
Leasing Activities Information



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

Royalty Suspension Provisions For Oil and Gas Production Cook Inlet Oil and Gas Lease Sale 191

In accordance with applicable regulations at 30 CFR Part 260, the following royalty suspension provisions apply to each lease issued as a result of Cook Inlet Oil and Gas Lease Sale 191.

These Royalty Suspension Provisions apply to initial volumes of Oil and Gas Production from each lease awarded in OCS Lease Sale 191. 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 also will apply to your lease.

- 1) A royalty suspension volume (RSV) of 30 million barrels of oil equivalent (30 MMbbl-BOE) will apply to initial volumes of oil and gas production from each lease. Oil and gas production are combined in the RSV allowance. Gas RSV is calculated on a volume basis (30 MMbbl-BOE = 168.6 Bcf). Rental payments apply during RSV periods. Royalty suspensions are subject to price thresholds which apply to all leases. The following price thresholds (both floor and ceiling) apply to production for each lease issued. (Oil price is per barrel (bbl); gas price is per million British Thermal Units (mmBTU).)

	Price Thresholds	
	Floor (not adjusted for inflation)	Ceiling – 1994\$ (adjusted for inflation)
Oil (per bbl)	\$18	\$28 (approx. \$34 in 2004)
Gas (per mmBTU)	\$2.25	\$3.50 (approx. \$4.20 in 2004)

- 2) The lessee of each lease must pay royalty on production of oil and/or gas that would otherwise receive royalty suspension relief (in 30 CFR Part 260) and such production will count towards the royalty suspension volume, in any calendar year during which the actual price, defined as the arithmetic average of the daily closing prices for the nearby delivery month on the New York Mercantile Exchange (NYMEX) for production of oil and/or gas, exceeds the adjusted upper product price threshold (or “ceiling price”) for the applicable product.

a) The ceiling price threshold for light sweet crude oil in any year, say t , is determined by inflating an oil price of \$28 per barrel beginning in base year 1994. 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 1994 and year t , resulting in the adjusted oil price ceiling for year t . For example, if the deflator from 1994 through 2004 indicates that inflation totaled 20 percent, then the price ceiling in calendar year 2004 would become \$33.60 per barrel for oil. Royalty on all oil production in calendar year 2004 would be due if the 2004 actual NYMEX oil price exceeded \$33.60 per barrel. Similar adjustments apply to gas.

b) The MMS will provide notice when price ceilings are exceeded. The MMS provides information on price thresholds at the MMS website (www.mms.gov/econ).

c) In cases where the actual price for the applicable product exceeds the ceiling price in any calendar year, royalties on that product must be paid in the following calendar year. (See 30 CFR 260.122 (c).)

3) Fixed floor price thresholds apply to oil and gas, at or below which the applicable product would be produced royalty free and that production would not count against the lease's original RSV. If the arithmetic average of the daily closing oil or gas prices for a quarter of a calendar year is at or below that product's floor price, then production of the applicable product during that calendar quarter, up to the amount of original RSV that remains, would be royalty free and would not count against the lease's remaining original RSV. However, if the arithmetic average of the daily closing oil or gas prices is at or below that product's floor price after the original amount of RSV has been fully used, the lessee receives no additional royalty-free production.

a) The MMS will calculate the actual price, for comparison to the fixed price floor, for a product from the arithmetic average of that product's daily closing prices for the **"nearby delivery month"** on the NYMEX. The period of assessment is a quarter of a calendar year with the calendar year quarters being January-March, April-June, July-September, and October-December.

b) The MMS will provide notice when the average NYMEX quarterly price of an applicable product, for the previous calendar quarter, falls at or below the floor price. If so, then production of such product for the calendar quarter will not reduce the lease's RSV. Information on the floor prices of oil and gas will be available at the MMS website (www.mms.gov/econ).

4) The price ceiling and floor provisions in items 2 and 3 above do not apply beginning with the period applicable to each threshold (calendar year for the ceiling, quarter of the calendar year for the floor) following the one in which the lease's original RSV amount has been exhausted.

5) In any calendar year in which a lease's original RSV has not been exhausted, it is possible that the actual price of one product, e.g., gas, may exceed its ceiling price while the actual price of the other product, e.g., oil, is at or below its ceiling price. In that case, royalties are due on gas production, but no royalties are due on oil production until the lease's original RSV is fully used.

Likewise, it is possible that the actual price of one product may be at or below the floor price while the actual price of the other product is above its floor price. In that case, royalties are due on the production of the product with a price above the floor price, but no royalties are due on production of the product with an actual price at or below its floor price. Further, in this event the production of the product that is not subject to paying royalties does not reduce the lease's remaining RSV.

6) Within a calendar year, quarterly average prices for a product could be equal to or less than the price floor in one or more quarters, but greater than the ceiling price for the full year. If that were to occur, and the lease has not exhausted its original RSV, the consequences of violating the price ceiling for the year would apply only to production during those quarters in which the price floor was not violated. For example, assume that a lease's calendar year oil production is 10 million barrels, and the average oil price for the year is greater than the ceiling price. Assume further that the lease's production of oil is 2 million barrels during a quarter of that same calendar year, and the average oil price 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 lease's remaining RSV at the end of the quarter would be the same as it was at the beginning of the quarter. Royalties would, however, be due on the 8 million barrels of oil produced during the other 3 quarters of that year, and the lease's remaining RSV at the end of the year would be 8 million barrels less than it was at the beginning of the year. A lease is deemed to have exhausted its original RSV on the last day of the month in which cumulative production reaches the original RSV amount.

7) For purposes of the RSV, a Sale 191 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 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.