

lease has earned the royalty suspension supplement.

For a well that falls below specified producibility standards or that we agree is non-commercial and which satisfies the post-drilling administrative requirements, we would then grant the lease a royalty suspension supplement. The supplement takes the form of a specified royalty suspension for use against gas or oil production on, or allocated under an approved unit agreement to, the same lease that occurs on or after the date the lessee files the data confirming failure. A lease-specific process for applying the royalty suspension supplement is the broadest we have legal authority to offer. Proposed § 203.44(b) specifies that we would allow royalty suspension supplements for up to two unsuccessful certified wells per lease (so as not to reduce the incentive to try again after an initial failure). Of the 61 leases in our data base that have been drilled to very deep depths, only one lease had more than two failed wells without having a success. We also would not allow more than one royalty suspension supplement from a single wellbore. For these and other reasons explained below, we are confident that the provision for up to two modest size supplements would not create incentives for incurring costs with only remote possibilities of success.

In § 203.45, we propose prompt use of this royalty suspension supplement, beginning the first day of the month the lessee files data with MMS confirming lack of success. We will allow the lease to retain the supplement if the lease has no other production against which to apply it at the time of this filing. In these cases the royalty suspension supplement is to be used beginning on the first day of the month that lease production starts.

Any royalty suspension supplements earned during the qualifying period up to five years after this rule becomes effective would remain available until used, until forfeited under proposed § 203.44(c), or until the lease expires. As is the case with royalty suspension volumes for deep gas production, these royalty suspension supplements would not override the minimum royalty or rental obligations of the lease and unused portions would be transferable to a successor lessee.

Also, the royalty relief would end as soon as the cumulative qualified production reaches the royalty suspension supplement. This procedure is even more critical in the case of an unsuccessful well than for successful drilling. This is because the royalty suspension supplement is applied to all

of a lease's production. In cases where the cumulative production reaches the royalty suspension supplement early in the month, most of that month's production should pay royalties. Without this timing provision, the cumulative amount of these smaller royalty suspension supplements may be reached early in a month, and all lease production for the remainder of the month would generate an unintended yet relatively large royalty-free windfall to the lessee.

Bounds on Royalty Suspension Supplements

A lessee could earn the royalty suspension supplement only by starting to drill a sub-18,000 foot well on the lease *before* any deep well on the lease produces. We don't propose to offer the royalty suspension supplements after a successful well because following a deep well discovery, the risk associated with further drilling is reduced substantially. We propose to reserve the combined incentive of royalty relief for both successful and unsuccessful wells to lessees that attempt to deepen significantly their productive horizon. For example, drilling a new well to 19,000 feet involves substantially more uncertainty on a lease that only experienced production from a 12,000-foot well than on a lease that already generated production from a 17,000-foot well. Hence, we believe only the former lease requires additional encouragement to drill deeper than 18,000 feet TVD SS, which we would provide in the form of a royalty suspension supplement.

As proposed in § 203.41(c), any royalty suspension volume a lease earns adds to any royalty suspension supplement the lease already has. However, if drilling on a well that ultimately reaches 18,000 feet TVD SS or deeper starts after the lease produces gas or oil from a deep well 15,000 feet TVD SS or deeper, then the lease would not earn any royalty suspension supplement.

Also, a lease could not obtain both a full royalty suspension volume and a full royalty suspension supplement within a single wellbore, as proposed in § 203.41(c). In this situation, the aggregate royalty suspension is unnecessary because another entire well cost is not involved.

Nevertheless, after a well earns a royalty suspension supplement for unsuccessful drilling, economic conditions may improve resulting in deep gas production from the same wellbore. In this case, the lease would receive a royalty suspension volume if the well meets the criteria for a successful qualified deep well. That

means production must begin before five years after the date of the final rule, and the well must be the first deep well to produce gas from the lease. Proposed § 203.44(c)(1) addresses this situation. It is designed to prevent a lessee from "double dipping" in royalty relief. Thus, a lessee would have to subtract any royalty suspension supplement used on other lease production from the royalty suspension volume applied to successful qualified deep gas production from the same wellbore (15 BCF from a 15,000—18,000 feet TVD SS well, and 25 BCF from a well more than 18,000 feet TVD SS). Further, the lessee would forfeit any unused royalty suspension supplement earned from that wellbore.

For example, suppose the lease has used three BCF of a royalty suspension supplement and then produces gas from the same wellbore used to qualify for the royalty suspension supplement under circumstances that qualify the well as a successful qualified deep well. Then, the used three BCF royalty suspension supplement must be subtracted from the royalty suspension volume allowed for the successful qualified deep well and the lease qualifies for a royalty suspension volume of 12 BCF or 22 BCF, depending on the depth of the deep producing well. The remaining unused two BCF of the original royalty suspension supplement is forfeited.

Proposed § 203.44(c)(2) addresses the unusual, though possible, situation in which the following sequence of events occurs:

- (1) An unsuccessful certified well earns a royalty suspension supplement,
- (2) Production from shallower reservoirs on the lease use the royalty suspension supplement,
- (3) A successful qualified deep well through a different wellbore earns a royalty suspension volume,
- (4) The royalty suspension volume exceeds the volume produced from that well, and
- (5) The wellbore originally used to qualify as an unsuccessful certified well later produces.

In that case, the unused royalty suspension volume from the successful qualified deep well could be applied to production from the originally unsuccessful deep wellbore under proposed §§ 203.41 and 203.42. But in some circumstances, that could result in "double dipping" from the originally unsuccessful wellbore.

For example, assume the lessee drills an unsuccessful certified well, and earns the five BCF royalty suspension supplement. Further assume that the entire royalty suspension supplement is