



United States Department of the Interior



MINERALS MANAGEMENT SERVICE

Royalty Management Program
P.O. Box 173702
Denver, Colorado 80217-3702

IN REPLY REFER TO:

OMB Control Number 1010-0126
Expiration date: July 31, 1999

CVD
MS-3670

FEB 1 1999

Dear Operator:

Our records indicate that your company is the operator or operating-rights owner for at least one Federal oil and gas lease or approved Federal unit agreement on the offshore Texas Outer Continental Shelf within the zone defined and governed by section 8(g) of the Outer Continental Shelf Lands Act of 1953 (OCSLA), 43 U.S.C. 1337(g). The Minerals Management Service (MMS) selected your lease or property as one from which the United States will take its royalty on natural gas production from that lease in kind beginning February 1, 1999 (see attachment). This project is one of MMS's Royalty-In-Kind (RIK) pilot projects.

This letter provides the procedures that you must follow for such RIK properties during the course of this pilot project. Our authority is the OCSLA, at 43 U.S.C. 1353, and the royalty provisions contained in your Federal lease(s). This letter establishes the terms and conditions under which the United States (Lessor) will take natural gas in kind during this pilot project, and under which you, the designated operator or operating-rights owner, as representative of the Lessee or operating-rights owner, must make natural gas taken as royalty-in-kind available to the Lessor or its purchaser or the purchaser's agent. For purposes of this letter, the term "Royalty Gas" means that portion of Federal lease or agreement production equal to the lease royalty rate.

Royalty-in-Kind Applicability

You must make all Royalty Gas available to the Lessor's purchaser or the purchaser's agent for the entire term of this RIK project. The term of this RIK pilot project is from December 1, 1998, through November 30, 2000. You must deliver all Royalty Gas produced from property(s) selected for this RIK project during the project term, including Royalty Gas from newly producing wells on these property(s).

Royalty Gas Delivery

You must deliver Royalty Gas to the Lessor's purchaser or the purchaser's agent at the Delivery Point. The Delivery Point will be the first onshore interstate pipeline interconnect, unless the Lessor designates another point in consultation with you and the Lessor's purchaser or the

purchaser's agent. Generally, the Lessor will attempt to identify delivery points that are acceptable to you and consistent with current transportation arrangements. Title to Royalty Gas passes to the Lessor or its purchaser at the delivery point. You must deliver Royalty Gas to the Lessor's purchaser or the purchaser's agent at the same frequency as it is produced from the property(s). Unless you are otherwise notified, this frequency is assumed to be daily. Royalty Gas must be delivered in marketable condition, which means the condition generally acceptable to purchasers in the field or area. You must perform any necessary gathering, dehydration, separation, compression, desulfurization (sweetening), or other processes currently required to place production in marketable condition under regulations applicable to royalty in value under 30 CFR part 206 (1998) at no cost to the Lessor. Questions regarding potential differences in marketable-condition requirements as between pipelines or purchaser's (including the Lessor's purchaser) should be directed to the Lessor Coordinator at the address and telephone number under "Lessor Point of Contact" on page 6 of this letter.

Reimbursement of Transportation Costs

Actual transportation costs incurred for the delivery of Royalty Gas from the royalty meter to the delivery point will be reimbursed by the Lessor's purchaser or the purchaser's agent. Reimbursable charges for transportation of Royalty Gas should be billed directly to the Lessor's purchaser or the purchaser's agent, with supporting documents, within 30 days following the end of the production months. The Lessor's purchaser or the purchaser's agent will reimburse you within 30 days after receiving notification of transportation costs due.

Fulfillment of Royalty Obligations

You represent and act on behalf of the Lessees and operating-rights owners for their properties. Delivery of the accurate volume of Royalty Gas (taking into account the effects of normal operational imbalances) in accordance with the terms of this letter will satisfy in full the Lessees' royalty obligation to the Lessor. However, the rights, duties, and obligations that currently exist between the Lessor, you, and the Lessee or operating-rights owner for natural gas avoidably lost prior to the Delivery Point under 30 CFR part 202 (1998) remain in effect.

Lessor Obligation to Take

The Lessor through its purchaser or the purchaser's agent will take 100 percent of the Royalty Gas delivered to it at the Delivery Point for the entire term of this RIK pilot project. The Lessor's purchaser or purchaser's agent, through customary industry practice in nominating and scheduling transportation services, will attempt to minimize the occurrence of imbalances with you, as operator. To facilitate timely and accurate delivery of Royalty Gas, the Lessor's purchaser or the purchaser's agent will communicate with you and make arrangements for the delivery and transfer from these properties.

You will incur no penalties if, through no fault of your own, the Lessor's purchaser or the purchaser's agent fails to take 100 percent of the Royalty Gas.

Reporting

You must continue to report natural gas production to MMS under current requirements, formats, and frequencies as specified in MMS regulations and the MMS PAAS Reporter Handbook. You, the Lessees, and the existing payors are not required to report natural gas revenues and values for the RIK pilot properties on the Form MMS-2014 or other similar form for the term of the project, except under the provisions described under “Gross Imbalances and Resolution” and “Imbalances at Project Termination” on page 4 of this letter. **Reporting requirements for production and royalties for any crude oil produced from these RIK pilot properties will not change.**

Communication with Royalty Gas Purchaser/Agent

No later than 10 working days before the first day of each month of the pilot project term, you must notify the Lessor’s purchaser or purchaser’s agent of the daily Royalty Gas volumes and natural gas qualities anticipated for the following month of production. You may change the notification time only with the approval of the purchaser or the purchaser’s agent. The Lessor understands that any such estimate is not a warranty of actual deliveries to be made but is provided to facilitate planning for transportation.

You must use reasonable efforts, consistent with industry practice, to inform the Lessor’s purchaser or the purchaser’s agent regarding significant changes in anticipated or actual natural gas production levels anticipated for pilot project properties. Such communication must occur as soon as practicable after you know of such anticipated or actual changes in production levels. You must notify both the Lessor and the Lessor’s purchaser or the purchaser’s agent in the event of a production shut-in.

Routine Imbalances During the Project Term and Balancing Account

For routine imbalances occurring during any month of the project, you and the Lessor’s purchaser or the purchaser’s agent must arrange for increased or decreased deliveries in the subsequent month to resolve the imbalances as soon as practicable. Imbalances less than 5 percent over or under the true volume of Royalty Gas are considered to be routine. (We expect that variances in production levels will be the cause of most routine imbalances.) The operator will be required to maintain a balancing account to track monthly imbalances between the operator and the Lessor’s purchaser or purchaser’s agent and make such accounting available to the Lessor’s purchaser or the purchaser’s agent in a timeframe agreed to with the Lessor’s purchaser or the purchaser’s agent.

Gross Imbalances and Resolution

Gross imbalances are imbalances that are larger than routine imbalances, which are defined in the previous section. The Lessor reserves the right to resolve gross imbalances by cash payment or adjustment in the delivery of gas in the subsequent month. All cash payments will be based

on MMS regulations at 30 CFR part 206.

Underdeliveries

If the gross imbalance is an underdelivery of Royalty Gas, and if the Lessor elects to take a cash payment in lieu of the Royalty Gas volume not delivered, and if you are the royalty payor for the lease, you must pay MMS the value of the undelivered volumes as determined under 30 CFR part 206. If you are not the royalty payor for the lease, you must notify all Lessees or their respective royalty payors for the lease (1) that a gross imbalance has occurred in an identified production month; (2) of the undelivered volume of Royalty Gas; (3) that the Lessor has elected to take a cash payment in lieu of delivery; and (4) that they must pay MMS the value of the undelivered volumes as determined under 30 CFR part 206. If the Lessor elects to take the undelivered Royalty Gas volume, you must deliver that volume in the production month following the month in which the imbalance occurred unless otherwise agreed to between you and the Lessor and the Lessor's purchaser or the purchaser's agent.

Overdeliveries

If the gross imbalance is an overdelivery of Royalty Gas, and if the Lessor elects a cash payment or a cash adjustment, and if you are the royalty payor for the lease, you may submit a credit for the value of the overdelivered volumes determined under 30 CFR part 206, or request a cash refund in that amount. If you are not the royalty payor for the lease, you must notify all Lessees and their respective royalty payors for the lease that they may either submit credits that total the value of the overdelivered volumes determined under 30 CFR part 206, or request cash refunds that total that amount. If the Lessor elects an adjustment in deliveries, you must reduce the volume delivered in the production month following the month in which the imbalance occurred by the overdelivered volume, unless otherwise agreed to between you and the Lessor and the Lessor's purchaser or the purchaser's agent.

Imbalances at Project Termination

Any imbalance at the termination of the pilot, regardless of whether the imbalance is gross or routine, will be resolved by cash payment or cash adjustment.

(a) If you are the royalty payor for the lease,

(1) you may submit a credit for the value of the net overdelivered volume determined under 30 CFR part 206, or request a cash refund in that amount, or

(2) you must pay MMS the value of the net undelivered volume as determined under 30 CFR part 206.

(b) If you are not the royalty payor for the lease, you must notify all Lessees and their respective royalty payors for the lease that

- (1) they may either submit credits that total the value of the net overdelivered volume determined under 30 CFR part 206, or request cash refunds that total that amount, or
- (2) they must pay MMS the value of the net undelivered volume as determined under 30 CFR part 206.

All cash payments or cash adjustments will be based on MMS regulations at 30 CFR part 206.

Volume Reconciliations

The MMS analysts will reconcile production and revenue reports with additional data, including pipeline data. Reconciliations will involve communication between you, the Lessor, and the Lessor's purchaser or the purchaser's agent. The MMS will conduct such reconciliation separately for each month of the project and will issue final reconciliations to you or to Lessees through orders appealable under 30 CFR parts 243 and 290 (1998).

Natural Gas Liquids

If the natural gas stream contains entrained liquid hydrocarbons that are separated from residue gas by processing, the Lessor may direct you to deliver the dollar value equivalent, as determined under 30 CFR part 206, of those liquids in dry residue gas (methane) in lieu of the Lessor taking extracted liquids in kind.

Interest

The Lessor will pay interest to the appropriate Lessee or operating-rights owner or royalty payor on the value of overdelivered Royalty Gas volumes, under 30 U.S.C. 1721(h) at the rate therein prescribed from the last day of the month in which the overdelivery occurred until the date the overdelivery was corrected or resolved by cash payment or cash adjustment. The Lessee or operating-rights owner or royalty payor must pay interest to MMS on the value of underdelivered volumes under 30 U.S.C. 1721(a) and corresponding regulations at 30 CFR 218.54 at the rate therein prescribed.

Audit Rights

The Lessor may audit your records regarding all information relevant to volumes and qualities of Royalty Gas produced, stored, used on lease, processed, measured, transported, and transferred. Except as noted below, the lessor will not audit your financial records or those of the Lessee of pilot project properties for revenue and valuation information pertinent to RIK properties for the term of this pilot project. However, if you resolve any imbalances through cash payment or cash adjustment (see above), MMS may examine the financial records of Lessees and operating-rights owners of the pilot properties. The MMS also reserves the right to examine transportation expenditures, agreements, royalty valuation data, and other accounts to ensure that amounts reimbursed to you for transportation are accurate.

You, any revenue payors, and the Lessee(s) and operating-rights owners must maintain all records of the types of transactions mentioned in the paragraph immediately above for a period of 6 years from the day on which the relevant transaction occurred unless MMS notifies the record holder of an audit or investigation. When an audit or investigation is underway, records must be maintained until the recordholder is released in writing from the obligation to maintain the records.

Assignability

If operating responsibility changes to another party during the term of this pilot project, all of the rights and responsibilities outlined in this document transfer to the new operator.

Lessor Point of Contact

You should keep on file copies of all correspondence between you and the Lessor's purchaser and the purchaser's agent. Additional information may be obtained from the persons named below, including address, point of contact, and telephone numbers of the Lessor's purchaser and the purchaser's agent by pilot property. Points of contact for the Lessor are as follows:

Lessor Coordinator:

Ms. Anne Ewell

Telephone: 703-787-1584; FAX: 703-787-1093

Reporting Issues:

Mr. Larry Barker

Telephone: 303-231-3157; FAX: 303-231-3189

Electronic Funds Transfer:

Mr. Dave Menard

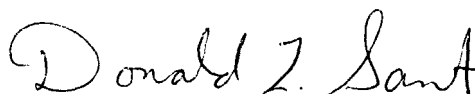
Telephone: 303-231-3574; FAX: 303-231-3501

Operators should communicate with the above points of contact to answer any further questions.

The Paperwork Reduction Act of 1995 requires us to inform you that this information is being collected by the Minerals Management Service to document details of royalty payments and sales of minerals from leases on Federal and Indian lands. We will use this information to

maintain and audit lease accounts, and we estimate the burden for reporting electronically is 2 minutes per line. Comments on the accuracy of this burden estimate or suggestions on reducing this burden should be directed to the Information Collection Clearance Officer, MS 4230, MMS, 1849 C Street, N.W., Washington, DC 20240 and to the Office of Management and Budget, Office of Information and Regulatory Affairs, Attention: Desk Officer for the U.S. Department of the Interior, Washington, DC 20503. Proprietary information submitted to the U.S. Department of the Interior is protected in accordance with standards established by the Federal Oil and Gas Royalty Management Act of 1982 (30 U.S.C. 1733), the Freedom of Information Act (5 U.S.C. 552 (b) (4)), and the Departmental Regulations (43 CFR 2). Storage of such information and access to it is controlled by strict security measures. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

Sincerely,

A handwritten signature in black ink that reads "Donald J. Sant". The signature is written in a cursive style with a large initial "D".

for Lucy Querques Denett
Associate Director for
Royalty Management

Attachment

PROPERTIES SCHEDULED FOR MMS TO TAKE
ROYALTIES-IN-KIND (RIK) BEGINNING FEBRUARY 1, 1999

<u>Block</u>	<u>Lease No.</u>	.
BA377	054-014803-0	
BA399	054-007218-0	
BA412	054-005003-0	
BA436	054-004258-0	
BA437	054-004140-0	
BA491	054-006069-0	
BA452	054-012363-0	
BA453	754-389018-0	
GA211	054-006094-0	