Leasing Activities Information

MMS U.S. Department of the Interior
Minerals Management Service
Alaska OCS Region

Royalty Suspension Provisions
For Oil and Gas Production
Cook Inlet Oil and Gas Lease Sale 191

In accordance with applicable regulations at 30 CFR Part 260, the following royalty suspension provisions apply to each lease issued as a result of Cook Inlet Oil and Gas Lease Sale 191.

These Royalty Suspension Provisions apply to initial volumes of Oil and Gas Production from each lease awarded in OCS Lease Sale 191. In addition, refer to 30 CFR 218.151 and applicable parts of 260.120-260.124 for regulations on royalty suspensions and rental obligations that also will apply to your lease.

1) A royalty suspension volume (RSV) of 30 million barrels of oil equivalent (30 MMBOE) will apply to initial volumes of oil and gas production from each lease. Oil and gas production are combined in the RSV allowance. Gas RSV is calculated on a volume basis (30 MMbbl = 168.6 Bcf). Until the RSV allowance has been fully exhausted, rental payments will be required in those quarterly and yearly periods during which no royalty is due. Upon reaching the RSV limit of 30 MMBOE, royalty will be due on future production and rental payments will cease. Royalty suspensions for oil are subject to price thresholds which apply to all leases. The following price thresholds (both floor and ceiling) apply to oil production for each lease issued. Price thresholds do not apply to gas. The price thresholds have been revised from the proposed NOS to be consistent with both current and expected future market oil prices. The price thresholds are:

Product	Price Thresholds	
	Floor (not adjusted for inflation)	Ceiling - 2004$ (adjusted for inflation)
Oil (per bbl)	$21.00	$39.00
Gas (per MMbtu)	Not Applicable	Not Applicable

2) The lessee of each lease must pay royalty on production of oil that might otherwise receive royalty relief (in 30 CFR Part 260) for any calendar year during which the actual NYMEX annual price of oil exceeds the "ceiling" price threshold (adjusted for inflation) for oil in that year. Such production will be deducted from the remaining RSV. The actual NYMEX

annual price of oil is defined as the arithmetic average of the daily closing prices for the **"nearby delivery month"** on the New York Mercantile Exchange (NYMEX) for oil (light sweet crude) in a calendar year. The actual NYMEX annual price of oil is calculated by averaging the daily closing prices of oil for each month in the year, and then averaging the 12 monthly averages.

a) The ceiling price threshold for oil in any year, say *t*, is determined by inflating the base year 2004 oil price of $39.00 per barrel. This base year price is modified by the percentage change in the implicit price deflator as reported by the U.S. Department of Commerce, Bureau of Economic Analysis, for the interval between 2004 and year *t*, resulting in the adjusted oil price ceiling for year *t*. For example, if the deflator indicates that inflation is 1.6 percent in 2005, then the price ceiling in calendar year 2005 would become $39.62 per barrel for oil. Therefore, royalty on **all** oil production in calendar year 2005 would be due if the 2005 actual NYMEX oil price exceeds $39.62 per barrel. (See exception in item 3 below.)

b) Royalties on oil production, when the actual NYMEX annual price of oil exceeds the ceiling price in any calendar year, must be paid no later than 90 days after the end of that calendar year. (See 30 CFR 260.122(b).) Also, when the actual NYMEX annual price of oil exceeds the ceiling price in any calendar year, royalties on oil production must be provisionally paid in the following calendar year. (See 30 CFR 260.122 (c).)

3) If the actual NYMEX quarterly price of oil is at or below the fixed "floor" price threshold of $21 per barrel (unadjusted for inflation) in any calendar quarter, then production of oil during that calendar quarter, up to the amount of RSV that remained unused at the beginning of the quarter, would be produced royalty free and this production would not count against the lease's remaining RSV. However, if the actual NYMEX quarterly price of oil is at or below the floor price after the RSV has been fully used, the lessee receives no additional royalty-free production.

   a) The actual NYMEX quarterly price of oil is defined as the arithmetic average of the daily closing prices for the **"nearby delivery month"** on the NYMEX for oil in the calendar quarter. The applicable calendar year quarters are January-March, April-June, July-September, and October-December. The actual NYMEX quarterly price of oil is calculated by averaging the daily closing prices of oil for each month in the quarter, and then averaging the 3 monthly averages.

   b) Note that, if the average NYMEX quarterly price of oil is equal to or below the floor price threshold, production of oil for that calendar quarter will not reduce the lease's RSV.

4) The price ceiling and floor provisions in items 2 and 3 above, do not apply beginning with the period (calendar year for the ceiling and quarter of the calendar year for the floor) following the exhaustion of the lease's original RSV amount.

5) Within the same calendar year, the actual NYMEX quarterly price of oil could be equal to or less than the price floor in one or more quarters, but the actual NYMEX annual price of oil

could be greater than the ceiling price. If that were to occur, and the original RSV for the lease has not been exhausted, the consequences of the actual NYMEX annual price of oil exceeding the price ceiling for the year would apply only to oil production during those quarters of the year in which the actual NYMEX quarterly price of oil is above the floor price. For example, assume that oil production from a lease is 8 million barrels in a calendar year, and the actual NYMEX annual price of oil is greater than the ceiling price. Assume further that the production of oil from that lease is 2 million barrels during a quarter of that same calendar year, and the actual NYMEX quarterly price of oil for that quarter is equal to or less than the floor price. In this situation, no royalties would be due on that quarter's oil production, and the remaining RSV for the lease would be unchanged for that quarter. Royalties, however, would be due on the 6 million barrels of oil produced during the other 3 quarters of that year, and the RSV remaining for the lease at the end of the year would be 6 million barrels less than it was at the beginning of the year. Notwithstanding the relationship of the actual price of oil to either floor or ceiling prices thresholds, note that any gas produced during this period will be converted to barrels of oil equivalent volume and subtracted from the remaining RSV.

6) For purposes of the RSV, a Sale 191 lease that is part of an approved unit agreement can only apply allocated production from the unit against the lease's RSV if that lease is included in an approved participating area. The RSV will be applied to each lease consistent with the production allocation schedule approved by the MMS for the participating area. Participating area means all or parts of unit tracts described and designated as a Participating Area under the unit agreement for the purposes of allocating one or more unitized substances produced from a reservoir.

7) A lease must resume paying full royalties on the first day of the month following the month in which the RSV is exhausted.

8) The MMS will provide notice when the actual NYMEX annual price of oil is above the ceiling price threshold, and when the actual NYMEX quarterly price of oil is equal to or below the floor price threshold. Information on actual and threshold oil prices can be found as the MMS website (www.mms.gov/econ).