

Dear Operator:

The Minerals Management Service (MMS) selected one or more Gulf of Mexico lease(s) you operate to be included in a Royalty in Kind (RIK) program. We will take natural gas royalties in kind beginning (insert start date). **You, as Operator, must notify the applicable working interest owners of this decision.**

This letter provides procedures and establishes **terms and conditions** under which the United States (Lessor), through MMS, will take royalty gas in kind from offshore leases as defined in the Outer Continental Shelf Lands Act of 1953, 43 U.S.C. 1337(g). MMS authority is the Outer Continental Shelf Lands Act at 43 U.S.C. 1353 and the royalty provisions contained in your Federal lease(s). For purposes of this letter, royalty gas means **daily Federal lease production multiplied by the lease royalty rate**. The Operator and MMS will coordinate and mutually resolve those situations where royalty rates are modified by statute or lease provision.

Term

The Lessor will take all royalty gas from properties listed in the enclosure beginning on (insert start date), and ending on the last day of the month subsequently designated by the Lessor as the date of termination. The Lessor will provide the Operator with a minimum 30-day prior written notice of termination of in-kind status.

Lessor's Designee

At times, the Lessor may act by or through a duly authorized designee. In such event, the Lessor will provide you with prior written notification of the identity of its designee(s) including contact persons. Such notification will include specific duties that will be handled by the designee on behalf of the Lessor. The Lessor will provide written notification to you when the designee changes. You are authorized to communicate with our designee, as specified in the notification. You will not be required to direct ordinary communications to both the Lessor and its designee. **For purposes of this letter, if the Lessor notifies you that it will use a designee, references to the Lessor shall refer to the Lessor's designee.**

The Lessor requires the designee to agree, when acting on behalf of the Lessor, to use industry practice set forth by NAESB and Council of Petroleum Accountants Societies (COPAS) for nominating and scheduling transportation services.

Fulfillment of Royalty Obligations

Delivery of the accurate volume of royalty gas in accordance with terms of this letter will satisfy, in full, the Lessee's royalty obligation to the Lessor. Lessor will take into account the impact of normal industry operational imbalances. However, rights, duties, and obligations currently existing between the Lessor, Lessee, and Operator for natural gas avoidably lost prior to the FMP or gas used on or for the benefit of the lease under 30 CFR part 202 remain in effect.

All rent or minimum royalty obligations on any property in this program remain the responsibility of the Lessee. If MMS believes the Lessee owes minimum royalties, we will issue an appropriate order to pay. The Lessee will have 30 days to review the bill and make payment or appeal the bill.

Lessor Obligation to Take

The Lessor agrees to take 100 percent of the royalty gas delivered ratably daily for the account of the Lessor or its designee at the delivery point. The Lessor, using customary industry practices outlined by the Gas Industry Standards Board (GISB) or North American Energy Standards Board (NAESB) standards and the Council of Petroleum Accountants Societies (COPAS) White Paper on Producer and Operator Roles and Responsibilities for nominating and scheduling transportation services, will exercise its best efforts to minimize the occurrence of imbalances with you and other Lessees. You will use a predetermined allocation equal to the royalty rate when available.

Royalty in Kind Operations

You must deliver all royalty gas to the Lessor from all your wells that are measured at the facility measurement points (FMPs) listed on the enclosure. In addition, you will make reasonable efforts to notify the Lessor of leases that, during the period of in-kind status, begin producing natural gas measured at these FMPs. Royalty on natural gas from your newly producing leases will be added to RIK volumes at existing delivery points upon mutual consent of the Lessor's natural gas designee and Lessor. Lessor will timely notify you whether such new production will be taken in kind and will make reasonable efforts to take in kind all production behind each FMP at which RIK gas is measured.

Royalty gas must be placed in marketable condition at no cost to the Lessor, even if activities required to meet this condition are performed downstream of points where royalty gas is delivered to the Lessor. Marketable condition means the condition generally acceptable to purchasers in the field or area. Questions regarding marketable condition should be directed to the Lessor's Program Coordinator.

If you are also a payor on the referenced property(s), please review your estimated payments. You should recoup the estimated payment if this property(s) is being taken in kind or reduce estimated payment to reflect only the in-value portion. Please be advised that MMS will not pay interest on estimates we consider excessive.

The amount of any flash gas allocable to the lease obtained downstream of the FMP will be included in the adjustments provided for volumetric make-up in the subsequent month as described under "Balancing Account and Imbalances" unless such flash gas is associated with retrograde condensate. Royalty gas delivered to the Lessor includes rights to process royalty gas to extract natural gas liquids.

The Lessor is currently evaluating, by pipeline system, the feasibility of taking retrograde or drip condensate (retrograde) in kind. As we complete the analysis on each pipeline system, we will notify you of the RIK procedures on retrograde for that system. Until that notice, the Lessor will elect not to receive an allocation of retrograde.

Royalty Gas Delivery

The Lessor will take delivery of the royalty gas at the delivery point. The Lessee must deliver, or accomplish delivery of, royalty gas to the Lessor at the delivery point at the same rate as it is produced and transported from the property. Only in the case of normal operational imbalances or subsequent month imbalance adjustments will the Lessee deliver more or less than the royalty share due the Lessor. Unless otherwise agreed, delivery will be assumed to be daily. Lessor does not require you to process royalty gas.

The delivery point for royalty gas produced from the leases is as follows:

- For properties connected to a third party pipeline through producer owned lateral line(s), the delivery point is the downstream terminus of the producer owned lateral line(s).
- For properties directly connected to a third party pipeline, the delivery point is the FMP approved by MMS as the royalty settlement point.

If your records show there is more than one approved FMP for any given property, consult with us and we will designate, in writing, one or more FMP(s) as the delivery point(s).

Communication with Lessor

No later than 5 business days before the first day of each month, you **must notify the Lessor's designee of daily royalty gas volumes anticipated for the following month of production in writing**. The designee understands that any such estimate is not a warranty of actual deliveries to be made but is provided to facilitate planning.

You must also use reasonable efforts, consistent with industry practice, to inform the Lessor regarding significant changes in gas production levels. Such communication must occur as soon as practicable after you know of such anticipated changes in production levels.

Responsibilities for Penalties

To facilitate timely and accurate custody transfer of royalty gas, you will communicate with the Lessor using customary industry practices regarding volumes of royalty gas to be nominated for movement beyond the delivery point(s). The Lessee will pay all transportation-related penalties incurred beyond the delivery point resulting from any failure of the Lessee to make royalty gas volumes available to the Lessor consistent with your communication regarding volumes to be delivered. This does not apply to normal production variances or to emergency operational situations where penalties result despite your reasonable efforts to communicate with the Lessor.

The Lessee will incur no transportation or royalty-related penalties because of the Lessor's failure to nominate or take delivery of gas volumes consistent with your communications.

Operator Assignments

For leases which are being taken in kind and which you are assigning to another Operator, notify the Lessor Program Coordinator of those assignments, the effective date of the assignment, and company that assumed the cumulative imbalance at the time of assignment. Any ending imbalance existing at the effective date of the assignment (Operator change date with MMS) will be cashed out in accordance with one of the methods described below.

Balancing Account and Imbalances (Lease Level Imbalances)

As Operator, you will take timely action to remedy potential imbalances through adjustments to royalty gas volumes delivered to MMS **in the current month**.

Imbalances between delivered and entitled volumes of royalty gas will be jointly monitored by you and MMS. Such volume adjustments will be identified in your communication of royalty gas volumes anticipated before the month of production and **will be taken at constant ratable volumes each day of the succeeding month**.

Requirements for handling routine imbalances are outlined below:

- Imbalances will be determined on the basis of the difference between the royalty share of production and the actual volumes delivered. These imbalances will be maintained at a lease, agreement, or FMP level. All royalty gas, including flash gas, will be balanced at the same level.
- **You, as the Operator, must provide the lease imbalance statement to the Lessor point of contact, as described under “Lessor Point of Contact, Imbalance Statements”, no later than 60 days after the end of the month of production.** Your imbalance statement must specify total production, MMS’ entitled share, volumes delivered, whether quantities are reported in Mcf or MMBtu, Btu content, the pressure base used in measurements, the monthly imbalance, and the cumulative imbalance.

The Operator will remedy imbalances in the production month following the month that the imbalance is identified. Routine imbalances not remedied within 120 days of the end of the production month will be resolved as follows:

- Mutually agreed upon make-up delivery schedule¹, or
- If mutual agreement is not reached, a cash out payment based on the Lessor’s sales price net of transportation costs from the lease for each month of the imbalance. Interest will accrue from the end of the month following the month of production.

In extraordinary imbalance situations, a cash out payment is based on the Lessor’s sales price net of transportation costs from the lease for each month of the imbalance. Interest will accrue from the end of the month following the month of production.

¹ If the agreed upon make-up delivery schedule exceeds 120 days, you must keep proper documentation showing how your production avails for the make-up months were calculated (i.e., the anticipated production plus or minus the agreed upon make-up amount.)

Imbalances remaining upon cessation of the royalty-in-kind term or cessation of production will be settled on the basis of the Lessor's sales price net of transportation costs from the lease for the final month of in-kind delivery. You will report the imbalance volume and value on the Report of Royalty Sales and Remittance (Form MMS-2014) as either a positive or a negative for the final month of delivery. Interest will accrue from the end of the month following the month of production.

Volume Reconciliation

The MMS analysts will monitor and reconcile production and volumes delivered with additional data, including pipeline data. The MMS will attempt to reconcile volumes as soon as practicable. Reconciliation will involve communication between you and the MMS. Upon project termination, you, as the Operator, must issue a final gas imbalance statement. You will settle in accordance with the section "Balancing Account and Imbalances."

Lessor Point of Contact

The Operator should keep copies of all correspondence between Operator and Lessor on file. Points of contact for the Lessor are as follows:

Lessor Program Coordinator:

Ms. Karen K. Johnson
Telephone: 303-231-3335; Fax: 303-231-3846
E-mail: karen.k.johnson@mms.gov

Volume Avails and New Lease Production:

Ms. Karen Bigelow
Telephone: 303-231-3890 Fax: 303-231-3846
E-mail: karen.bigelow@mms.gov

Imbalance Statements:

Fax/E-Mail:
RIK Gas Team
Fax: 303-231-3846 or 303-231-3849
E-mail: rik.gas.team@mms.gov

Regular Mail:
Attention: RIK Gas Team
P.O. Box 25165, MS330B2
Denver, CO 80225-0165

Physical Address (Overnight)

Attention: RIK Gas Team
MS 330B2
Bldg. 85, 6th and Kipling
Denver Federal Center
Denver, CO 80225

Scheduling, Transportation, and Daily Imbalance Issues:

(MMS' gas purchaser assumes all responsibilities of the Lessor for these issues)
(MMS will notify you of its gas purchaser's point of contact)

Electronic Funds Transfer:

Mr. Fred Hampel

Telephone: 303-231-3034; Fax: 303-231-3501

E-mail: fred.hampel@mms.gov

The Lessor acknowledges that you have given proper notice when you communicate with the Lessor using the telephone number, fax number, or email address given above, provided any telephone communication regarding volumes is confirmed by fax or email no later than 1 business day after telephone communication occurs. The Lessor further agrees to make arrangements to receive such communications regarding gas scheduling issues on a 7-day-a-week, 24-hour-a-day basis. Operators and Lessees should communicate with the above points of contact to answer any further questions.

Reporting

You must continue to report natural gas production on the Oil and Gas Operations Report (OGOR) under requirements specified in MMS regulations and the MMS *Minerals Production Reporter Handbook* at <http://www.mrm.mms.gov/ReportingServices/PDFDocs/ProductionHB.pdf>. You will **not** be required to report natural gas information for the leases in this program on the Form MMS-2014 or other similar form for the term during which the Lessor takes royalty in kind, except under provisions described below in this section and under provisions described under "Balancing Account and Imbalances." Reporting and payment requirements for production and royalties for any crude oil or condensate for the leases included in this natural gas royalty-in-kind program will not change. Reporting will not change for leases not included in this program. If you have reporting issues, please see our website at <http://www.mrm.mms.gov/ReportingServices/RepServhome.htm> for a complete list of MRM company representatives and their telephone numbers.

You must report any transportation allowances and any final imbalances on your Form MMS-2014. For delivery points of properties connected to the third party pipeline via a producer owned lateral line, you must report the producer owned lateral line charges as a transportation allowance on your Form MMS-2014. You will report separate entries for the allocated volume and values of transportation costs and final imbalances for each of the lease(s) identified in the enclosure. The payor code you will use for this Form MMS-2014 is your existing applicable code.

Audit Rights

The Lessor may audit your records regarding all information relevant to volumes and qualities of royalty gas produced, stored, used on the lease, measured, delivered, and, if applicable, transported. The MMS reserves the right to examine the financial records of you and the Lessees of the subject properties related to any transportation expenditures incurred prior to the delivery point.

Lessees, Operators, and revenue payors must maintain all records of transactions mentioned in the above paragraph for a period of 7 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 record holder is released in writing from the obligation to maintain the records.

Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*) requires us to inform you that we collect this information to document fulfillment of royalty obligations on minerals removed from leases on Federal lands. This information collection is approved by the Office of Management and Budget and is titled “30 CFR Part 208—Sale of Federal Royalty Oil; Sale of Federal Royalty Gas; and Commercial Contracts (OMB Control Number 1010-0119, expiration date February 28, 2009).” We use this information to maintain and audit lease accounts. Responses are mandatory to obtain a benefit.

Proprietary information 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 Department regulations (43 CFR 2). 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. Public reporting burden is estimated to average 1 hour per response, including the time for reviewing instructions, gathering and maintaining data, and completing and reviewing the data. Direct comments regarding the burden estimate, or any other aspect of this information collection, to the Information Collection Clearance Officer, Minerals Management Service, Mail Stop 4230, 1849 C Street NW, Washington, DC 20240.

Sincerely,

Diane S. Dundee
Manager, Gas Marketing
Royalty in Kind

Enclosure