UNITED STATES DEPARTMENT OF THE INTERIOR
MINERALS MANAGEMENT SERVICE

Appendix II to NTL No. 99-N04

GUIDELINES FOR THE APPLICATION, REVIEW, APPROVAL, AND ADMINISTRATION OF ROYALTY RELIEF FOR END-OF-LIFE LEASES

March 1999

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Recovery of Costs

Under Federal policy and statute, we'll charge you a fee for applying for royalty relief to recover our cost of processing your application. The Administrative Procedures Act (31 U.S.C. 9701) and Office of Management and Budget Circular A-25 require that we recover our costs when we provide services that confer special benefits or privileges to identifiable non-Federal recipients. Processing of applications for royalty relief clearly falls within this mandate.

The Omnibus Appropriations Bill (PL. 104-134, 110 Stat. 13221, April 26, 1996) authorizes our fees. The statute provides "That beginning in fiscal year 1996 and thereafter, fees for the royalty rate relief applications shall be established (and revised as needed) in Notices to Lessees, ... for the costs of administering the royalty rate relief authorized by 43 U.S.C. 1337(a) (3)."

We may issue a revised notice to lessees (NTL), updating NTL 98-5N, to provide more detailed information on the royalty relief application fees and when and how you make payments. Currently, we charge $8,000 to review your application and an additional $12,500 if we decide we need to audit your historical data to confirm that you qualify for relief. We will revise the NTL periodically to reflect our cost experience in administering this program.

OVERVIEW OF GUIDELINES
FOR END-OF-LIFE ROYALTY RELIEF UNDER 30 CFR PART 203

We issued final regulations (30 CFR Part 203) in January 1998 to implement the Outer Continental Shelf Deep Water Royalty Relief Act (Public Law 104-58 (DWRRA)). As part of that rule-making, we simplified and revised the way we implement authority the Secretary of the Interior has under 43 U.S.C. 1337(a)(3)(A) to reduce or eliminate royalties. This authority applies to oil and gas leases anywhere in the Federal Outer Continental Shelf (OCS). Leaseholders who have inadequate revenues to sustain production qualify for royalty relief if we determine that a modification in the royalty arrangement will result in recovery of additional resources.

Affected lessees may apply to the Minerals Management Service (MMS) for a reduced royalty rate by submitting the information specified under the final regulations. The specific data, reports, and spreadsheets in an application are described in supplementary guidelines, issued as an attachment to this Notice to Lessees and Operators (NTL). These supplementary guidelines also explain the procedures we will follow for evaluating applications and implementing royalty relief, and our rationale for excluding selected cost items from consideration.

We advise that you carefully review a copy of these guidelines if you intend to request End-of-Life Royalty Relief. They do not add any requirements to the regulations, but they will help you structure your application so as to expedite our evaluation. Be sure to use the most current version of these guidelines as we will periodically update them to reflect our experience in processing applications.

The NTL, the computer spreadsheet, and these guidelines are available from your regional office or on the MMS website at http://www.mms.gov.

Any collection of information that we mention in these guidelines provides clarification, description, or interpretation of requirements contained in 30 CFR Part 203. The Office of Management and Budget has approved our collection of information required by these regulations and assigned OMB Control Number 1010-0071. These guidelines do not impose additional information collection requirements that would be subject to the Paperwork Reduction Act of 1995.

Dated: March 5, 1999

/s/
Carolita U.Kallaur,
Associate Director for
Offshore Minerals Management

UNITED STATES DEPARTMENT OF THE INTERIOR
MINERALS MANAGEMENT SERVICE

Effective Date: March 5, 1999

Guidelines for the Application, Review, Approval,
and Administration of Royalty Relief for End-of-Life Leases

A. Introduction

These guidelines interpret regulations (30 CFR Part 203.50 through 203.56 and 203.81 through 203.84) which establish the terms and conditions for granting reductions in royalty rates to end-of-life leases under the Outer

Continental Shelf (OCS) Lands Act. This form of relief applies to Federal leases anywhere on the OCS that have meaningful levels of production. Other guidelines interpret regulations for deep water royalty relief.

As with the rule, we have written these guidelines in the "plain English" or conversational style. We (Minerals Management Service) instruct you (applicants, lessees, operators) on how to determine when you qualify for royalty relief and how you apply for it in a way that most efficiently facilitates our review. Also, we explain how we administer relief you may receive.

Guidelines are not strict rules like regulations, so we may deviate from individual elements of them if an applicant makes a convincing argument to do so. We will consider requests for departure from the guidelines only when an applicant provides compelling reasons for deviating from a provision before, or when submitting, a royalty relief application.

For purposes of royalty relief, designated unit operators may act as the applicant on behalf of all lessees (payors). Operators acting as applicants are responsible for assuring that the application contains accurate revenue, royalty, and transportation and processing allowance data on all sales from the lease. When not privy to all actual revenue, royalty and cost allowance data, operators must fully explain how they estimated those amounts and alert all payors that we may require such data and explanation from each one before we can make a final decision on an application.

B. Royalty Rate Reductions - General

Under 43 U.S.C. 1337 (a)(3)(A), we may reduce or eliminate the royalty or net profit share specified for your producing OCS lease to promote increased production. The purpose of royalty relief is to allow you reasonable financial returns so as to increase ultimate resource recovery (e.g., oil, gas, or sulphur) and augment receipts to the Federal Treasury. Therefore, we will modify the royalty rate where sound engineering and economic principles indicate that this change will extend the productive life of your lease.

We use only historic data to determine if you need end-of-life royalty relief. That reliance presumes that you continue to operate your lease in a way that does not significantly alter historical practice. We rely on certain procedures to protect the integrity of a decision based on historic data. If you have recently instituted or plan significant changes to your operation, you should implement such changes and operate for 12 months in your new configuration before seeking to qualify for royalty relief. Otherwise, we will defer action on your application until that circumstance is achieved. Until your application fully reflects the effect of recent significant changes to your operation, we cannot be confident that you need royalty relief to continue operations. We will wait up to 2 years for you to provide updated data reflective of your new configuration. Further, we will terminate your relief if you subsequently do things that we have notified you are significant changes to your operation.

C. Qualifications for Relief

Producing leases that have inadequate revenues to sustain continued production, i.e., end-of-life leases, can apply for royalty relief. The term "lease" refers to either a lease or an approved unit. To qualify for royalty relief, you need to show that your lease satisfies the following production and economic conditions.

1. To be eligible for royalty relief, the rule specifies that your lease must satisfy certain production requirements during a qualification period. By ***production***, we mean the sum of dispositions for oil and gas reported by the operator on MMS-4054 Form (OGOR-B report) to MMS. Under the rule, ***qualification months*** consist of the most recent 12 of the last 15 calendar-months in which you satisfy the following production requirements.

For an oil and gas lease, the production requirement during a *qualifying month* is an average of at least 100 barrels of oil equivalent (BOE) per day. For a non-oil and gas lease, any positive level of production will satisfy the production requirement needed in a *qualifying month*.

To allow for lags in data availability and you time to prepare an application, your 15 month period may end up to 120 days before the date we receive your certified application. Part of your application is an independent opinion from a certified public accountant (CPA). To expedite a CPA review, Attachment 3 outlines the confirmation procedures we believe are necessary for an independent opinion on the reliability of the data in your application.

2. To demonstrate that your lease is becoming uneconomic, the rule specifies that you must show that royalties you paid ***(ROY)*** exceed 75 percent of ***net revenues (NR)*** generated during your qualification months. The clearest way to show this is by substituting your data into the formulas below. Define ***Royalty Share*** (***RS***) as:

$$RS = \frac{ROY}{NR} (100\%) \quad \text{where}$$

ROY is the net royalty that you have paid under the existing royalty arrangement, after determining royalty due and deducting any ***transportation and processing allowances*** (***TPA***) that you are permitted under regulations at 30 CFR 206 and recent precedents.

NR is your net revenues as defined by: $NR = GVP - AC - TPC,$ where

Gross Value of Products (GVP) is gross proceeds all lease owners receive under arm's-length contracts for sale of production in marketable condition. Our Oil and Gas Payor Handbook, Volume III, Product Valuation gives details on how to compute this *GVP* as well as *TPA*.

In cases where a unit operator serves as the applicant on behalf of multiple payors, he must illustrate how he calculated *GVP*, *ROY*, and *TPA* on his part of sales. Integral to that illustration is a careful explanation of the basis for determining the amounts authorized by regulation at 30 CFR 206 and recent precedents. We will compare those amounts attributed to other payors on the lease from operator's calculation with what they actually reported to MMS. Where we find material discrepancies, we will request documented calculations from those payors.

Allowable Costs (AC) is a variable representing the sum of your expenses during the qualification months that are necessary for the continued operation of your lease. We follow the cost accounting structure prescribed for Net Profit Share Leases in 30 CFR 220.011 - 220.015 because it describes actual expenditures that benefit the on-going operation of your lease. Attachment 1 summarizes costs we consider allowable for end-of-life royalty relief qualification.

Generally, you may include expenses for operating and maintaining the existing wells and facilities on your lease and costs for replacement or side track wells completed in the same producing reservoir because these expenses are necessary for full recovery of the resources. With the exception of certain rentals described in Attachment 1, you may not include charges for recovering the capital cost of equipment or reserves (i.e., amortization, depreciation, depletion) because they are development costs not consistent with an end of life circumstance.

If you expend funds to place production in salable condition to obtain the *GVP* used for royalty calculation, you may include expenses for the requisite treatment activities (separation, dehydration, stabilization, etc.) that take place prior to the sales point. If these activities are carried out under an arm's-length contract with a nonaffiliated plant, allowable expenses equal the fees you pay for the treatment activities. Otherwise, we only allow fees in the amount that you can show reflect the actual costs incurred by the affiliated plant in treating

your production. We follow the definition of affiliation (10 percent or more ownership) used in 30 CFR 206.101. Gas plant processing costs for activities designed to remove elements or compounds (hydrocarbon and nonhydrocarbon) from gas, including absorption, adsorption, or refrigeration should be included in the transportation and processing allowance category described below.

You may also include reasonable portions of joint costs which rightfully should be allocated to this lease. Joint costs mean any of the cost items listed in Attachment 1 that benefit this lease and one or more other operations or leases. For instance, costs associated with producing reservoirs or part of reservoirs in State waters from a facility on a Federal lease are generally not allowable costs for Federal royalty relief purposes. However, if the State/Federal parts of the field are unitized, then we may allow the portion of unitized costs allocated to production from the Federal part of the lease. Because some joint costs may be difficult to allocate, we also allow you to assign a 5 percent overhead amount to certain cost items.

As the rule states, we may, in our review and evaluation of your application, disallow certain costs when we consider them to be unnecessary for the ongoing operation of your lease.

Transportation and Processing Costs (TPC) is a variable representing the sum of your reasonable, actual costs for transportation and processing associated with the oil and gas produced from your lease. *TPC* is based on the ***transportation and processing allowance (TPA)*** you are permitted under the regulations at 30 CFR 206 and recent precedents. You should illustrate and explain how you determined the *TPA* shown on the Report of Sales and Royalty Remittance (Form MMS-2014) you submitted during the qualifying period.

The ***TPA*** represents the part of your total *TPC* incurred to handle the lessor (royalty) share of the total product. Your *TPC* should never exceed your *TPA* divided by your royalty rate.

An example helps clarify the calculation for relief qualification.

Suppose $GVP = 100$, $AC = 54$, $TPA = 2$, and the effective royalty rate in the qualifying months is 1/3.

Then, $TPC = 2 / (1/3) = 6$;
$ROY = (1/3) * (100 - 6)$ or $= [(1/3) * 100] - 2 = 31.33$; and
$RS = [31.33/(100 - 54 - 6)] *100$ percent = 78.3 percent

If your actual *TPC* is less than the amount calculated in this way, you should use the actual amount of your costs, with one exception. The exception is that in cases where you have approval of the MMS Royalty Management Program to report a tariff approved by the Federal Energy Regulatory Commission (FERC) in lieu of actual transportation costs, you may claim the part of the tariff associated with the royalty portion of production as the transportation allowance. However, for the remaining non-royalty portion of production, you must count only the reasonable actual costs, as opposed to any imputed costs or tariffs, incurred in transportation of the non-royalty portion of your production.

Processing costs can be claimed only for gas plant products, as defined in the regulations. The processing costs approved by the MMS Royalty Management Program can be claimed as part of the actual costs associated with the royalty portion of gas plant production. For the remaining non-royalty portion of the gas plant products, you must count only the actual costs, as opposed to any imputed costs, incurred in the processing of these products.

D. Form of Relief

Upon qualification, we will reduce the royalty rate to a fixed ***royalty relief rate*** of half of the lease's effective royalty rate, where the ***effective royalty rate*** represents the average royalty rate applied to the gross production

volume during the 12 months included in the qualifying period. You may still claim the *TPA* credit against royalties owed after we grant relief.

If we have given relief to this lease before, the original lease rate may not be the same as the *effective royalty rate*. The following example illustrates how to find your *effective royalty rate* when more than one fixed rate has applied during the qualifying period.

> Suppose that for 4 months production totals 500 (that is, averages 125/month) and one royalty rate (1/6) applies, and for the other 8 months production totals 2,000 while another royalty rate (1/3) applies.
>
> The production-weighted average royalty rate over the qualifying period or the *effective royalty rate* is {[(500 * (1/6)) + (2,000 * (1/3))]/(500 + 2,000)} * 100 percent = 30 percent, so the *royalty relief rate* would be 15 percent.

If you operated under a net revenue share royalty system, you must derive an *effective royalty rate* for each month by dividing royalties owed by well-head value (*GVP* - *TPC*). The following example illustrates how to find your *effective royalty rate* for one month when your royalty was determined by a net revenue or net profit share system.

> Suppose your monthly royalty obligation is 50 percent of *GVP* (of say 3,000) less *TPC* (of say 700) and less an allowable operating cost (of say 920).
>
> Your *effective royalty rate* for the month is {[(0.5 * (3,000 - 700 - 920))]/(3,000 - 700} * 100 percent = 30 percent
>
> The calculation must be repeated for each of the 12 qualifying months and the result for each month weighted by the production volume in the same month. If the production-weighted average of your *effective royalty rates* in all 12 qualifying months worked out to be 30 percent, your *royalty relief rate* would again be 15 percent.

The royalty relief rate will apply to production up to the ***royalty relief volume***. It is equal to the monthly average number of barrels of oil equivalent produced over the 12 months in the qualification period. For natural gas production, 5,620 cubic feet of gas is equivalent to one barrel of oil.

> With the production numbers from the above example, the *royalty relief volume* would be (500 + 2,000)/12 = 208.3.

Any monthly volume of production above and up to 2 times the *royalty relief volume* will bear royalties at 1.5 times the effective royalty rate. Production above 2 times the relief volume amount pays the effective royalty rate. The following illustration continues the example.

> Suppose production reaches 300 in a month after relief is granted.
>
> You would owe royalties on the first 208.3 at a 15 percent rate, while you would owe royalties on the remaining 91.7 at a 45 percent rate (1.5 * 30 percent).

You should compute an average royalty rate each month, which serves as the rate for calculating actual royalties due. You find it by taking the production-weighted average of the rate associated with production up to the relief volume (equal to ½ the *effective royalty rate*), and the rate associated with additional production (equal to 1.5 times the *effective royalty rate* for up to double the *royalty relief volume* and the effective royalty rate for any greater volume). The following illustration completes the example.

The average royalty rate for a month with production of 300 is {[(208.3 * 0.15) + (91.7 * 0.45)]/300} * 100 percent = 24.17 percent.

If production climbs to 420, the average royalty rate is {[(208.3 * 0.15) + (208.3 * 0.45) + (3.4 * 0.3)]} * 100 percent = 30 percent. In effect, the average *relief royalty rate* gradually increases (as monthly production) rises to a cap at the pre-relief *effective royalty rate*.

E. Suspension of Relief

You owe royalties at the *effective royalty rate* on all production during any month in which sweet crude oil and natural gas prices increase by more than 25 percent. You should calculate the increase as the difference between the current weighted 12 calendar-month rolling average of NYMEX (New York Mercantile Exchange) and the weighted 12 calendar-month average of NYMEX prices during your qualification months. The weighting factors for oil and gas are the percentages of your total production provided by each product during the 12 qualifying months. In these cases, the *effective royalty rate* will apply to all your production.

Suppose you produced an average of 3,500 bbls of oil and 2,810 mcf of gas (with 1.1 MMbtu per mcf) per month during your 12 qualifying months. Converting gas to BOE using a factor of 5,620 scf/bbl, your production weighting factors are {3,500/[(3,500 + (2,810/5.62)]} * 100 percent = 87.5 percent oil and 12.5 percent gas.

Suppose over your 12 qualifying months average NYMEX oil prices were $12/bbl and average NYMEX gas prices were $2 per million Btu. Your base price level is ($12 * 0.875) + [(2 * 1.1) * 0.125] = $10.775/BOE. If average NYMEX prices weighted by these factors exceed ($10.775 * 1.25) = $13.47/BOE, you would owe royalties at your pre-relief or effective rate. This happens if the average NYMEX oil price rises to $15/bbl and the average NYMEX gas price rises to $2.50/MMBtu over the same 12 month period. It also would happen if the average NYMEX oil price rose to $15.08/bbl and gas prices remained at $2/MMBtu.

F. Termination of Relief

End-of-Life royalty relief ends in any of three situations.

1. At any time you may renounce, by written notification to the MMS Regional Director for your area, the royalty relief granted under these guidelines. After we acknowledge the change, you will owe royalties at the pre-relief or effective rate as of the next full month when royalties are due.

2. Relief ends when your average royalty rate equals the effective rate for 12 consecutive months. This would happen if prices remain more than 25 percent above their average level in your qualifying months or if your production is double or more the relief volume for 12 consecutive months.

3. We reserve the right in individual cases to specify activities that will end relief because they are not compatible with an end-of-life circumstance. If we choose to reserve this right in your individual case, we will notify you in our letter approving your end-of-life relief what activities are incompatible with continuation of relief and when relief would terminate. Also, we will indicate the terms to which your royalty obligation will revert in the event such activities occur.

G. Withdrawal of Relief

If we find that you provided false or intentionally inaccurate information that was material to our granting you relief, you must pay full royalties and late payment interest determined under 30 U.S.C. 1721 on all production on which you used the royalty relief. You may also be subject to penalties under other provisions of law.

H. Review And Audit

All data you submit in support of the relief application is subject to review and audit.

I. Procedures for Submitting Applications

You should file your application for royalty relief with the MMS Regional Director for your area. Under the rule, your application must contain two reports: (1) Administrative Information; and (2) Net Revenue and Relief Justification. Attachment 2 describes what should be in these reports.

Attachment 3 outlines procedures for an acceptable CPA certification. Attachment 4 illustrates a spreadsheet format you should use in the Net Revenue and Relief Justification Report.

Ordinarily we would not expect the operator and owners who file an application for royalty relief to change while we are evaluating the application. To preserve the integrity of a pending application, we insist that the designated operator remain unchanged until we render a relief decision. However, owners may change during our evaluation period without affecting a pending application. After we have rendered a relief decision, operators as well as owners are free to change without affecting relief we have already granted.

Before you can reapply either for relief after your previously held relief has ended, or for more relief, the rule holds that your lease must have 12 qualifying months under the same royalty or relief terms. When you have had the same royalty terms for 12 qualifying months, you still have to pass the qualifications listed in Section C above.

J. Procedures for Review, Evaluation, And Decision

We will review the royalty relief application for completeness and verify that the data are reasonable. If we determine that you do indeed meet the qualification requirements, then we'll give you royalty relief because it should induce meaningful quantities of incremental production. We will notify you in writing of the *royalty relief volume* amount, the *effective royalty rate*, the threshold average oil and gas price level at which suspension and possible termination of relief occur (for an oil and gas lease), other conditions or clarifications of the arrangement, and the date on which the new terms would begin. Your new arrangement normally would start on the first day of the month following the date we approve your relief.

If your application is incomplete or we decide your data are not reasonable, we will give you the opportunity to submit additional or revised information. If your response cannot clear up our concerns, we will deny your request for royalty relief. If we deny your request, we will explain our decision and rationale to you in writing. We retain the application fee. You may appeal any of our decisions to the Director, MMS, within 30 days, under the provisions of 30 CFR 290.

Attachment 1
Allowable Cost Categories Associated with the Cost Variables
Used to Determine Qualification for Royalty Relief

The text of these guidelines refers to several different cost variables we use to determine your qualification for royalty relief. Each of these variables consist of expenditures associated with several different cost categories. This attachment summarizes categories of allowable cost, drawn from 30 CFR 220.011, and describes what expenditures we view as eligible costs in the respective cost categories. Our companion guidelines on deep water royalty relief includes an almost identical attachment (Attachment C) on allowable costs. *Italics* in this Attachment 1 denote passages which deviate from Attachment C in the other guidelines.

Table 1 - Cost Codes and Categories

Cost Code	Cost Category
100	Labor
200	Material
300	Transportation
400	Contract Services
500	Lessee Owned Rentals
600	Insurance
700	Communications
800	Ecological and Environmental
900	Abandonment
1000	Other Costs
1100	Other Credits

Many of the allowable cost definitions we use for royalty relief are the same as those we allow for Net Profit Share Leases (NPSL). Where the definition of terms is identical, we refer to the corresponding cite in the Code of Federal Regulations. In those instances where the definitions differ, we specify the definition appropriate for royalty relief purposes.

Costs associated with Labor, Material, Abandonment and Other Costs categories are eligible for an overhead allowance of 5 percent, slightly more generous than the share allowed during the relief period in the NPSL regulations at 30 CFR 220.012. Other categories tend to be contract costs which already have an overhead included in them. Joint costs and credits should be allocated to the lease in the same manner as described in the NPSL regulations at 30 CFR 220.014.

There are two basic rules you should follow when making decisions on whether to include particular costs in the application. First, we count and you should submit only costs or portions of costs that you can validate as necessary for the proper conduct of your lease operations.

Second, we don't allow and you should not submit costs for any obligation that *you incurred before the qualifying period. For example, we don't allow amortization or depreciation charges for equipment or facilities you acquired before the qualifying months. You incurred such capital costs because you anticipated being able to recover them without royalty relief.* Likewise we don't allow the costs incurred for the abandonment of pre-existing wells and facilities. These obligations remain regardless of the economic performance of your lease, so they are not relevant to whether you continue to produce on an otherwise profitable lease.

A. Labor (cost code 100) covers:

1. Salaries and wages of field employees, first level supervisors, and technical employees employed in the operation of your lease, in the area of your lease.

2. Salaries and wages of technical employees within technical branches of your organization that may not work in the area of the lease but are working "full time" on some particular technical problem or operations aspect of your lease. Excluded from this category are employees assigned a role in your lease's operations as a duty collateral with other duties that do not directly benefit that lease.

3. Salaries and wages of technical employees within technical branches of your organization who are assigned technical tasks directly related to the operation of your lease provided they are supported by adequate time records showing the nature of the task and the hours spent on the task.

4. Employee benefits allowable according to 30 CFR 220.011(b)(2-6).

5. Overhead allowance up to 5 percent of the sum of the other costs in this category. This, together with the corresponding amounts in items B, I, and J, below is designed to cover your finance, administration, and management activities appropriate for the lease.

B. Material (cost code 200) covers items you purchase or furnish as lease property. We look for the following attributes in costs you claim in this category.

1. You charge or credit material at amounts specified in 30 CFR 220.015. Your purchase and inventorying of material conforms to the conditions and provisions of 30 CFR 220.032.

2. You charge to the lease only such material purchased or furnished as lease property that is consistent with efficient and economical operations. You have not accumulated surplus stocks.

3. You credit to your lease costs for salvaged or returned material.

4. Overhead allowance up to 5 percent of the sum of the other costs in this category.

C. Transportation (cost code 300) covers charges for transportation of employees and material necessary for your lease operations to, from and within the lease area. We look for the following attributes in transportation charges you claim.

1. You only charge transportation costs for material for a distance not greater than the distance from where like material is normally available.

2. You count transportation charges for material shipped from the lease only for lease material and then only to the nearest reliable supply store, barge terminal, or railway receiving point.

3. You do not include expenditures under $200 in transportation charges for material.

D. Contract Services (cost code 400) covers the cost of services and utilities provided to your lease under contract by outside parties and rental charges paid to outside parties for the use of equipment in the lease area in support of lease operations. These services must be provided under an arm's-length contract as defined in 30 CFR 206. Actual costs, rather than fees, for services provided under a non-arm's-length contract must be included in the following cost categories. We look for the following attributes in the costs you claim for contract services.

1. The contract services constitute proper and necessary lease operations or support for lease operations.

2. You charge the contract rate for contract services (including consulting services or contracted technical personnel) established exclusively for the lease.

3. You allocate the cost of contracted services shared among this lease and others pro-rata to the applicable leases.

4. You do not count the costs of contract services for research and development.

E. Rental of Equipment and Facilities Furnished by Lease Owner(s) or affiliated parties (cost code 500) covers the use of equipment and facilities which you acquire *during the qualifying months* that are proper and necessary for lease operations and are not lease property.

1. These may include shore base and offshore facilities, and pipelines from the lease to shore based facilities.

2. The methodology for determining allowable charges for the use of non-lease equipment furnished by the lessee is specified at 30 CFR 220.011(g).

F. Insurance (cost code 600) covers net premiums you pay for insurance you are required to carry for lease operations.

G. Communications (cost code 700) cover the costs of leasing, acquiring, installing, operating, repairing, and maintaining communication systems, including radio, microwave facilities, and computer production controls for lease operations according to the proportion of those costs that are allocable to lease operations.

H. Ecological and Environmental (cost code 800) cover three items.

1. Those costs you incur in the lease area as a result of statutory regulations for archeological and geophysical surveys relative to the identification and protection of cultural resources.

2. Your cost to provide or to have made available pollution containment or removal equipment, including payments to organizations or funds which supply equipment or assistance in the event of oil spills or other environmental damage.

3. Your costs for the actual control and cleanup of oil spills and resulting responsibilities required by applicable laws and regulations except in cases of your negligence or willful misconduct. We don't allow any costs from an incident resulting in civil or criminal penalties.

I. Abandonment (cost code 900) covers three items.

1. We allow costs associated with abandonment of wells *you drilled during the qualification period* but not costs associated with wells existing before *the start of the qualification period*.

2. We allow costs associated with abandonment of a well bore for the purpose of using it to drill into *a producing* reservoir included in the project and with modification of platform equipment for project specific purposes.

3. Overhead allowance up to 5 percent of the sum of the other costs in this category.

J. Other Costs (cost code 1000) covers costs not included above that you incur in the necessary and proper conduct of the lease operation. You should have any costs in this category specifically approved by the Director, MMS, or appropriate delegated authority. You may include an overhead allowance of up to a 5 percent of the other costs in this category.

K. Other Credits (cost code 1100) cover credits to lease operations for:

1. Lease property you lease to or use in non-lease operations,

2. Your sale of information derived from test wells and geological and geophysical surveys, and

3. For any and all amounts earned or otherwise due you as a result of lease operations.

In addition to those costs listed at 30 CFR 220.013, the following costs are not allowable:

1. OCS rental payments on the lease(s) in the application.

2. Damages and losses.

3. Taxes.

4. Any costs associated with activities that are exploratory in nature.

5. Civil or criminal fines or penalties.

6. Royalty relief application fees.

7. Costs associated with prior existing obligations (e.g., royalty overrides or other forms of payment for acquiring a financial position in a lease).

Attachment 2
Reports Required for a Complete Application

The rule specifies that your application must include the following information.

1. **Administrative Information Report** - You use this report to identify your lease or unit and to summarize its background. It includes:

   - Serial number and block designation of your lease, names of the titleholder of record, the lease operator, the identification of whether the lease is part of a unit and description of lease or unit history.

   - Company designation, the API number, location and status of each well that has been drilled on the lease.

   - Full information as to whether you are obligated to pay royalties or payment out of production to anyone other than the United States, the amount to be paid, and your efforts to reduce them.

2. **Net Revenue and Relief Justification Report** - You use this report to summarize your lease or unit's production, revenue and cost history for your qualifying months.

- It consists of a cash flow statement with the following items for each of 12 qualifying months (i.e., those most recent 12 of the last 15 months which had production of at least 100 barrels of oil equivalent per day). Attachment 4 illustrates the spreadsheet format we recommend that you use for your cash flow statement.
  1. All lease production subject to royalty computed in accordance with the lease and applicable regulations.
  2. Total revenues received on all lease production.
  3. Total royalties paid on all lease production.
  4. Allowable costs (using the cost categories identified in Attachment 1).
  5. Total transportation and processing costs allowed under MMS regulations.
  6. Calculation of net income and revenue share.

- The spreadsheet should demonstrate that royalties paid exceed 75 percent of net revenues generated during the qualifying months.

- You must have this report certified by an independent certified public accountant (CPA) expressing any specific reservations or the lack of any reservations about the accuracy of the historical financial information and that the presentation and interpretation of the data elements conform to the MMS guidelines. Attachment 3 describes the essential elements of this CPA certification.

- You should carefully explain any significant variability within a cost variable or category.

Attachment 3
Procedures For Streamlining CPA Certification

The purpose of CPA certification is for an independent expert to confirm that only allowable operating, transportation, and processing costs are used for qualification. Three steps are critical: (1) separating charges incurred on the subject lease(s) from ones incurred elsewhere; (2) identifying and eliminating any charges not allowed under MMS regulations and guidelines; and (3) dividing the remaining operating charges into two parts, those authorized to claim a 5 percent overhead and those not authorized to claim overhead.

The applicant's own accounting system may not match that described in Attachment 1 of the MMS end-of-life Guidelines. When that is the case, the following procedural checks should suffice to certify accuracy of historical financial information and conformity to MMS guidelines.

1. To confirm applicability and accuracy of costs, identify and list other audits performed for the qualifying period used in the application that contain these lease(s) and associated facilities.
    a. If one or more other audits have been performed, review cost structure provided in the application to be sure it is consistent with costs for the application lease(s) shown in the other audits. Identify any inconsistencies.
    b. If no other audits have been performed for the qualifying period, audit a random sample of sub-ledger records for charges assigned to the lease(s). Check invoices for any unusually large or erratic items (e.g., $2 million, or double previous month's level).

2. To confirm inclusion of only allowable costs, determine which categories in the applicant's own accounting system are likely to record charges not allowed under MMS regulations and guidelines (30 CFR 220.013 and Attachment 1 of end-of-life guidelines).
    a. Review cost elements in these categories of the applicant's own accounting system which should record any non-allowed costs. Eliminate charges for any items found to be non-allowable from the amount confirmed in procedure 1 above.
    b. Compare any transportation and processing costs shown in the application with transportation and processing allowances claimed against past royalty payment obligations. Certify that the two figures are consistent.

3. To confirm that only authorized overhead is claimed, allocate cost categories from the applicant's accounting system either to those authorized to charge overhead (labor, material, abandonment, or other as described in Attachment 1) or to those not allowed to (contract services, transportation, rentals, insurance, communications, ecological and environmental). Either of two options may be used to check the size of the overhead subset of allowed costs.
    a. If a majority (>50 percent) of charges in an applicant's cost category fall into MMS categories that are authorized overhead, the whole category of costs is allocated to the overhead subset, otherwise the whole category of costs is allocated to the non-overhead subset.
    b. In each category of the applicant's accounting system, charges authorized overhead may be identified and combined with like charges in the other categories of the applicant's accounting system.

Attachment 4
Spreadsheet Format for Production, Revenue and Cost Data

We urge you to report your data in the format shown on this and the next two pages. You may get a computer (Excel) version of this spreadsheet, which includes formulas to preform the appropriate calculations, from your Regional MMS Director or MMS website at http://www.mms.gov.

Zeros or "ROY/NR" in the following spreadsheet tables indicate cells where formulas calculate values based on entries in the blank cells. Entries in the "Month/Year" column are simply illustrations to be replaced by the qualification period relevant to your application.

End-of-Life Royalty Relief

Relief Qualification Worksheet (page 1)

	Royalties Paid	Gross Value of Production	Allowable Costs	Transportation & Processing Costs	Net Revenue (NR)	Royalty Share
Month/Year	(ROY)	(GVP)	(AC)	(TPC)	(GVP - AC - TPC)	
Jan-98	$0.00	$0	$0	$0	$0	ROY/NR
Feb-98	$0.00	$0	$0	$0	$0	ROY/NR
Mar-98	$0.00	$0	$0	$0	$0	ROY/NR
Apr-98	$0.00	$0	$0	$0	$0	ROY/NR
May-98	$0.00	$0	$0	$0	$0	ROY/NR
Jun-98	$0.00	$0	$0	$0	$0	ROY/NR
Jul-98	$0.00	$0	$0	$0	$0	ROY/NR
Aug-98	$0.00	$0	$0	$0	$0	ROY/NR
Sep-98	$0.00	$0	$0	$0	$0	ROY/NR
Oct-98	$0.00	$0	$0	$0	$0	ROY/NR
Nov-98	$0.00	$0	$0	$0	$0	ROY/NR
Dec-98	$0.00	$0	$0	$0	$0	ROY/NR
12 month total/average	$0	$0	$0	$0	$0	ROY/NR

End-of-Life Royalty Relief

Production/Royalty Summary - All Products by Month/Year (page 2)

Product	Jan-98	Feb-98	Mar-98	Apr-98	May-98	Jun-98	Jul-98	Aug-98	Sep-98	Oct-98	Nov-98	Dec-98
Oil												
Sales Volume												
Sales Value												
Transportation												
Royalties Paid												
Gas												
Sales Volume												
Sales Value												
Transportation												
Royalties Paid												
NGL												
Sales Volume												
Sales Value												
Transportation												
Processing												
Total T&P	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Royalties Paid												
Other Products												
Sales Value												
Total T&P												
Royalties Paid												
All Products												
Sales Value	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total T&P	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Royalties Paid	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0

End-of-Life Royalty Relief

Allowable Costs (page 3)

Code	Category	Jan-98	Feb-98	Mar-98	Apr-98	May-98	Jun-98	Jul-98	Aug-98	Sep-98	Oct-98	Nov-98	Dec-98
100	Labor												
	5% Overhead	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
200	Material												
	5% Overhead	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
300	Transportation												
400	Contract Services												
500	Lessee Owned												
	Rentals												
600	Insurance												
700	Communications												
800	Ecological &												
	Environmental												
900	Abandonment												
	5% Overhead	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
1000	Other Costs												
	5% Overhead	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
1100	Other Credits												
	Total Costs	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0