MINUTE ITEM

10/79
PRC 987.1
Priddy

33. RENEGOTIATION OF ROYALTY RATE STATE OIL AND GAS LEASE PRC 987.1 HUNTINGTON BEACH OIL FIELD

Calendar Item 33., attached, was pulled from the agenda prior to the Meeting.

Attachment: Calendar Item 33. (3 Pages)

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33.

RENEGOTIATION OF ROYALTY RATE STATE OIL AND GAS LEASE PRC 987.1 HUNTINGTON BEACH OIL FIELD

State oil and Gas Lease PRC 987.1 is a one-well lease owned and operated by Ocean Front Oil Company. The well was drilled in 1927 on privately-owned land trespassing into State lands. After court action (State v. Ocean Front Oil Company, Orange County Seperior Court Case No. 454667) and payment of a $5000 fine, the State granted Easement 289 to the operator in 1934. The easement was subsequently renewed in 1954 as State Oil and Gas Lease PRC 987.1.

The royalty formula is price sensitive. The royalty rate from 1959 to the latter part of 1973 was 19% to 23% when the price of oil was between $2 and $3 per barrel. With the recent increase in the price of oil, the royalty rate has increased to 80% - 100%.

In 1972 the 91 Main Zone Unit was formed for the purpose of increasing oil recovery through secondary recovery operations. At that time the State renegotiated royalty rates with well owners that joined in the project. However, the lessee under Lease PRC 987.1 elected not to participate in the project.

The well was initially produced in 1933 at 285 BOPD. By 1956 production had declined to 25 BOPD. Currently the well produces less than 1 BOPD and approximately 1000 barrels of water per day.

Staff has reviewed the status of the well and has determined that the well is in a hazardous condition and is not being operated within good engineering practices. The casing and well head equipment should be pressure tested to determine if any damage has occured due to wear or corrosion. A subsurface safety valve and tubing packer should be installed to prevent uncontrolled flow of oil and salt water from the well in the event of damage to the well head. Additionally production and storage facilities require maintenance and repair.

The lessee has requested that the royalty rate be renegotiated at a lower rate and since September 1973 has paid under protest royalties in the amount of $47,583. The staff has reviewed the request and recommends that the royalty rate

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be adjusted to no less than the rate currently levied on the well-owners that joined the 91 Main Zone Unit. The rate is determined by the following formula:

$$\frac{\text{Posted Price} - \$2.25/\text{bbl}}{\text{Posted Price}} = \%\ \text{Royalty}$$

Application of this formula to the royalties paid under protest for production during the months of September 1973 through March 1979 would result in a refund of $4903. The staff feels that this method of determining the royalty rate is fair and equitable to all parties concerned. However, staff suggests that no refund be made until one of the following conditions has been satisfies:

1. Property abandonment of the well;

2. Equip the well and associated production facilities with safety shut-in equipment and make appropriate repairs as prescribed in the Commission's Procédures for Drilling and Production Operation, increase the bond to cover the cost of properly abandoning the well and provide evidence that the lease is capable of producing oil or gas in paying quantities.

IT IS RECOMMENDED THAT THE COMMISSION AUTHORIZE THE RENEGOTIATION OF THE ROYALTY RATE FOR STATE OIL AND GAS LEASE PRC 987.1 USING THE FOLLOWING ROYALTY FORMULA:

$$\frac{\text{Posted Price} - \$2.25/\text{bbl}}{\text{Posted Price}} = \%\ \text{Royalty}$$

IF THE LESSEE ACCEPTS THE STATES OFFER THE NEW FORMULA WILL BE EFFECTIVE FROM SEPTEMBER 1973 WITH AN APPROPRIATE REFUND TO BE MADE IN ACCORDANCE WITH THAT FORMULA: ALL OTHER CONDITIONS TO REMAIN IN FULL FORCE AND EFFECT. NO REFUND OR ROYALTY SHALL BE MADE UNTIL ONE OF THE FOLLOWING CONDITIONS HAS BEEN SATISFIED:

1. PROPER ABANDONMENT OF THE WELL.

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2. EQUIP THE WELL AND ASSOCIATED PRODUCTION FACILITIES WITH APPROPRIATE REPAIRS AND SAFETY SHUT-IN EQUIPMENT, AND MAKE INCREASE THE BOND TO COVER THE COST OF PROPERLY ABANDONING THE WELL AND PROVIDE EVIDENCE THAT THE LEASE IS CAPABLE OF PRODUCING OIL OR GAS IN PAYING QUANTITIES.