

the new leases because their lease terms included deep gas royalty relief. Lessees of older leases had no expectation of royalty relief so their lease bids included no such premium. Allowing new lessees to switch lets those who paid for deep gas royalty relief in their bonus bid choose the more favorable of the two incentives. This switching provision also optimizes the incentive effects of the proposed rule because it will promote more deep gas development by those lessees that choose to switch. Finally, switching enables administrative simplifications when lessees on the same unit choose the same incentive terms. We estimate the aggregate small entity share of the one-time paperwork cost to be proportional to their presence in offshore activity, *i.e.*, 70 percent of \$3500, or about \$2500.

The proposed rule slightly overlaps two regulations applicable to OCS leases. OCS lessees must submit an application for permit to drill (30 CFR 250.414) to the local MMS district office for review, processing, and eventual entry into an agency-wide data base. This application is a more involved submission than the letter required in the proposed rule notifying MMS-PD of intent to commence drilling. We propose to require the simplified but duplicate version of this application because it is a minimal action that provides important lead time for coordinating other MMS actions that may concern the lease. For example, a potential royalty suspension requires adjustment if the subject lease participates in our royalty-in-kind program. OCS lessees must also notify the local MMS district office when production begins on the lease (30 CFR 250.180). If the deep well is not the first production on the lease, the notice required under this rule would not be duplicative. It, also, would be vital to help avoid confusion when a lease has both royalty-bearing and now royalty-free production. Most of the older leases in shallow water have to be in production already as a condition of holding their lease. The proposed notification would be redundant only when the deep well is the first production on the lease. We believe it is simply easier to set this minimal notice burden on the start of all deep production than to create separate notice rules depending on whether a lease has prior production or not. Even when redundant, the notice serves as a useful check on a long-standing routine report.

Significant Alternatives to the Proposed Rule

The Regulatory Flexibility Act requires the agency to consider alternatives to the proposed rule. The paperwork costs are only 1/10th of 1 percent of these benefits and are the minimal necessary to allow the monitoring essential to a consistent administration of a categorical relief program across all participants. The alternative of a case-by-case relief program, where each operator would apply to participate would enormously increase the paperwork burden and associated costs for all participating lessees, both small and large entities. While case-by-case review might reduce forgone royalty, it would add uncertainty about approval and thus discourage new drilling relative to the categorical program. Also, an application process would discourage participation especially by small operators who are unlikely to have the staff needed to assemble and defend an appropriate application.

Alternative forms of the categorical deep gas incentive we considered included: (1) Reduction of royalty rates for production emerging from new deep wells, (2) suspending royalty for a fixed value rather than a volume of new deep production, (3) a royalty suspension volume only for successful deep wells, (4) different royalty suspension volumes, and (5) no incentives. These alternatives are fully discussed in the detailed economic analysis of this regulation and will be available at www.mms.gov/econ. The administrative costs are the same for all the categorical incentive alternatives. Only the benefits are different. The alternative we chose results in the largest benefit to producers and to the small entity share of producers.

A summary discussion of the alternatives is included in the section titled "Details of Proposed Royalty Relief for Deep Gas Production" of this preamble. We chose the incentive form that combines a royalty suspension volume for successful deep gas wells and a royalty suspension supplement for unsuccessful deep wells for three reasons:

- (1) It is large enough to generate substantial deep drilling activity;
- (2) It is the most cost-effective incentive structure for the Government because it does not waste as much relief as alternatives on prospects that will be drilled anyway; and
- (3) It concentrates most of the incentive on the very deep (18,000 feet or deeper subsurface) zones where we

believe most of the undiscovered potential is to be found.

A more detailed explanation of these findings is contained in the economic analysis of this regulatory action. Additionally, this proposed incentive structure also may especially benefit small operators more than the alternative categorical incentive structures mentioned above.

The royalty suspension supplement feature improves the ability of small companies with limited drilling programs to spread their risk. Success on one or two of many deep wells that a large operator drills in a given period can pay the costs incurred for the unsuccessful wells. Small operators may be able to drill only one or two deep wells in a given period. The royalty suspension supplement can reduce the net cost of unsuccessful deep wells immediately, so the small operator does not necessarily have to wait for a deep well success in a later period to offset at least some unsuccessful exploration costs. This is a feature not found in any of the alternative categorical incentive structures which confer royalty relief only on successful wells.

Because of the risk, high cost, and technical complexity, we expect most lessees/operators involved in exploration and development in deep drilling depths of the GOM to be large companies. However, the location eligible for deep gas royalty relief is in shallow water, where we find relatively more small operators compared to those found in deep water. Thus, relatively more of those OCS operators who will benefit from the deep gas incentive in this rule may be in the small business category than those who benefit from deep water royalty relief.

For these reasons we believe this proposed rule is likely to provide at least a proportionate share of its benefits to small businesses. Nevertheless, MMS seeks to understand and address unforeseen impacts of this proposed rule on small businesses. Please provide comment on any or all provision in the proposed rule with respect to its effect on small entities. In particular, pay specific attention to the following sections of the proposed rule and assumptions discussed above:

- The overlapping notice of intent to commence drilling, §§ 203.43(a) and 203.46(a);
- The possibly overlapping notice that deep production has commenced § 203.43(b);
- The requirement to provide seismic and well test information to confirm drilling an unsuccessful well § 203.46(b);