# Leasing Activities Information

MMS

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

## Royalty Suspension Provisions

## Oil and Gas Lease Sale 202
## Beaufort Sea
## April 18, 2007

In accordance with applicable regulations at 30 CFR 260, the following royalty suspension provisions apply to leases issued as a result of Beaufort Sea Oil and Gas Lease Sale 202. The zones in which blocks are indicated on the Block List and the map included in the Notice of Sale package are available from the MMS Alaska Region office.

**These Royalty Suspension Provisions apply to Oil Production. 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 will apply to your lease.**

1. A lease in the Beaufort Sea, depending on surface area and zone, will receive a royalty suspension volume (RSV) as follows:

| Lease Size Hectares | Zone A Million Barrels RSV | Zone B Million Barrels RSV |
|---|---|---|
| Less than 771 | 10 | 15 |
| 771 to less than 1541 | 20 | 30 |
| 1541 or more | 30 | 45 |

2. The RSV applies only to liquid hydrocarbon production, i.e., oil and condensates. Natural gas volumes that leave the lease are subject to original lease-specified royalties. The market value of natural gas will be determined by MMS's Minerals Revenue Management (MRM) office. The MRM will value the natural gas from Sale 202 based on its potential uses and applicable market characteristics at the time the gas is produced.

3. Each lessee 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 New York Mercantile Exchange (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 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 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, 2.1 percent in 2006, and 2.5 percent in 2007, then the price ceiling in calendar year 2007 would become $41.47 per barrel for oil. Therefore, royalty on **all** oil production in calendar year 2007 would be due if the 2007 actual NYMEX oil price as calculated above exceeds $41.47 per barrel. (See exception in item 5 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)).

4. If the actual NYMEX quarterly price of oil is at or below the fixed "floor" price threshold of $21 per barrel (the price will not be adjusted for inflation) in any calendar quarter, then oil produced during that calendar quarter would be royalty free and 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.

   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.

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 are 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.

6. For purposes of the RSV, a Sale 202 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. Price thresholds apply throughout those periods (calendar year for the ceiling and quarter of the year for the floor) that commence with some RSV remaining unused.

8. A lessee must resume paying full royalties on the first day of the month following the month in which the RSV is exhausted. Lessees do not owe royalties for the remainder of the month in which the RSV is exhausted, unless the actual NYMEX annual price of oil exceeds the ceiling price threshold for that year.

9. The MMS will provide notice when the actual NYMEX annual price of oil is above the ceiling price threshold, or 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 at the MMS website (www.mms.gov/econ).