

If we decide to provide royalty relief for deep sidetracks, we have a range of options for doing so. For example, we could offer the proposed royalty suspension volumes to new deep wells and to a subset of new deep sidetracks that meet certain timing or offset distance considerations. We could offer a lower royalty suspension volume than proposed here to all new wells drilled to a given depth. We could offer one royalty suspension volume for new deep wells and another lower or variable (e.g., based on offset distances) for deep sidetracks.

To help us evaluate these and other options, we would like responses to the following questions included in comments:

- To what extent does the absence of royalty relief for sidetracks adversely affect deep depth drilling and distort the choice between the types of wells drilled?

- If a subset of deep sidetracks were to receive a royalty suspension volume:

- Should we limit the incentive to sidetracks that achieve a minimum offset distance? If so, what is the proper minimum offset distance and why is this offset distance appropriate?

- Should we limit the incentive to a sidetrack from a new well that is drilled after the publication date of this proposed rule? Why?

- Should we limit the incentive to a sidetrack from a deep well as opposed to a shallow well? Why?

- Should a single royalty suspension volume be set based on the relative average costs of sidetracked deep wells in comparison to new deep wells?

- What other elements should we consider in determining the royalty suspension volume if we decide to employ different ones for new deep sidetracks and for new deep wells?

- Should the size of the royalty suspension volume vary with the offset distance of a sidetrack or should there be a single volume for deep sidetracks? Why?

- Does the cost of a sidetrack increase per extra foot drilled relative to that of a straight hole?

- Should the royalty suspension volume for sidetracks apply to only the very deep total depths (18,000 feet TVD SS or deeper)? Why?

- Should sidetracks receive the same, different, or no royalty suspension supplement as new wellbores drilled to very deep total depths (18,000 feet TVD SS or deeper)?

- What size supplement would be effective and efficient in the program for drilling unsuccessful sidetrack wells?

- In addition to the API survey, are there any other publicly available sources that offer data on deep sidetrack drilling costs?

#### Auction Mechanism Discussion

MMS would like to solicit comments on an alternative mechanism to allocate royalty relief for existing leases. This approach will not be pursued for this rulemaking, but may be pursued for future allocations. MMS would like to solicit comments on the feasibility of this approach, as well as solicit inputs on alternative approaches to make the allocation of royalty relief more efficient. This approach would seek to allocate approximately the same total royalty relief, but would differ in that not all lessees would receive the same relief, with the objective of encouraging greater levels of overall drilling at lower or comparable Federal cost.

Under this alternative, MMS would allocate royalty relief suspension volumes and supplements as soon as practicable after publishing the final rule. Authorized leaseholders, those with leases awarded prior to 2001, would submit to MMS an offer of the volume of royalty relief they would require to undertake deep well drilling. MMS would rank the offers from the least amount of royalty relief to the greatest, taking into consideration the depth of the wells (15,000–18,000 ft or >18,000 ft). MMS would select the best ranked offers according to a process described below. MMS would then renegotiate the terms of existing leases of the selected leaseholders to provide the royalty relief per their individual offers. The remaining offers—those requiring the largest royalty relief—would not be accepted. For any royalty relief awarded, the leaseholder must begin drilling a deep well within a designated time period.

The cutoff for accepting the ranked offers in this approach would be based on the incremental production MMS estimates the relief will produce and the total Federal cost expended. This would include, for example, the total number of wells MMS expects to produce, the volume of royalty relief provided to each well, the expected number of wells that would not be drilled without royalty relief, the number of bids judged to have been offered by authorized lessees who can claim relief from new drilling activities and who actually intend to drill to deep depths, and the likelihood of drilling success. In using those estimates to determine the pool of accepted offers, MMS would seek to

allocate approximately the same total royalty relief as the preferred alternative.

The eligibility requirements that MMS would apply to the preferred alternative would also apply under this approach. For example, leaseholders that have already drilled successful deep wells before the proposed rule is published would not be eligible for this program. However, leaseholders who first drill a successful deep well after the proposed rule is published would be eligible to receive royalty relief if their bid for royalty relief was accepted. MMS would ask leaseholders to specify in their offers the depth of wells they would drill, and the volume of royalty relief suspension volume they seek on a successful well. Leaseholders would specify separate royalty relief suspension volumes in their submission, one for 15,000–18,000 ft depth and the other for >18,000 ft depth. Leaseholders can also specify a royalty relief supplement for up to two unsuccessful wells in the >18,000 ft depth. The magnitude of the royalty relief supplement per well should not exceed 5 BCF.

This alternative approach may result in added drilling activity and production for lower or the same Federal forgone royalties compared to the preferred alternative, because it encourages lessees who would drill without relief to accept lower relief amounts than they would receive under a fixed allocation system.

There are some unresolved issues with this approach. MMS would like to specifically solicit comments on the following issues:

- (1) What is the risk to the integrity of the auction approach if successful bidders choose not to drill within the specified period and thus inadvertently penalize unsuccessful bidders? What can or should MMS do to minimize this outcome?

- (2) What is a reasonable period of time in which to expect operators to commence drilling after their offer is accepted? Is three years too short of a period?

- (3) Should MMS accept offers in a single sale at the outset of the program, or allocate the relief in a series of sales held over several years?

- (4) How does this approach compare with the preferred alternative in its likelihood of granting relief to those who really need it and those who do not?

- (5) What technical considerations arise in ranking the offers and determining the cutoff for the accepted ones?