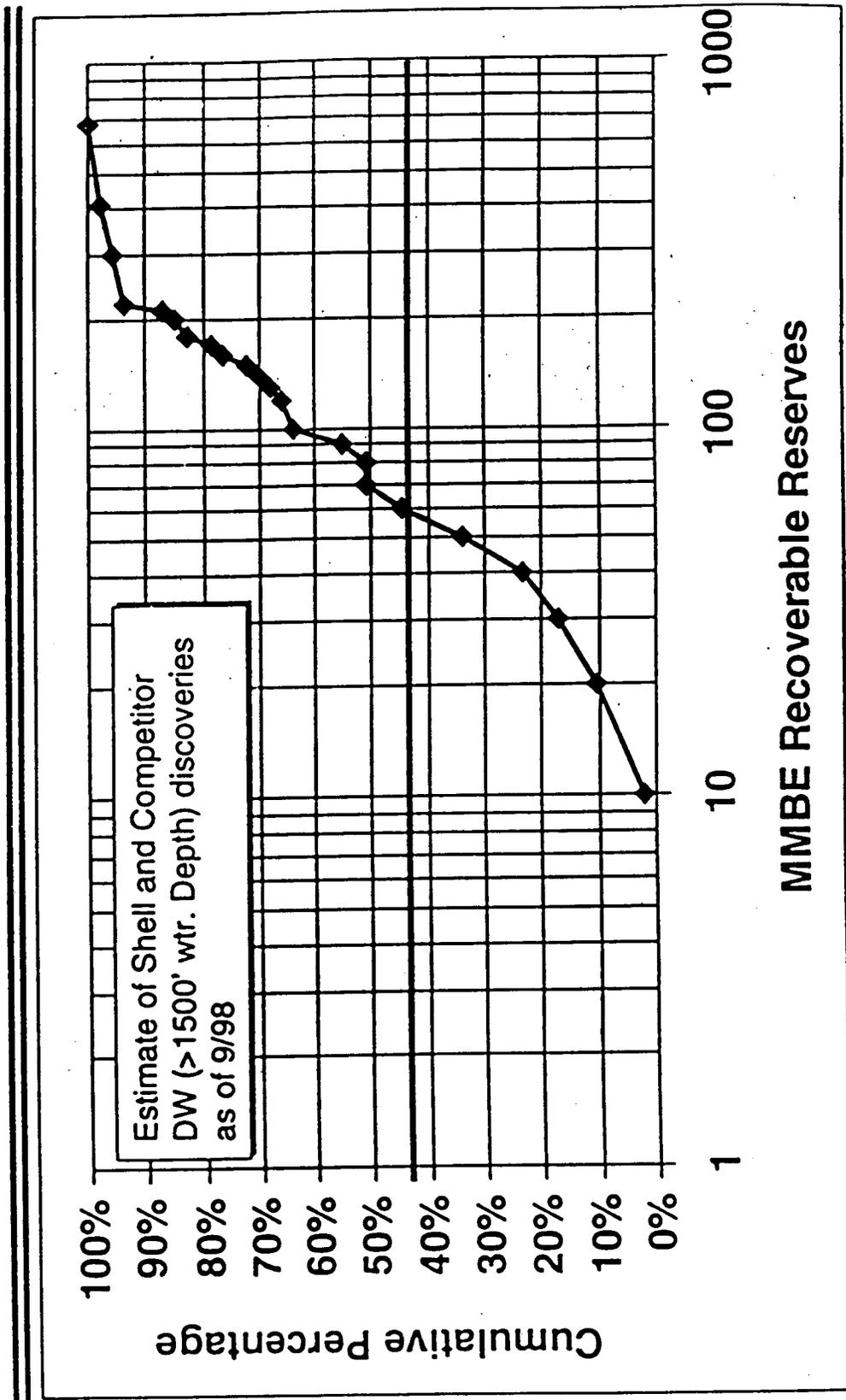
Dates Shown are First Production

Current Production Systems





Deepwater Volume Distribution



Subsea - A Business Decision

- Pros:
 - Lower Capital (\$400MM vs \$1,000MM)
 - Quicker route to recovery (18 months vs 3+ years)
 - No navigational or surface construction issues
 - Better for lighter crude oil, and gas developments
 - Permits Phased Development approach
- Cons:
 - Not suitable for all reservoir types (heavier crudes)
 - Needs infrastructure (host facilities, pipelines)
 - Higher intervention cost
 - Limited expansion / multiuse potential
 - Cold flow, long offsets (hydrates & paraffin)

Subsea Works Best when ...

- Reservoir characteristics are well known and likely to be consistent through field life
- Infrastructure is close at hand (Pipelines and Host Facilities)
- Some redundancy and maintenance / intervention capability is designed in
- Marginal fields that individually do not justify capital expense of surface facility can be combined

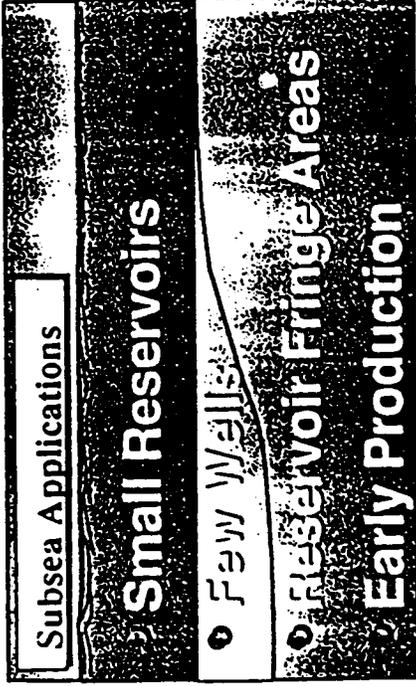
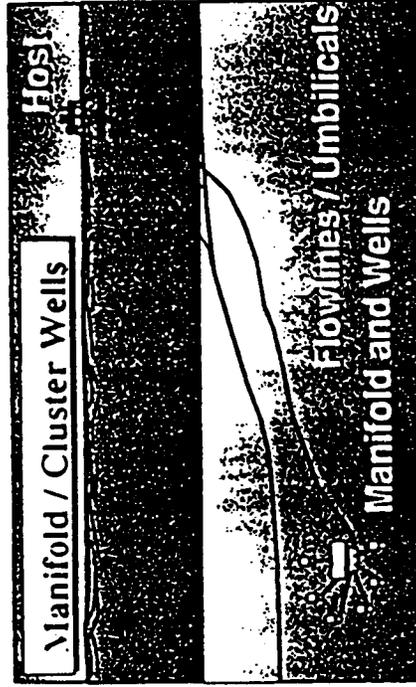
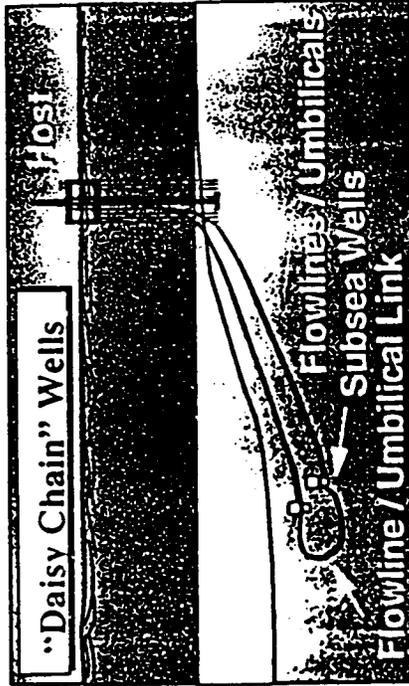
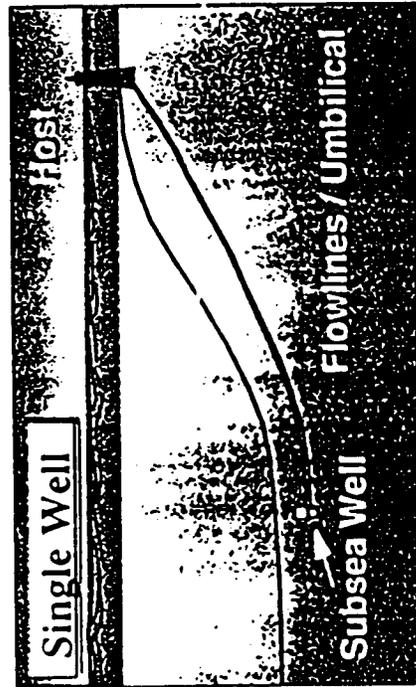
Definition of Terms

- **Subsea** - Located on the sea floor.
- **Host Facility** - A fixed or floating OCS facility that receives produced hydrocarbons from, and provides control and monitoring support to a subsea development.
- **Hub** - A host facility that serves as a processing point for a number of subsea developments.
- **Intervention** - Using a drilling rig or specialized vessel to reenter a subsea well for maintenance or flow enhancement purposes.
- **Laydown Sled** - Device on the end of a flowline or umbilical which facilitates connection/distribution to subsea wells or manifolds.

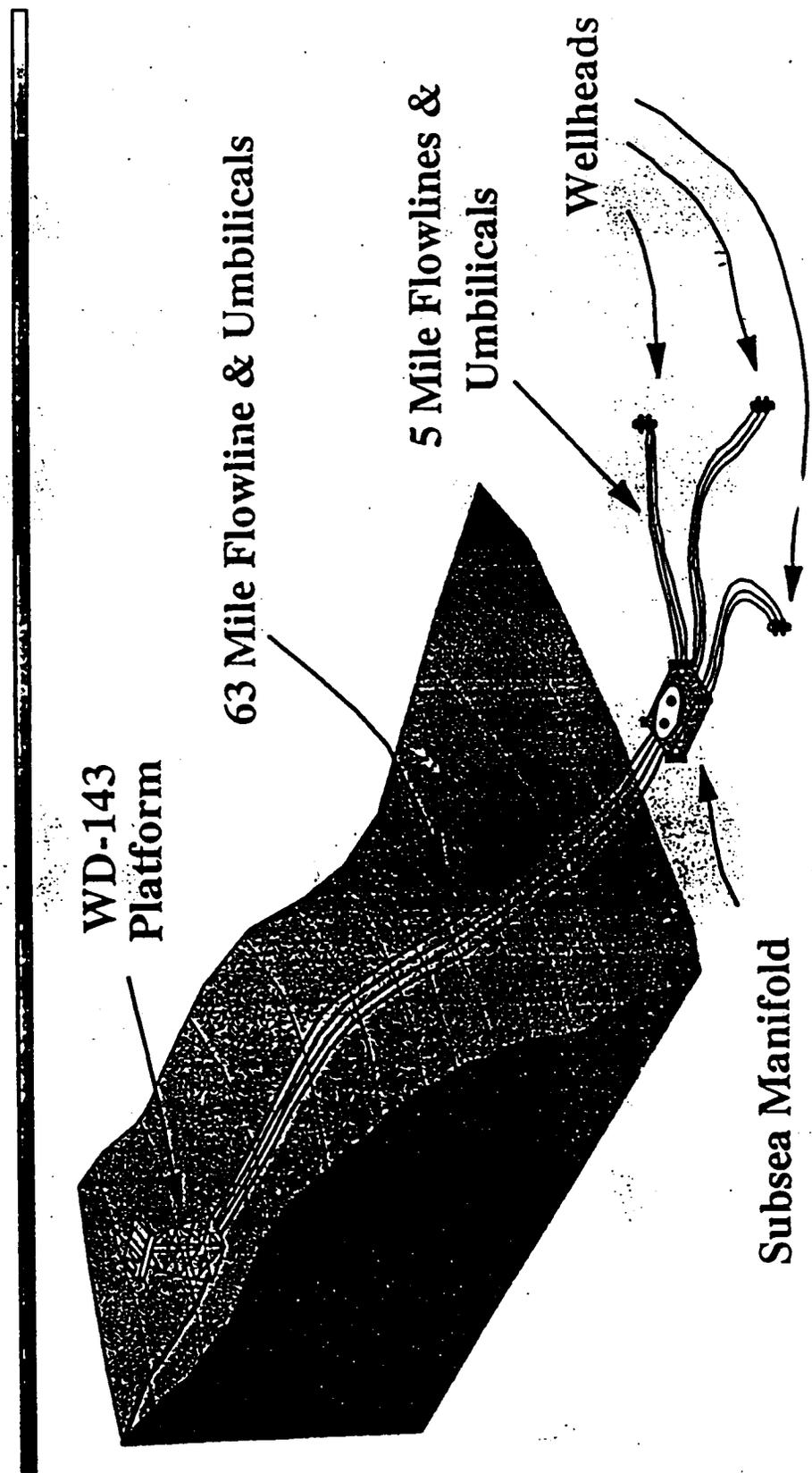
Definition of Terms (*cont'd*)

- **Subsea Manifold** - A subsea device that serves as a collection and distribution point for produced hydrocarbons from subsea wells.
- **Subsea Wellhead** - Series of control valves on sea floor that permits access to and recovery from the well bore.
- **Flowline** - Piping that carries produced hydrocarbons from the well, to manifolds and from the manifold to the host facility.
- **Umbilical** - Electric and/or hydraulic lines from host facility for purpose of controlling and monitoring the subsea system. Chemical lines for the delivery of chemical treatments to the wells and flowlines.

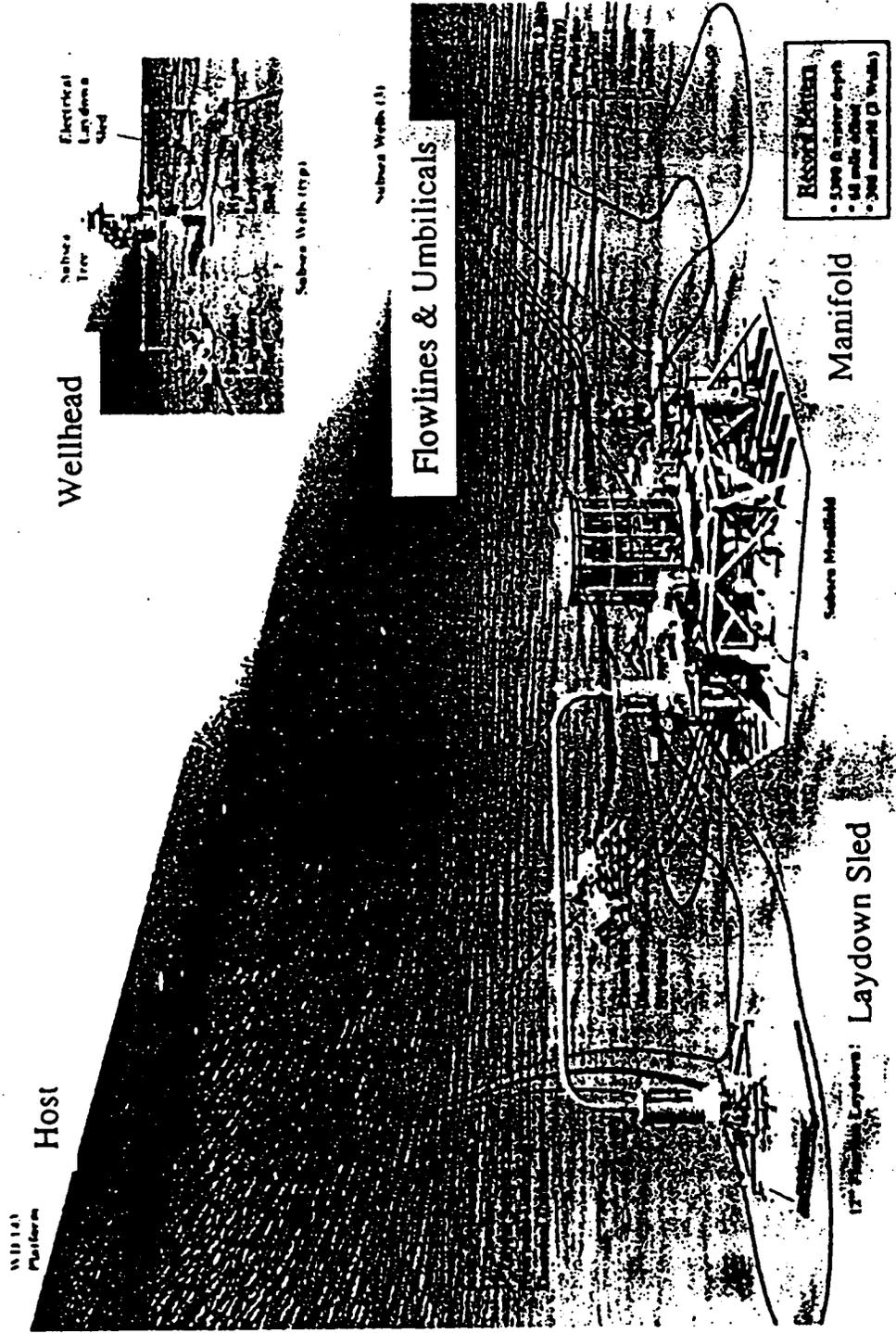
Subsea System Building Blocks



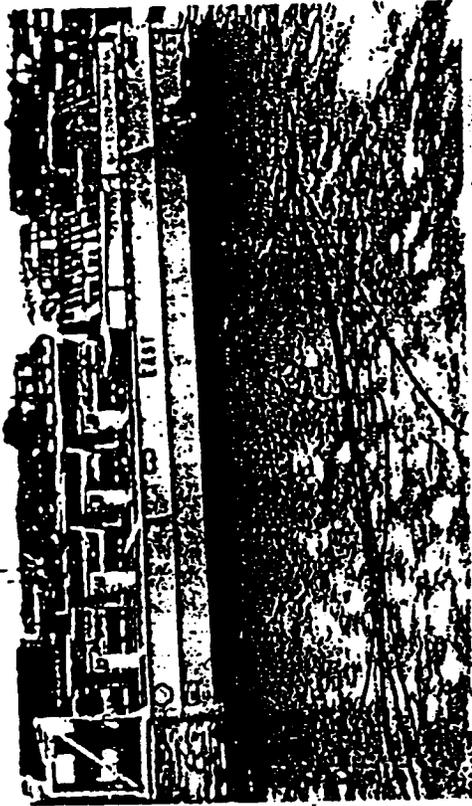
Mensa Schematic



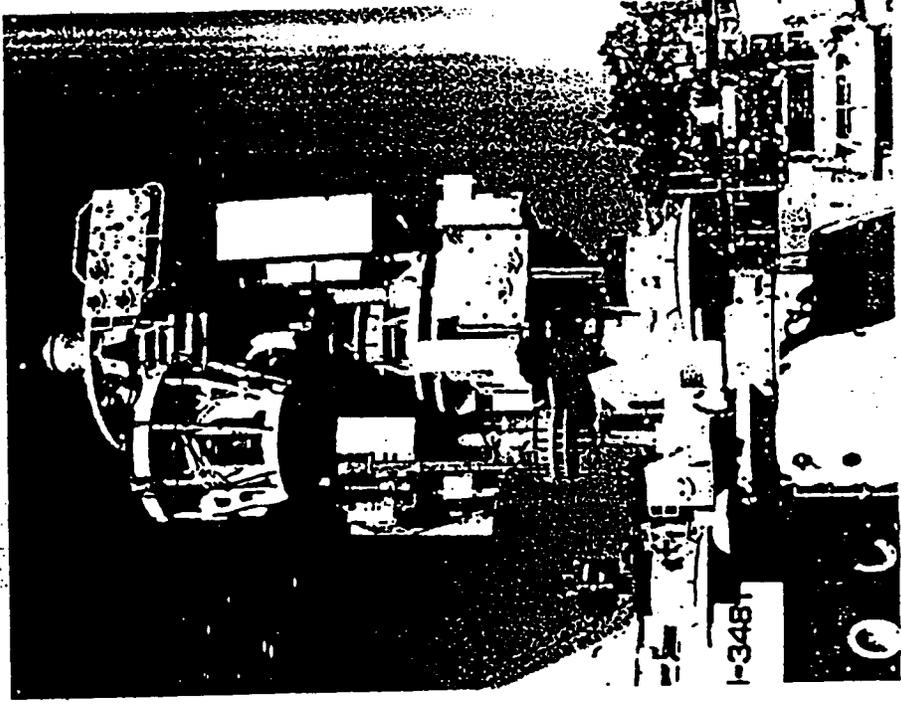
Example of a Subsea System



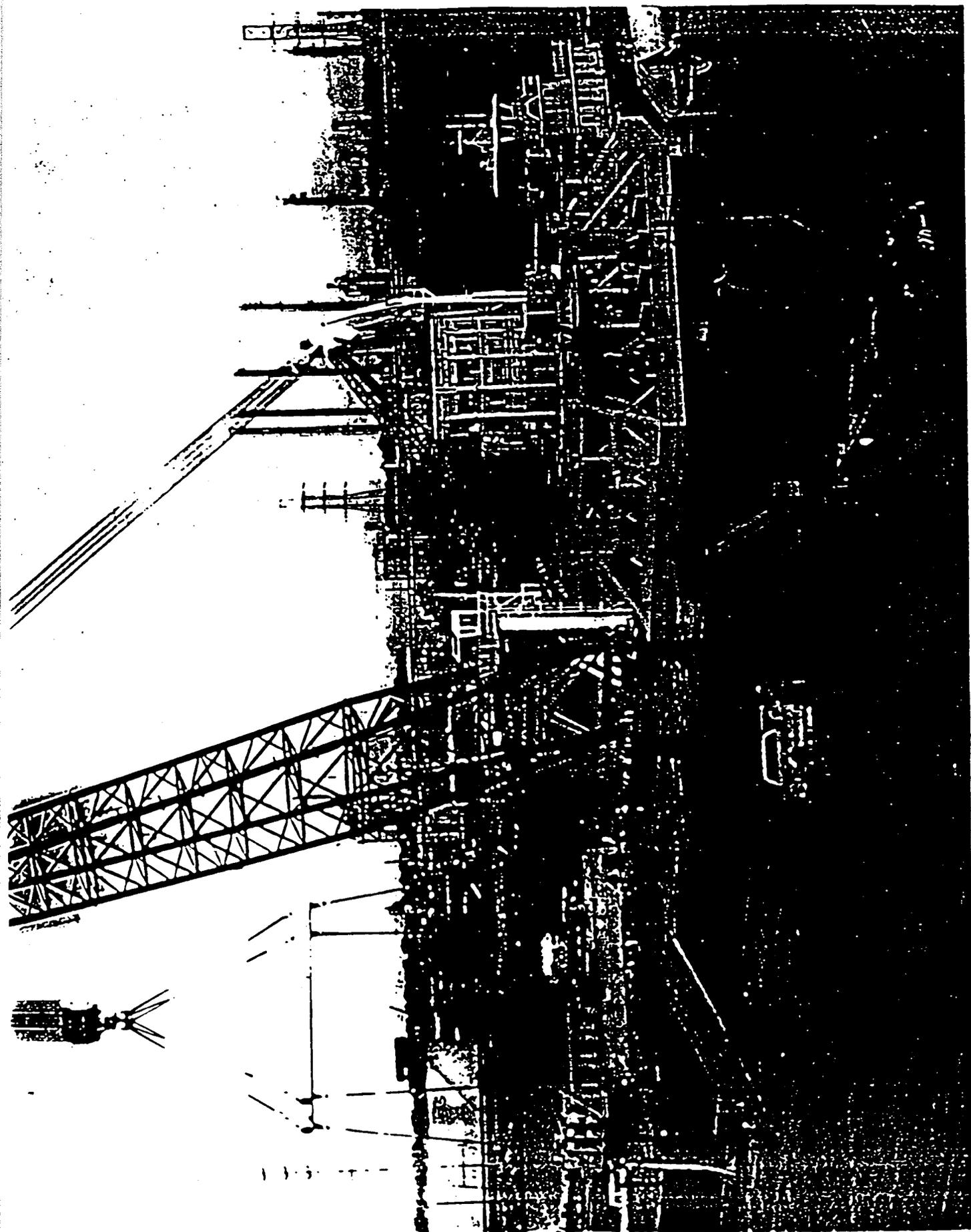
Subsea Components



Electrical Distribution
Structure



Subsea Tree (Wellhead)



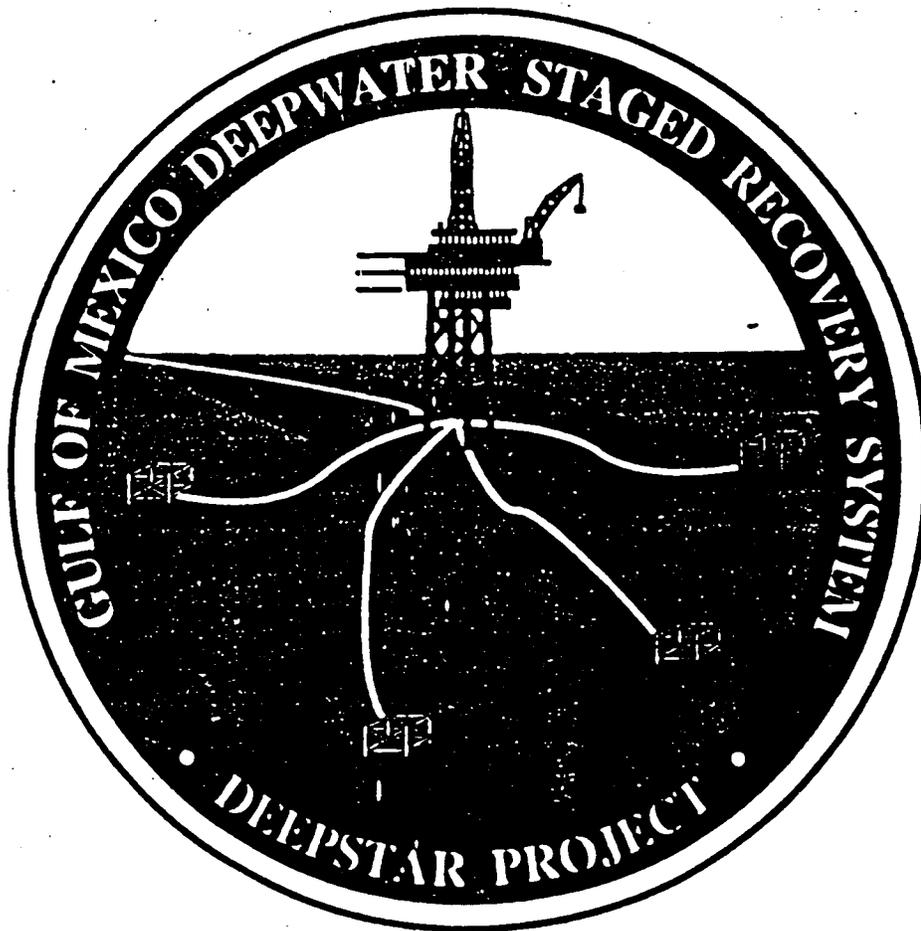


Subsea Challenges

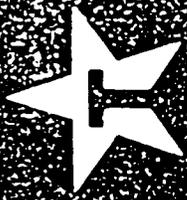
- Application of existing MMS regulations and policies to subsea technology is evolving
- Combining process streams from multiple SS developments with varying properties and ownership/royalty issues
- Technology rapidly advancing (water depths, offsets, composite materials, complexity, metering)
- Long term reliability in deepwater applications is not yet proven

17

DEEPSTAR



DEEPWATER STAGED RECOVERY



Present and Projected

Production

Present Limits

2 Yrs

5-7 Yrs

Gas

60 Miles

65 Miles

80 Miles

3200' WD

5500' WD

7500' WD

Light Oil

15 Miles

30 Miles

45 Miles

3200' WD

6000' WD

7500' WD

Heavy Oil

10 Miles

15 Miles

30 Miles

3200' WD

4500' WD

6000' WD

Challenges:

Well Testing

Production Risers

Subsea Pressure Boosting

Mooring

Show Stoppers: Hydrates

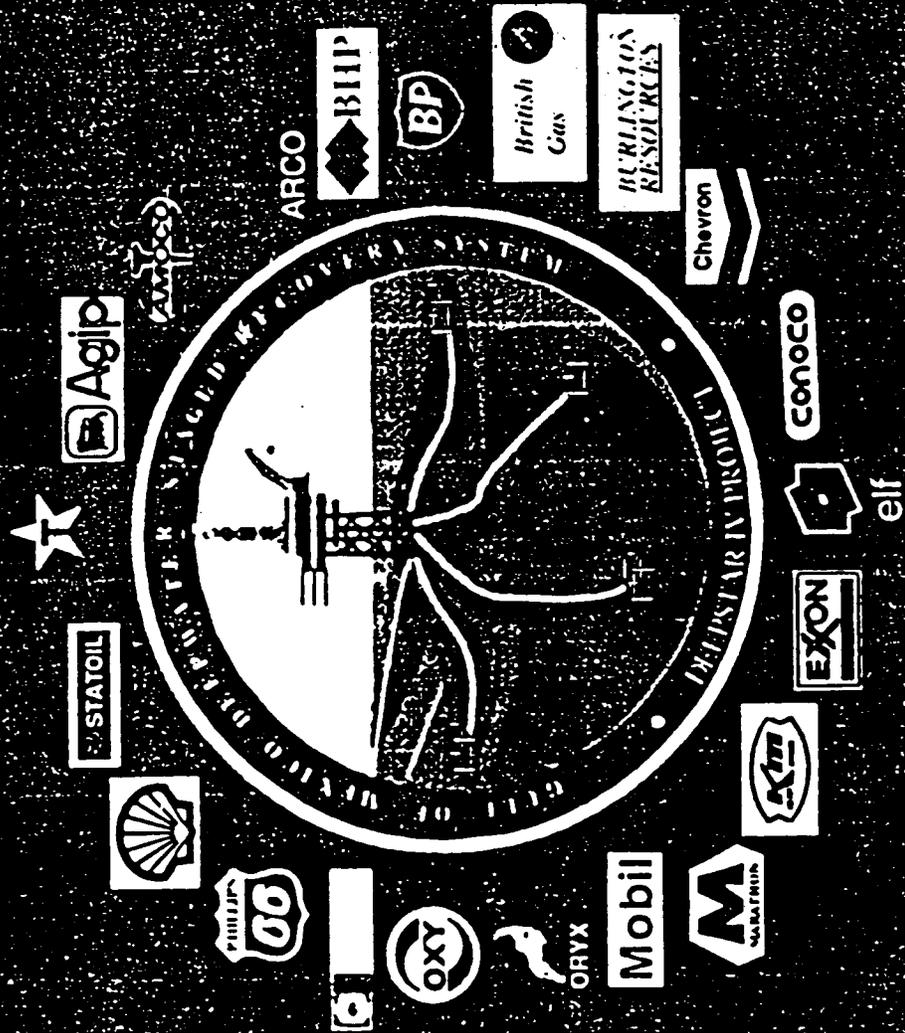
Paraffin

Asphaltenes

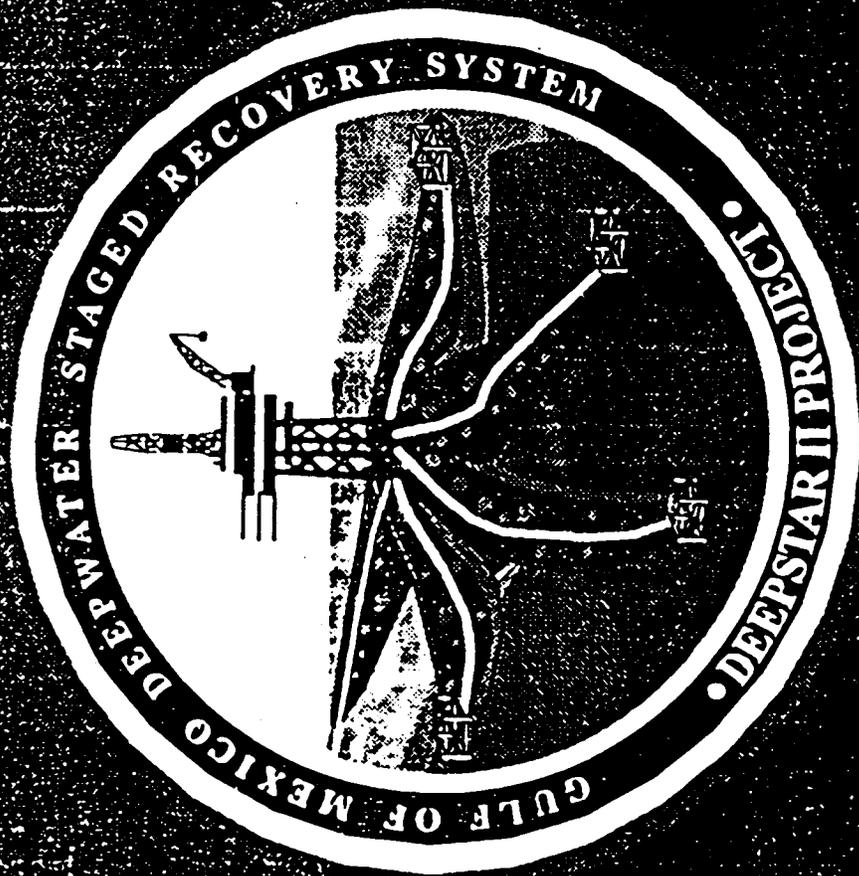




The DeepStar Project Participants



The DeepStar Project





The DeepStar Project

Manufacturers & Service Companies

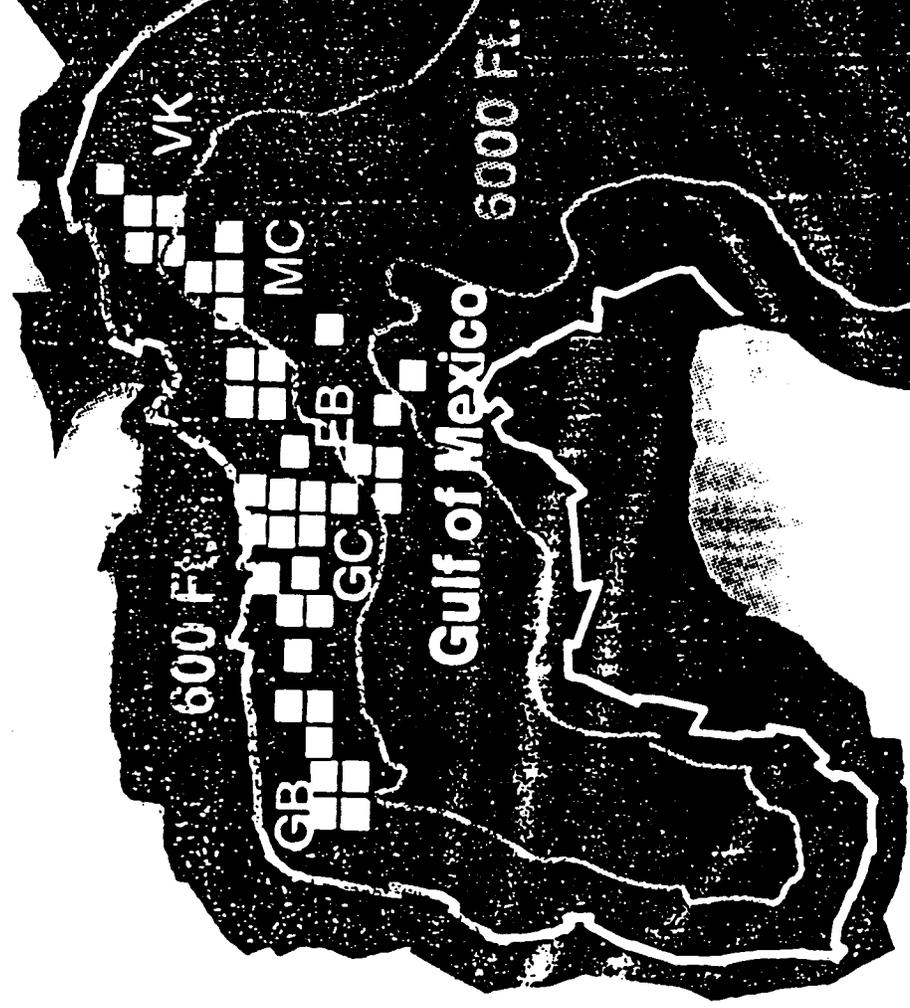


DEEPSTAR

- **An Industry Wide Cooperative Effort**
- **Focused On Identification and Development of Economically Viable, Low Risk Methods to Produce Hydrocarbons from Deepwater Tracts in the Gulf of Mexico.**

Indicated Discoveries Water Depths > 1,500

United States of America



Mexico





New Orleans

Why DeepStar?

- **Technology**
 - ▶ **Shared effort**
 - ▶ **Cost effective**
- **Business Synergy**
 - ▶ **F&D costs**
 - ▶ **Lifting costs**
 - ▶ **Cycle time**



The DeepStar Concept

DeepStar Provides:

- * A Development Strategy
- * Risk Management
- * Capital Cost Control
- * Cooperative Working Relationship With Industry



Development Strategy

- Utilize existing infrastructure where possible for Deepwater field evaluation/development
- Extended reach subsea tie-back concept



Development
Production

Based development approach

Proves reservoir performance

Proves development concept

Allows system design & imz

Phase II
Full Field
development

Phase I
Initial SS
development

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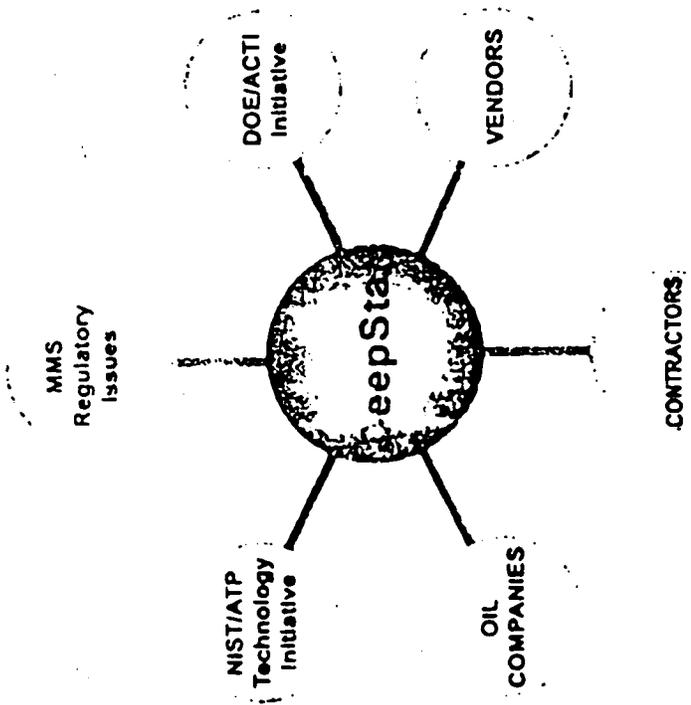
10

TECHNICAL SERVICES
TECHNICAL SERVICES
TECHNICAL SERVICES

TECHNICAL SERVICES



Industry ↔ DeepStar ↔ Government



DeepStar provides a working interface between industry and government agencies to address regulatory issues and critical technology development issues.



Historical Progress

Phase I - 1992-1994 - Scoping Phase and Initial Identification

Phase II - 1994-1995 - Establishing Technology Limits
Phase IIA - 1995-1996 - Exploring New Processes and Hardware for Deepwater

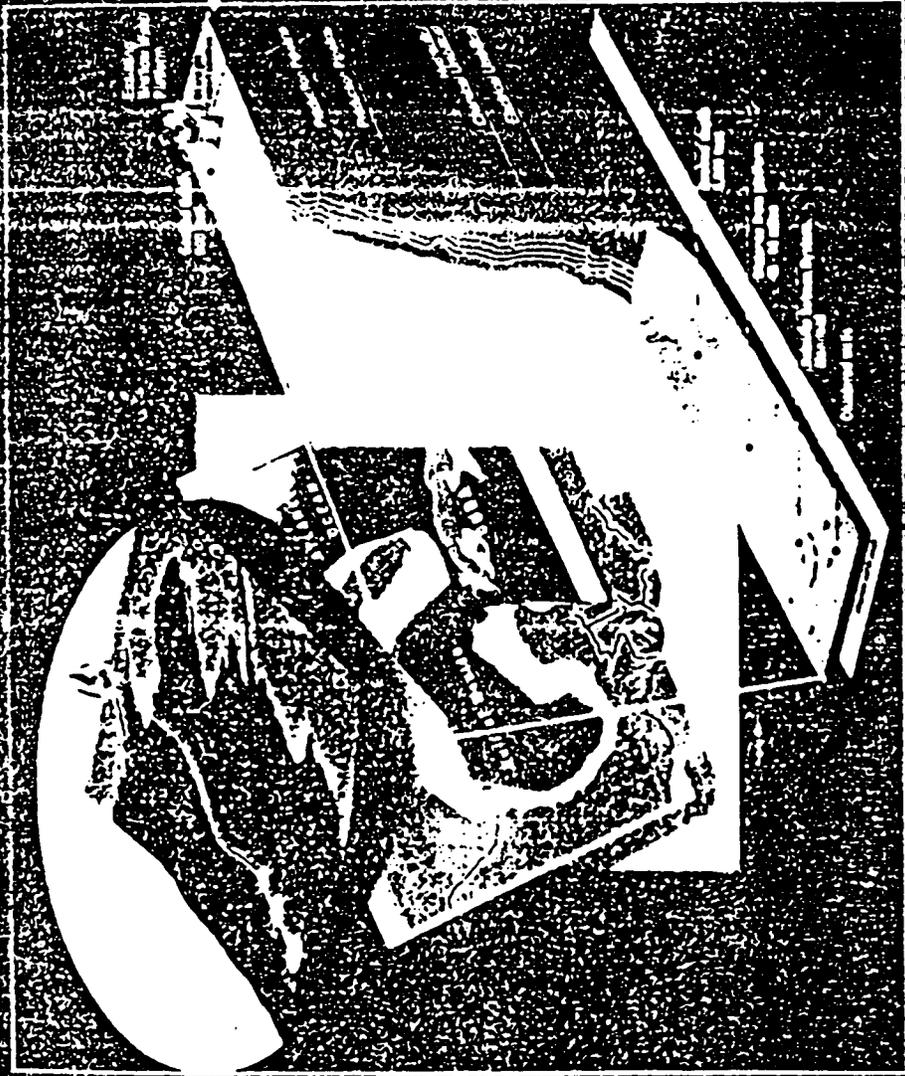
Phase III - 1996-1997 - Focusing on Lessons Learned and Systems Performance

Phase IV - 1998-1999 - Systems Development and Deployment

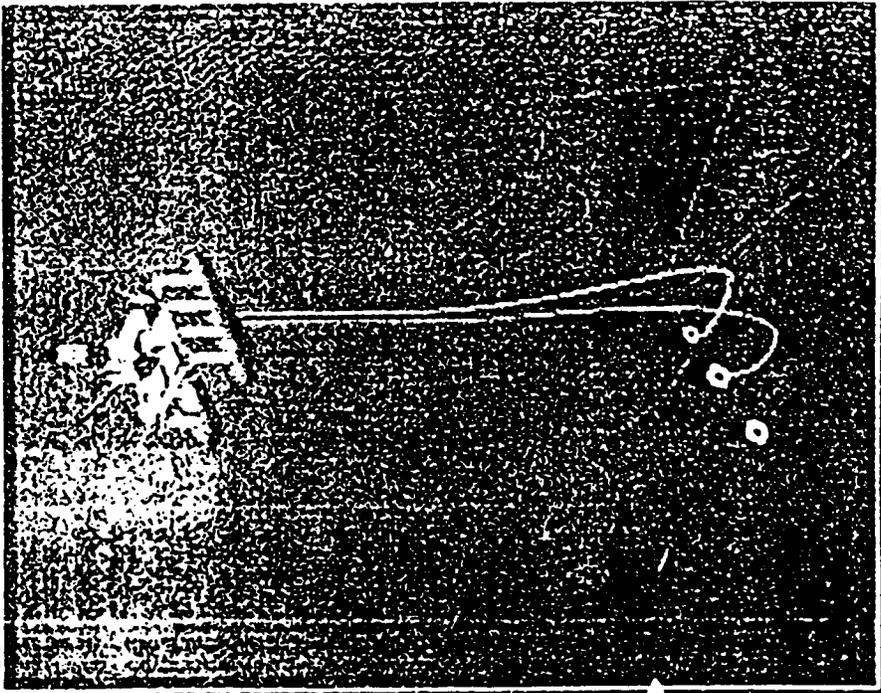


Kick Off Held in January 1998

- **\$12 million, two year program**
- **21 participants**
(Gas Authority of India and Unocal are promising prospects)
- **continue involvement with vendor community**



DeepStar Original
Extended Reach
Subsea Tieback
Concept



Our primary focus has
evolved and broadened to
‘How to develop Deepwater
Technology.’



DEEPSTAR STRETCH GOALS

Regulatory: Get FPSO's in the GOM

Flow Assurance: Achieve bare pipe extended reach technology capability to: (1) Predict (2) Prevent (3) and Remediate long offset, deepwater tie-backs

Subsea: Subsea facilities for 60 miles Tie-Back from 10,000 ft. of water

Vessel, Mooring Floating (moored) Drilling and

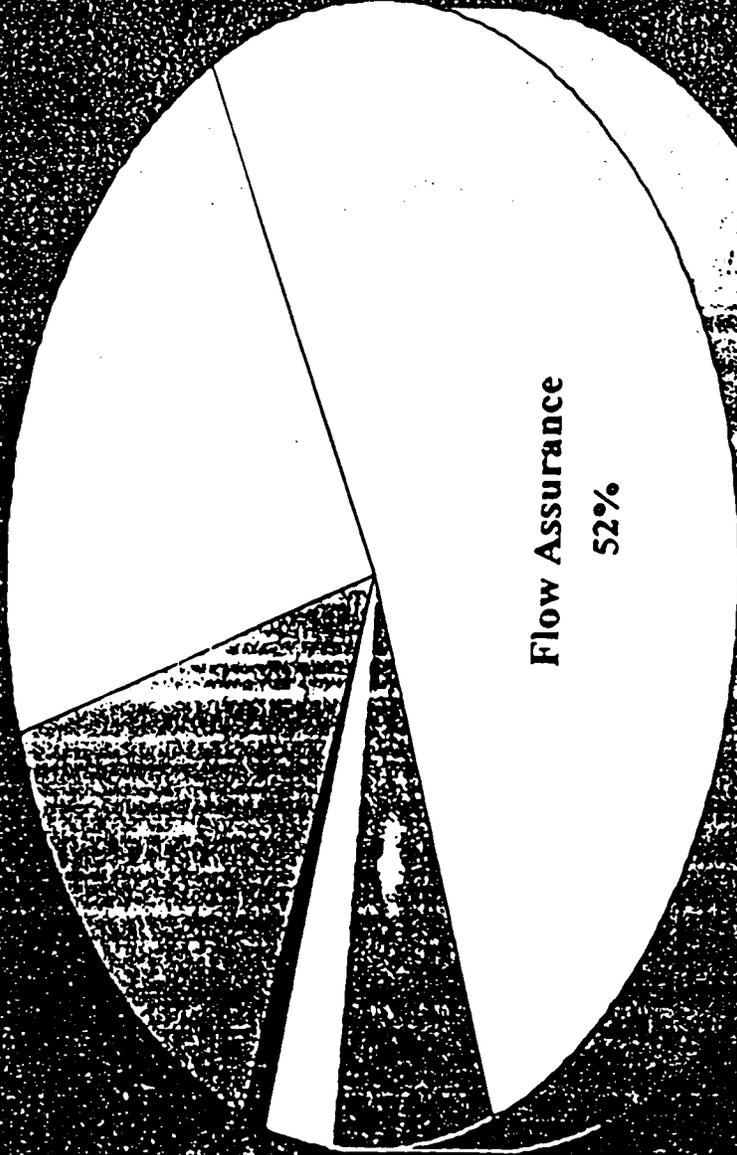
& Risers: Production in 10,000 ft. Water-depth

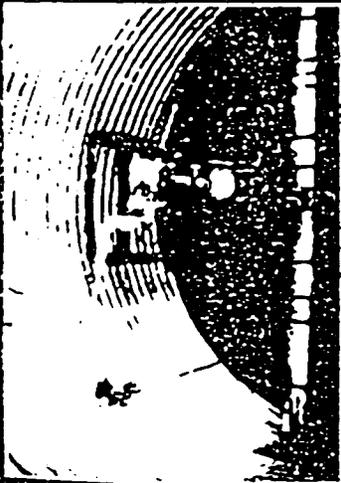
Drilling: Ultra - reliable, ultra-deepwater well installations

Oceanography: Provide full current data for the entire GOM

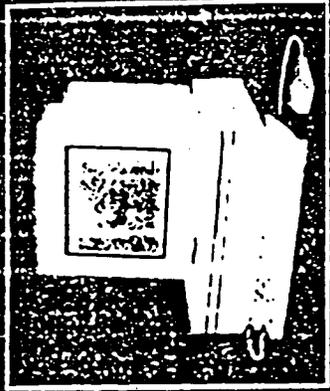


DEEPSTAR PHASE IV

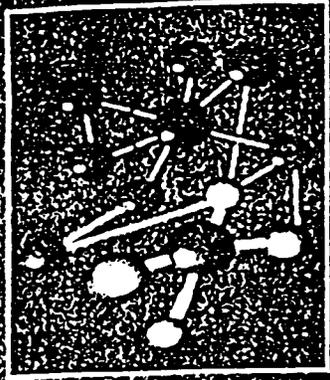




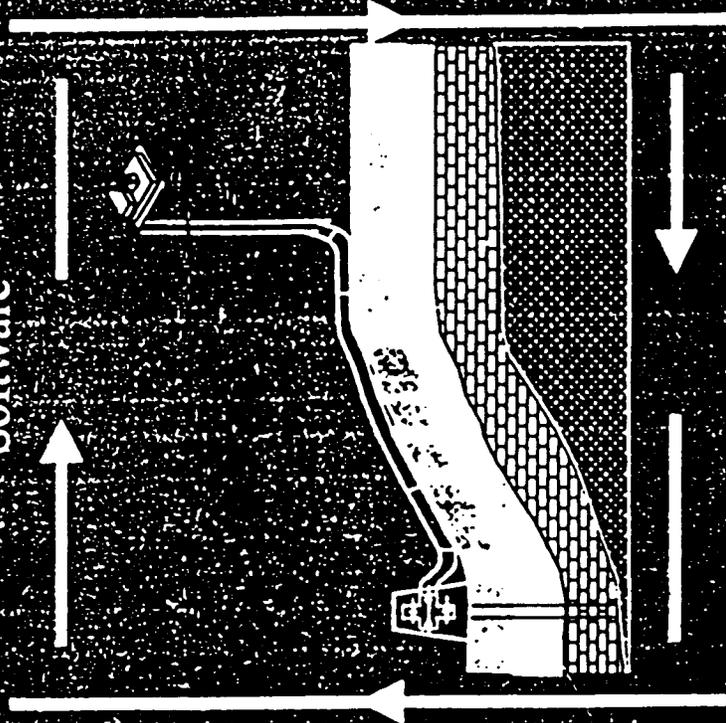
Data Retrieval & Field Quality Novel Instrumentation



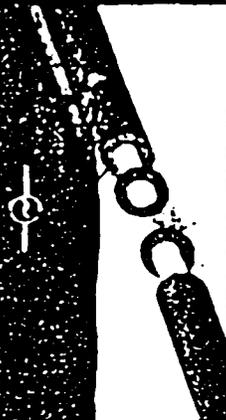
Validate Predictive Software



Test New Chemistries & Novel Methods



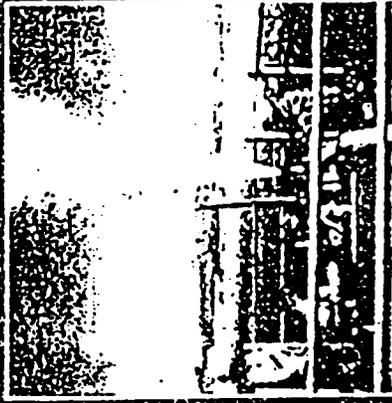
DeepStar Phase IV Flow Assurance Program



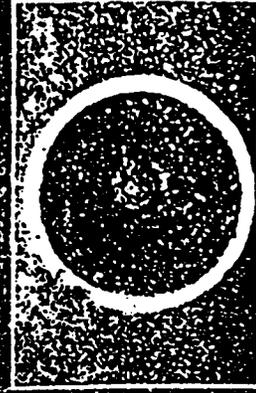
Electrically Heated Pipeline



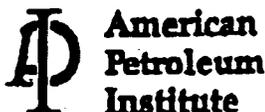
Aggressive & Multi Diameter Pigging



Hydrate Remediation



Wax Remediation



1220 L Street, Northwest
Washington, DC 20005-4070
Phone: 202/682-8116
Fax: 202/682-8428
E-mail: rubinm@api.org

Mark Rubin
Upstream General Manager

December 18, 1998

Mr. Todd McCutcheon
Chief, Policy & Management Improvement
Minerals Management Service
U.S. Department of the Interior
P. O. Box 25165 - MS 9200
Denver, CO 80225

Dear Mr. McCutcheon:

I am writing on behalf of the American Petroleum Institute's (API) more than 400 members, many of whom operate on the outer continental shelf (OCS) and have a business interest in deep water leases. API strongly supports the Minerals Management Service's (MMS) subsea gathering and transportation initiative described in the MMS notice at 63 FR 56217 (October 21, 1998). We appreciate MMS' continued interest in reviewing the appropriateness of transportation allowances for deepwater subsea operation.

Several representatives of API member companies participated in the MMS-sponsored November 16, 1998 meeting in New Orleans, and we hope the preliminary information they provided was useful. To complement those discussions, we want to reinforce industry's point of view on this important matter. API recommends specific criteria that MMS might employ in evaluating whether transportation allowances are appropriate for deepwater subsea production operations in the Gulf of Mexico. Further, the lessor, as beneficiary of the transportation service, should share the cost of that service. And, the MMS' regulations as presently written, permit subsea movement to be classified as transportation.

The great challenges of exploring and developing deep-water leases have required the oil and gas industry to expand its technological capabilities far beyond those used to explore and develop conventional shallower water shelf leases. Water depth, distance from infrastructure, tremendous variances in temperature and pressure, extraordinary costs, and extraordinary seafloor topography have tested the research and development capabilities of lessees. For some deepwater Gulf of Mexico areas and under some conditions in the deepwater subsea development may be the only technological, practical, and economically viable method to develop a lease. In a very real sense, subsea developments are as technically innovative as the first push by industry out into the Gulf of Mexico in the late 1940's. The technical presentations made by Dennis McLaughlin of Shell and Al Verret of Texaco were intended to demonstrate how far development technology has advanced and how it has yet to go. We attach as Exhibit "A," copies of Dennis McLaughlin's slides describing an actual subsea gas development, and as Exhibit "B," copies of the slides used by Al Verret.

In subsea development, a central fact is that production is physically moved at a great cost over long distances to a point where it is more valuable and more easily sold. The selection of subsea systems for lease/unit development is principally driven by economics. In most instances, lease/unit development would not have been economic utilizing a platform-type development. Consequently, the royalty settlement point is at a remotely located surface platform because it is not technically or economically feasible to accomplish this at the lease. If a surface platform-type system were utilized for lease/unit development, movement of production away from the lease would clearly be deemed transportation. The fact that a different development system is utilized for economic reasons should, therefore, not preclude production movement away from the lease/unit from receiving transportation allowances in subsea development situations.

MMS operations personnel in the Gulf of Mexico Regional Office have had to use existing operating regulations geared principally to shelf operations and adapt them to the deep-water environment. The MMS should use the current royalty regulations to address the physical facts of deepwater subsea development, recognizing that the deepwater environment differs from that of the shelf.

As explained in the technical presentations made at the workshop, in subsea development it is not technically and economically feasible to treat production to marketable condition at the producing lease or subsea manifold. The subsea manifold serves as a central accumulation point for wells that often are located away from the lease where the treatment facility is located. Production from several wells on the producing lease, or often on different leases, is commingled at the manifold and is then moved to a surface facility miles away. In this instance, the subsea manifold functions similarly to a central accumulation platform except that physical treatment is not feasible at the manifold itself.

In granting transportation allowances for subsea movement, MMS would not be breaking new ground. The existing regulations lead to the conclusion that such movement qualifies as transportation. Evaluating the purpose and function of subsea movement is a function test that both the MMS and the Interior Board of Land Appeals (IBLA) has used repeatedly under the existing regulations to determine the true character of transportation. Some examples of this application follow.

First, in *Exxon Company, U.S.A.*, MMS-VSD-OG93-0075 (December 29, 1994), the MMS allowed a transportation allowance for oil in a bulk oil stream that moved to shore from offshore platforms for processing and handling. In so allowing, the MMS looked to the true nature of the service and found that the function provided was part of necessary transportation to the nearest onshore market. Distance moved, pipeline size and the mere fact that the oil in question was untreated and not in marketable condition did not automatically disqualify the movement as transportation. Instead, in granting transportation, the agency used the standard royalty lease provision language of "other relevant matters" to consider the fact that, irrespective of marketable condition of production, movement to shore to reach market was an inevitable fact. The same is true of subsea production.

Second, in *Shell Offshore Inc.*, 142 IBLA 71 (1998), the Board found that the additional platform costs were an integral part of the transportation system because their function or purpose was to serve the purpose of transportation. The test of function is flexible enough to accommodate many different circumstances. Shell had sought to include a portion of the cost of the surface structure of the tension leg platform (TLP) associated with transportation in the calculation of the transportation allowance. The Board found that the weight sensitive TLP had specific costs integral to the function or purpose of transportation. Its decision on whether to include the space revolved around a determination of function or relationship of the space to transport. The Board found the additional platform costs were an integral part of the transportation because of their function or purpose.

Third, in 1988, when the current MMS definitions were promulgated, most deep-water developments and non-traditional or alternative deepwater development scenarios were not in existence. The history of prior OCS shelf development provided the backdrop for the 1988 royalty regulations. Under that history, two non-traditional scenarios were most prevalent. One was based on a development scheme of one or two platforms on the same lease with one or more subsea wells producing at each platform but with bulk production from one platform then moving to the other where treatment facilities placed production into marketable condition. A second scenario was virtually identical, except that the two platforms may have been located on adjacent leases with multi-well production flowing to a central accumulation point on each but with bulk production from one then moving to the other for treatment for the convenience of the lessees. These scenarios allowed for the construction of only one set of handling facilities to place production in marketable condition. Handling could have been done at each platform at a proportionally higher cost but lessees chose not to do so.

Under these circumstances, the MMS found that this type of off lease movement, or "gathering," did not qualify for transportation. The lessee, who for its convenience had moved production to a central accumulation at reduced facility capital cost and enhanced lessee profitability, was not allowed to also take a deduction by classifying this movement as transportation. This is not the case for subsea production where physical treatment of production is not feasible.

Fourth, in one of the earliest decisions on offshore OCS transportation in *Shell Oil Company et al*, 70 I.D. 393 (1963) the Solicitor examined the facts surrounding the necessity of barge transportation of OCS production. He found certain factors to be unique to the offshore environment: "production difficulties peculiar to offshore operations," "distances traversed," "high costs in purchase and maintenance of sea going barges and tugs," and "volume of crude oil." In concluding his opinion, the Solicitor required consideration of barge costs as "other relevant matters" to be considered under the regulation and lease when reaching a value determination. The realities of subsea movement over thirty years later compels a similar re-thinking on the part of the Department:

4. Deepwater production from a single well that flows to a surface platform located on a lease not adjacent to the producing lease or unit should also qualify for the allowance.
5. Marketable condition and facility measurement point for deepwater subsea should not be determinative of transportation qualification. In the deep-water subsea environment, movement to a non-adjacent lease should be dispositive.
6. Direction of movement and pipeline size should not be determinative.
7. Additional subsea transportation allowances should be considered on a case by case basis.
8. The existing regulations on non-arm's-length transportation provide a method to calculate the size of the allowance.
9. MMS should grant subsea allowances for bulk production moved from deep-water surface facilities where bulk production is moved to the shelf tie in point.

In closing, let me reiterate our strong support for the MMS's willingness to explore this importance issue. We encourage the MMS to pursue the subsea initiative expeditiously and we would welcome the opportunity to meet with you again or provide you with additional information as you crystalize your plans.

Sincerely,



Attachments (2)
(Sent under separate cover via Airborne Express)

Mobil

MOBIL BUSINESS RESOURCES CORPORATION
3000 PEGASUS PARK DRIVE
DALLAS, TEXAS 75247

P. O. BOX 650232
DALLAS, TEXAS 75265-0232

TEL: (214) 951-3349
FAX: (214) 951-2029
E-MAIL: debbie_b_haglund@email.mobil.com

DEBORAH BAHN HAGLUND
COUNSEL
OFFICE OF LEGAL COUNSEL
MEPUS PRACTICE GROUP

December 18, 1998

VIA FAX (303-275-7124)
ORIGINAL BY U.S. MAIL

Todd McCutcheon, Chief
Policy and Management Improvement
Minerals Management Service
U.S. Department of the Interior
P.O. Box 25165 – Mail Stop 9200
Denver Colorado 80225

Dear Mr. McCutcheon:

Mobil Exploration & Producing U.S. Inc. ("Mobil") welcomes the opportunity to comment on the subsea gathering and transportation initiative described in the Minerals Management Service ("MMS") notice published at 63 Fed. Reg. 56217 (October 21, 1998). Mobil strongly supports this initiative, and we greatly appreciate MMS' continued interest in reviewing the appropriateness of transportation allowances for subsea operations.

Mobil concurs with the written comments submitted by the American Petroleum Institute ("API"), as well as with the oral comments made by the API member companies who made a presentation at the MMS-sponsored workshop held in New Orleans, Louisiana, on November 16, 1998. Accordingly, Mobil adopts those comments, by reference, as its own.

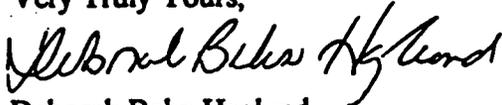
As is more fully explained in API's comments, current MMS regulations and existing lease terms authorize MMS to grant allowances for subsea transportation whenever that transportation serves the function of moving federal lease production from the offshore to the first available market. This transportation enhances the value of the production, regardless of whether or not the production is in "marketable condition" at the time of the

transportation. Since MMS is the beneficiary of the enhanced value resulting from the transportation, it should share in the cost of that transportation.

Mobil also concurs with API's recommendation that MMS not engage in a case by case analysis for every subsea development, but rather that it establish two categories, one category which would be clearly entitled to the allowance and another which would be decided on a case by case basis. This would reduce the administrative burden on the MMS as well as on lessees, and it would add greater certainty to the royalty valuation process. The recommended categories and criteria to be used are discussed more fully in API's comments. Mobil concurs fully with these recommendations.

Mobil appreciates your consideration of these comments. If you have any questions regarding the comments, please call me at 214-951-3349.

Very Truly Yours,



Deborah Bahn Haglund

Attorney for Mobil Exploration & Producing U.S. Inc.

Dow L. Campbell
Attorney



539 South Main Street
Findlay, OH 45840-3295
Direct No. 419/421-4121
Main No. 419/422-2121
Facsimile 419/427-3681
E-mail: DLCampbell@MarathonOil.com

December 18, 1998

Via Facsimile: (303) 275-7124

Mr. Martin C. Grieshaber
Minerals Management Service
U.S. Department of the Interior
Denver Federal Center
P.O. Box 25165 - MS 9200
Denver, Colorado 80225-0165

Re: Comments MMS Workshop on the Development of Criteria to be used in distinguishing between Gathering and Transportation in Deep Water in the Outer Continental Shelf (63 FR 56217, October 21, 1998)

Dear Mr. Grieshaber:

Marathon Oil Company (Marathon) appreciated the opportunity to attend and participate in the Mineral Management Service's (MMS) November 16, 1998, workshop in New Orleans on the development of criteria to be used in distinguishing between gathering and transportation in deep water in the outer continental shelf.

Marathon welcomes the MMS' investigation of this important issue. However, Marathon prefers to see the MMS develop a set of criteria for production movements and when such criteria are met by a specific production movement, the movement would automatically be entitled to a transportation allowance. A case-by-case analysis would then only be applied to those situations which are exceptions to the established criteria. This would benefit both the MMS and industry by reducing administrative burdens imposed by implementing solely a case-by-case analysis and would also be advantageous by giving industry a sense of certainty.

Marathon supports the analysis and criteria offered by the American Petroleum Institute, both at the November workshop and in its written comments.

If you should have any questions please contact me.

Sincerely,

A handwritten signature in cursive script that reads "Dow L. Campbell".

Dow L. Campbell

(101368)

Domestic Petroleum Council Independent Petroleum Association of America

December 18, 1998

Mr. Todd McCutcheon
Chief, Policy & Management Improvement
Minerals Management Service
U.S. Department of the Interior
P. O. Box 25165 - MS 9200
Denver, CO 80225

Dear Mr. McCutcheon:

We are writing to express the strong support of the Independent Petroleum Association of America (IPAA) and the Domestic Petroleum Council (DPC) for the Minerals Management Service's (MMS) subsea gathering and transportation initiative described in the MMS notice at 63 FR 56217 (October 21, 1998).

Our Supplemental Comment filed in response to the MMS' inquiry in the Federal Register, 63 FR 38353 (July 16, 1998), explained that the current regulations are ill suited to identify the true function of subsea pipeline facilities. We were therefore very gratified that the MMS convened the November 15, 1998 workshop and the Staff stated at the workshop their belief that a new policy is appropriate in this area.

The Gulf of Mexico is a critical basin for the domestic petroleum industry. As shown in Arthur Andersen's recent report entitled "1998 U.S. Oil & Gas Industry Outlook Survey Results", independents believe the deepwater Gulf has the greatest potential for new discoveries of crude oil and natural gas reserves. The same report also shows that independents assign a high ranking to the O.C.S. Gulf for new discoveries of crude oil and natural gas reserves. However, exploitation of such discoveries will require very substantial capital expenditures and the use of new and innovative technologies. In the current climate of depressed commodity prices, it is especially important to recognize that new subsea pipeline technologies can play a critical role in moving oil and gas from offshore leases to market centers in a safe and cost effective manner.

DPC and IPAA actively participated in the workshop and the legal panel included a company representative. We joined with the American Petroleum Institute (API) in recommending that the MMS create a "safe-harbor" category, where movements of deepwater¹ production would be clearly entitled to transportation cost allowances.

Independents, who often rely on project financing by lenders or investors for development, need a safe-harbor to ensure timely project development occurs. Requiring case-specific approval would unduly delay project funding and would place independents at a competitive disadvantage to those producers who do not utilize external financing for development activities.

At the workshop, the technical panel demonstrated that new technologies permit subsea facilities to replicate on the sea floor the production accumulation and transportation functions traditionally performed on the O.C.S. by a combination of surface structures and linked pipelines. However, measurement and treatment functions still must be performed on "host" surface structures² downstream of the subsea point where production is aggregated and production enters the pipeline. Consequently, the traditional MMS policy that labels the movement by pipeline of production not treated to marketable condition as "gathering" leads to an arbitrary and discriminatory result, where the producer is denied any cost allowance for moving deepwater production -- frequently over very long distances -- to the host surface structure.³ We strongly believe this outcome was not contemplated when the current regulations were adopted in 1988 and it is contrary to law.

To remedy this problem, we recommend the MMS adopt a policy incorporating the following criteria into a safe-harbor transportation allowance for deepwater production:

- **Deepwater production moving through a subsea manifold to a surface structure located on a lease not adjacent to the producing lease or unit should qualify for a safe-harbor allowance.** The transportation allowance should apply to all costs incurred after the production enters the manifold. As explained by the technical panel, the manifold is not a production facility, but rather serves as a header for the movement of accumulated production

¹ Deep water should be defined at 200 meters of water or more just as it is in the Deepwater Royalty Relief Act. Water depth should be determined by either or both of the subsea production well tied to the manifold or the manifold itself.

² Surface structures include both fixed and floating structures, including fixed platforms, compliant towers, spars, floating production systems and tension leg platforms.

³ The Supplemental Comments filed by IPAA and DPC explain in detail why this outcome is arbitrary and discriminatory and point out analogous instances where transportation allowances have been granted when physical or other factors prevented separation or treatment functions from being performed upstream of the pipeline at issue.

through the downstream pipelines. Movement of deepwater production through those pipelines to a non-adjacent lease should be considered transportation per se, because such movement is a costly endeavor and clearly not a matter of the lessee's operational convenience.

- **Deepwater production moving from subsea "daisy-chain" wells to a surface structure on a lease not adjacent to the producing lease or unit should also qualify for a safe-harbor allowance.** As explained at the workshop, installation of a manifold is not necessary when wells can be linked in seriatim. In this case, the transportation function includes only the flow through the linking pipelines. The same factors as are discussed above for the manifold configuration support a cost allowance for these facilities.
- **Deepwater production moving from a single subsea well to a surface structure on a lease not adjacent to the producing lease or unit should also qualify for a safe-harbor allowance.** Here only the pipeline linking the subsea wellhead to the host facility would qualify for a cost allowance. Again, the same factors as are discussed above for the manifold arrangement justify a cost allowance for these facilities.
- **Deepwater production (whether produced from a subsea well or not) moving from a surface structure to a host facility not adjacent to the lease or unit where the surface structure is located should also qualify for a safe-harbor allowance.** A cost allowance should be provided whenever deepwater production is moved in bulk form downstream of a surface structure where the production is not separated and/or treated to marketable condition to a host facility not adjacent to the lease or unit where the upstream surface structure is located. We believe the upstream surface structure is performing an accumulation function and that the movement by pipeline downstream of that structure is transportation. Even though subsea production may not be involved, the above-discussed operational factors, e.g. the movement of bulk production a substantial distance away from the lease, justify a cost allowance.

The MMS should also provide a cost allowance for other types of movements of bulk production from any offshore lease that extend from the lease to a point not adjacent to the lease or unit. In this case, the lessee would be required to show that it is not operationally feasible, practical, or safe to separate and/or treat the production to marketable condition before it enters the pipeline.⁴ The lessee would apply for this allowance on a case by case basis.

⁴ See *Exxon Company, U.S.A.*, MMS-VSD-OG93-0075 (December 29, 1994), where the MMS allowed a transportation allowance for oil in bulk stream which moved to shore from offshore platforms for processing and handling.

Mr. Todd McCutcheon
Minerals Management Service
December 18, 1998
Page 4

For purposes of both the safe-harbor and the case by case determination, the marketable or non-marketable condition of the product being transported and the location of the facility measurement point should not be considered. However, the lessee should not receive an allowance for the allocated cost of moving non-marketable substances such as free water through the pipeline.

Following the workshop, an MMS representative inquired whether a black-and-white, facility-specific test could be devised to define the scope of the transportation allowance. We believe that a litmus test should not be created. For example, while the deepwater temperatures approach freezing and present significant operational challenges, temperature of the transported product is not an appropriate criterion, because technologies may be employed to insulate or heat the production in the pipeline. Likewise, while increased pipeline wall thickness is often associated with deepwater production, new metallurgic technology will reduce required wall thickness over time. Policies that focus on specific facility characteristics are destined to failure due to the rapidly changing nature of the technologies being employed.

In conclusion, IPAA and DPC strongly support MMS' subsea initiative. We very much appreciate the very significant resources MMS is committing to work with industry in this area. We look forward to a further constructive exchange of information and ideas on this very important topic.

Sincerely,



Ben Dillon
Vice President
Public Resources
Independent Petroleum Association
of America
1101 16th Street, NW
Washington, DC 20036
202 857 4722
202 857 4799 (fax)



William F. Whitsitt
President
Domestic Petroleum Council
201 Maryland Avenue, NE
Washington, DC 20002-5703
202 544 7100
202 543 0616 (fax)

**CNG Producing
Company**

A **CNG** COMPANY

CNG Tower
1450 Poydras Street
New Orleans, LA 70112-6000
(504) 593-7356

PAUL P. GREGG
Senior Vice President and Chief Financial Officer

December 18, 1998

Mr. Todd McCutcheon
Chief, Policy & Management Improvement
Minerals Management Service
U.S. Department of the Interior
P. O. Box 25165 - MS 9200
Denver, CO 80225

Dear Mr. McCutcheon:

I am writing to express the strong support of CNG Producing Company (CNG) for the Minerals Management Service's (MMS) subsea gathering and transportation initiative described in the MMS notice at 63 FR 56217 (October 21, 1998).

CNG is an independent producer with substantial production and reserves in the Gulf of Mexico. CNG is ranked by Offshore magazine (June, 1998 edition) as the third largest producer of oil and gas from water depths greater than 1500 feet.

CNG remains optimistic about the potential for new discoveries of oil and gas reserves, both in the deepwater Gulf and on the Outer Continental Shelf. However, exploitation of such discoveries will require very substantial capital expenditures and the use of new and innovative technologies. In the current climate of depressed commodity prices, it is especially important that the MMS recognize that new subsea pipeline technologies can play a critical role in moving oil and gas from offshore leases to market centers in a safe and cost effective manner.

CNG has also sought a transportation allowance for CNG's movement by pipeline of subsea gas production from the deepwater Popeye field to a "host" facility on the O.C.S. Regrettably, the MMS denied that allowance and CNG was forced to appeal. However, the MMS is now reconsidering that decision in light of this initiative and we are gratified by this action.

CNG has reviewed the comments jointly filed by the Independent Petroleum Association of America and the Domestic Petroleum Council. We urge expeditious adoption of the recommendations set forth therein.

CNG very much appreciates the very significant resources MMS is committing to work with CNG and other producers in this very important area. We look forward to a further constructive exchange of information and ideas.

Very truly yours,


Paul P. Gregg
Senior Vice President &
Chief Financial Officer



Chevron

December 18, 1998

VIA FACSIMILE

(303) 275-7124

Mr. Todd McCutcheon
Minerals Management Service
Policy & Management Improvement
P. O. Box 25165
Denver, CO 80225-0165

Chevron U.S.A. Production Company
1301 McKinney Street
Houston, Texas 77010-3029
Mail Address: P. O. Box 3725
Houston, Texas 77253-3725

George W. Butler III
Senior Counsel
Law Department
(713) 754-7809
Fax (713) 754-3366

Deepwater Transportation

Dear Sir:

Chevron U.S.A. Production Company, a Division of Chevron U.S.A. Inc., appreciates the opportunity to comment on transportation and gathering issues recently discussed at an MMS workshop in New Orleans.

Chevron actively participated in the formation of the proposal presented by Shell, Texaco and Marathon representatives at the recent workshop, as well as the comments submitted by the American Petroleum Institute, which Chevron endorses and incorporates by reference herein.

We stand ready to participate in future workshops and in the rulemaking process. We encourage MMS to address this very important issue as soon as practicable.

Respectfully submitted,

George W. Butler

cc. R. J. Sandilos HOU130/2478

EXXON COMPANY, U.S.A.

P.O. BOX 2024 • HOUSTON, TX 77252-2024

December 18, 1998

CONTROLLER'S DEPARTMENT
OWNERSHIP

W.L. STONE
REGULATORY AFFAIRS ADVISOR

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. F. Stone

Author: Platte Clark at -MMS-DOI2
Date: 2/17/99 1:51 PM
Priority: Normal
TO: Martin Grieshaber at -MMS-DENVER-GH-1
Subject: Re: Deep Water Transportation/Gathering

----- Message Contents -----

I have no serious comments.

I would think the transportation allowance should be limited to the movement after the production has been moved to the nonadjacent lease. The movement to the nonadjacent lease should be considered gathering and not deductible.

Reply Separator

Subject: Deep Water Transportation/Gathering
Author: Martin Grieshaber at -mms-denver-gh-1
Date: 2/17/99 10:12 AM

Attached is a paper summarizing industry comments requested at a meeting held in New Orleans on November 16, 1998. The paper also proposes options on what course of action MMS should take regarding the deep water transportation/gathering issue.

Please review and provide me with comments (and a preferred option) by COB February 26. Comments will be taken in any format. My phone number is (303) 275-7118.

If additional discussion is needed based upon the comments, I will schedule a telecon/videocon/meeting as appropriate. I am targeting the March Quality Council meeting for a presentation/decision on this issue.

Thanks,

Marty

February 8, 1999

**Summary of Industry Comments
Options and Recommendation
Gathering/Transportation for Deep Water Subsea Wells**

The purpose of this paper is twofold.

- 1) The paper summarizes industry's comments requested at the November 16, 1998, meeting held in the Gulf of Mexico (GOM) Outer Continental Shelf (OCS) Regional offices. At the November meeting, oil and gas industry representatives made technical presentations concerning the new technology being used in the GOM to develop discoveries in deep water on the OCS.
- 2) The paper outlines options based upon industry's comments, and recommends a preferred option for Minerals Management Service management to consider.

Summary of Industry Comments

The comments are summarized alphabetically by commentator.

American Petroleum Institute

- The MMS should divide the subsea allowance into two categories, one category which is clearly entitled to the allowance and another which would be decided on a case-by-case basis.
- The following criteria can be used to establish the two categories:
 - Deep water should be defined at 200 meters of water or greater, just as it has in the Deepwater Royalty Relief Act. Water depth should be determined by location of the subsea well or the subsea manifold.
 - All subsea production in deepwater moving through a subsea manifold to a surface platform located on a lease not adjacent to the producing lease or unit should qualify for the allowance. The transportation allowance should be granted for costs incurred after production enters the subsea manifold.
 - Production from subsea "daisy-chain" wells that flow to a platform on a lease not adjacent to the producing lease or unit should also qualify for the allowance.
 - Deepwater production from a single well that flows to a surface platform located on a lease not adjacent to the producing lease or unit should also qualify for the allowance.
 - Marketable condition and facility measurement point for deepwater subsea should not be determinative of transportation qualification. In the deepwater subsea environment, movement to a non-adjacent lease should be dispositive.
 - Direction of movement and pipeline size should not be determinative.
 - Additional subsea transportation allowances should be considered on a case-by-case basis.

- The existing regulations on non-arm's-length transportation provide a method to calculate the size of the allowance.
- MMS should grant subsea allowances for bulk production moved from deepwater surface facilities where bulk production is moved to the shelf tie-in point.

CNG Producing Company

- Reference the allowance applied for from the deep water Popeye field to a "host" facility on the OCS.
- Urges expeditious adoption of the comments jointly filed by the Independent Petroleum Association of America and the Domestic Petroleum Council.

Chevron

- Endorses the comments submitted by API.

Domestic Petroleum Council and Independent Petroleum Association of America

- Join API in recommending the creation of a "safe harbor" category where movements of deepwater production would be clearly entitled to transportation allowances.
- Specific Criteria
 - *Deep water should be defined at 200 meters of water or more just as it is in the Deepwater Royalty Relief Act.*
 - *Deepwater production moving through a subsea manifold to a surface structure located on a lease not adjacent to the producing lease or unit should qualify for a safe-harbor allowance. Allowance would apply to all costs incurred after the production enters the manifold.*
 - *Deepwater production moving from subsea "daisy-chain" wells to a surface structure on a lease not adjacent to the producing lease or unit should also qualify for a safe-harbor allowance.*
 - *Deepwater production moving from a single subsea well to a surface structure on a lease not adjacent to the producing lease or unit should also qualify for a safe-harbor allowance.*
 - *Deepwater production (whether produced from a subsea well or not) moving from a surface structure to a host facility not adjacent to the lease or unit where the surface structure is located should also qualify for a safe-harbor allowance. A cost allowance should be provided whenever deepwater production is moved in bulk form downstream of a surface structure where the production is not separated and/or treated to marketable condition to a host facility not adjacent to the lease or unit where the upstream surface structure is located. The upstream structure is performing an accumulation function.*
- The MMS should also provide a cost allowance for other types of movements of bulk production from any offshore lease that extend from the lease to a point not adjacent to the lease or unit. The lessee must show that it is not operationally feasible, practical, or safe to separate and/or treat the production to marketable condition before it enters the pipeline.
- For both the safe-harbor and case-by-case determination, the marketable or non-marketable condition of the product being transported and the location of the facility

measurement point should not be considered. However, the lessee should not receive an allowance for the allocated cost of moving non-marketable substances such as free water through the pipeline.

Add technical not critical to determination

Exxon

- Supports the recommendations of the API.
- Technological and operational realities of deep water subsea production environment do neatly fit into the 1988 regulations.
- Movement of bulk production from subsea wells and/or manifolds to distant host platforms serves a transportation function.

Marathon Oil Company

- Supports the analysis and criteria offered by API.
- Prefers to see the MMS develop a set of criteria for production movements and when such criteria are met by a specific production movement, the movement would automatically be entitled to a transportation allowance.
- If criteria not met, then a case-by-case analysis.

Mobil

- Concurs with the written comments submitted by the API.
- Current regulations authorize MMS to grant allowances for subsea transportation whenever that transportation serves the function of moving federal lease production from the offshore to the first available market.
- Establish two categories - 1) clearly entitled to an allowance, and 2) case-by-case.

Shell Exploration & Production Company

- Endorses the substantive comments submitted by API.

Texaco

- Adopts the comments submitted by API.

Options

Option 1

Status Quo - Continue making transportation/gathering determinations using the location of the facility measurement point and the marketable condition of the production as critical factors..

Pros

- Requires no additional guidance.
- No reduction in royalties.

Cons

- Doesn't consider the function of the movement.
- Exxon Grand Isle exception.
- Litigation.

Option 2

Adopt all of the following industry proposals.

- Deep water should be defined at 200 meters of water or greater. Water depth should be determined by location of the subsea well or the subsea manifold.
- All subsea production in deepwater moving through a subsea manifold to a surface platform located on a lease not adjacent to the producing lease or unit should qualify for the allowance. The transportation allowance should be granted for costs incurred after production enters the subsea manifold.
- Production from subsea "daisy-chain" wells that flow to a platform on a lease not adjacent to the producing lease or unit should also qualify for the allowance.
- Deepwater production from a single well that flows to a surface platform located on a lease not adjacent to the producing lease or unit should also qualify for the allowance.
- Marketable condition and facility measurement point for deepwater subsea should not be determinative of transportation qualification. In the deepwater subsea environment, movement to a non-adjacent lease should be dispositive.
- Direction of movement and pipeline size should not be determinative.
- Additional subsea transportation allowances should be considered on a case-by-case basis.
- Deepwater production (whether produced from a subsea well or not) moving from a surface structure to a host facility not adjacent to the lease or unit where the surface structure is located should also qualify for a safe-harbor allowance.

Pros

- Provides industry with significant allowances.
- Incorporates Exxon Grand Isle as standard policy for deepwater production..
- Simplifies gathering/transportation determination process.

Cons

- Additional guidance required.
- Reduction in royalties.
- Expands allowances to include movement of non-royalty bearing substances.

Option 3

Permit an allowance for transportation of deepwater production when the following conditions are met.

- Deepwater defined at 200 meters.
- Production moved from producing lease to a facility not on an adjacent lease. An adjacent lease is defined as any lease with at least one point of contact with the producing lease. Typically, there are eight adjacent leases.
- All subsea production in deepwater moving to a surface platform located on a lease not adjacent to the producing lease or unit should qualify for the allowance. The movement may be through a subsea manifold, from a single well, or from multiple wells connected in series. The allowance is only for production movement beyond the last point at which production is commingled.
- The costs of movement must be allocated between royalty bearing and non-royalty

bearing substances.

- Allowance rates will be calculated in accordance with the current regulations regarding non-arm's-length transportation.
- Additional subsea transportation allowances should be considered on a case-by-case basis.

Pros

- Provides industry with an allowance for deepwater subsea production that is moved significant distances.
- Simplifies gathering/transportation determination process.

Cons

- Requires additional guidance.
- Reduces royalties.
- Increased workload due to monitoring/auditing allowances.
- Increase in industry workload in calculating allowances.

Recommendation

Option 4 - Any

Case-by-case

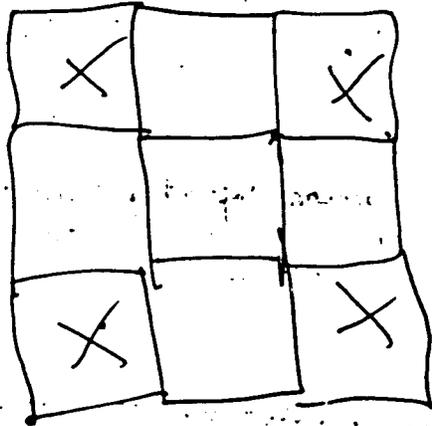
- subsea wells on shelf
- movement of bulk to not adjacent lease

Optional case-by-case

Movement of bulk from deepwater surface facility

Concerns

- How to prevent expansion to onshore?
 - Deepwater
 - New technology? no
- Do not get into onlease/offlease allocations.
- Last point of comingling of bulk production
- Lease ad unit are treated the same
- Calculation of allowance - NAI ad AL (just like current regs)



Subsea/Deep Water Gathering/Transportation

Talking Points - March 26, 1999 QC Meeting

Background

Appeal Cases - CNG primarily instigated review
Team - RMP, PMI, OMM (New Orleans & Herndon)
Issue document
Number of subsea wells 27 (11 deepwater)
Significant decisions
Exxon - Grand Isle (relevant matters)

Industry Input - Federal Register Notice
New Orleans (November 16, 1998)
Criteria Requested
Comments summarized

Options

- 1) Continue with current policy using FMP and marketable condition as primary criteria
Common to options 2, 3, and 4
Deepwater defined at 200 meters
Production moved to facility not on an adjacent lease
Case-by-case
- 2) Industry Proposal
All subsea production qualifies for safe harbor allowance.
Bulk production
Any deepwater production moving from surface structure to facility on non-adjacent lease qualifies
- 3) Modified Option 2
Allocate allowance between royalty bearing and non-royalty bearing substances
- 4) Any deepwater production qualifies
Allocate allowance between royalty bearing and non-royalty bearing substances

Summary of Votes

Option 1 - 1 vote (PMI Appeals)
Option 2 - Uncounted industry support
Option 3 - 2 votes (Debbie GT, Eric Primeaux - modified, no water depth specification)
Option 4 - 3 known supporters (Jim M., Dave H., Marty G.) And Solicitor has stated could support Option 4

Considerations

The following are factors to consider when making a choice between options.

- The policy should be unique to deep water production. Industry's argument that

TALKING POINTS

Deep Water Transportation Allowances

- The 1988 regulations did not anticipate the significant expansion of oil and gas development into water depths exceeding 200 meters. This decision provides guidance for interpretation of MMS regulations by energy companies, MMS auditors, and MMS valuation personnel.
- Oil and gas companies will be allowed to deduct the costs of transporting the royalty bearing components of the bulk production stream downstream of the central accumulation or treatment point. Companies have never been allowed to deduct the costs of moving the non-royalty bearing components (basic sediment and water - BS&W) of the bulk production stream. Gathering - the movement of bulk production to a central accumulation or treatment point - still exists. Gathering costs are the responsibility of the lessee.
- The guidance applies only to production from deep water (>200 meters) Outer Continental Shelf leases. By limiting the guidance to deep water only, the adjacent state's revenues are not affected.
- The MMS consulted with its industry constituents in order to reach an equitable solution. Industry comments consistently recommended limiting the allowance to water depths greater than 200 meters, and movement to a point farther than a location on an adjacent lease.
- The decision is consistent with prior MMS decisions. The MMS previously permitted Exxon an allowance for the movement of the royalty bearing portion of a bulk oil stream in the Grand Isle area.
- The guidance resolves a contentious issue and will save MMS legal resources. The appeal submitted by CNG Producing can be decided. Probable appeals by Shell in either the Mars or Ursa projects will likely not occur.
- The guidance promotes deep water development for leases issued in the post deep water royalty rate reduction era. The decision has a negligible, if any, impact on leases issued under the provisions of the OCS Deep Water Royalty Relief Act (Act). Most of these leases will never pay any royalties due to the minimum volumes of production not subject to royalty prescribed in the Act.
- The decision applies to all types of deep water development technologies (subsea wells, tension-leg platforms, etc.) And newer technologies as they become available. Oil and gas companies can make deep water development decisions without the royalty impacts.

if the production weren't in deep water, a more conventional method (platform) would be employed, and an allowance would be appropriate is persuasive. The use of new technology as a justification provides a potential argument for expanding the policy to production in water depths less than 200 meters, and even to onshore.

- FERC issued a Declaratory Order in Docket No. CP96-113-000 on March 13, 1996. In that Order, FERC stated:
 - “ In a policy statement issued on February 28, 1996, 26/ the Commission concluded that it will retain the existing “primary function” test to determine the jurisdictional status of natural gas pipeline facilities in shallower waters on the OCS. In addition, the Commission concluded that a further refinement of the “primary function” test is necessary for facilities that are constructed to access new deep water production areas. Specifically, the Commission established a presumption that new facilities that are designed to collect gas produced in water depths of 200 meters or greater qualify as gathering facilities up to the point or points of potential interconnection with the interstate pipeline grid.”
- Leases and units should be treated synonymously.
- By making it clear that transportation begins downstream of “the last point of commingling” (e.g. the last well in a series of connected wells), MMS doesn't begin sharing in gathering costs, which have always been the responsibility of the lessee. Additionally, the allowance is for the movement of production from that point forward, there should be no reduction in the allowance for the portion that occurs on the lease/unit.
- Most transportation will be non-arm's-length. However, the MMS should accept transportation costs (whether arm's-length or non-arm's-length) determined in accordance with the existing regulations.