

CALENDAR ITEM

76

A	37	06/22/17 PRC 421.1 PRC 3120.1 PRC 3242.1
S	19	J. Planck S. Blackmon

CONSIDER ACKNOWLEDGEMENT OF THE COMMISSION’S ONGOING ACTIONS TO ENSURE THE SAFETY OF OFFSHORE OIL AND GAS LEASE NOS. PRC 421.1, PRC 3120.1, PRC 3242.1, AND PROVIDE A STATUS UPDATE RELATING TO VENOCO, LLC’S CHAPTER 11 BANKRUPTCY, OFFSHORE SANTA BARBARA COUNTY

INTRODUCTION:

This Staff Report is intended to provide the Commission and the public with a comprehensive chronicle of the events leading to Venoco LLC’s (Venoco) quitclaim of State Oil and Gas Leases PRC’s 421.1, 3120.1 and 3242.1 (collectively the “Leases”), subsequent bankruptcy, and the Commission’s actions to ensure the health and safety of the people of California as well as the integrity and health of California’s offshore ecosystems relating to the decommissioning of Platform Holly and the Ellwood Beach Piers.

BACKGROUND:

In 1964 and 1965, the Commission issued State Oil and Gas Leases PRC 3120 and PRC 3242 to Atlantic Richfield Company (ARCO), after competitive bidding. In 1966, production from the South Ellwood Field began using Platform Holly, subsea pipelines, and the Ellwood Onshore Facility (EOF). The EOF is located on privately owned lands and is not under the Commission’s jurisdiction. Following the 1969 oil spill offshore Santa Barbara, Platform Holly was shut-in until 1974 when production resumed pursuant to an Environmental Impact Report required by the Commission. In 1993, Mobil Exploration and Producing, Inc. (Mobil) acquired the Leases from ARCO. In 1997, Mobil assigned the Leases, including Platform Holly and the Ellwood Beach Piers (Oil and Gas Lease PRC 421), and other facilities to Venoco, which has since operated the facilities. The Ellwood Beach Piers include two wells in the surf zone. In 2013, through the settlement of litigation with Venoco, the Commission negotiated an increase in the surety bond associated with the Leases. The base bond of \$10 million was to be increased by \$4 million per year, reaching a maximum of \$30 million in November of 2018.

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Following the May 19, 2015, Refugio oil spill, Line 901 (owned and operated by the Plains All American Pipeline Company), the primary transportation pipeline for oil and gas products produced along the southern central coast of California, has been out of operation. Venoco, like most other offshore oil and gas producers in the region, ceased oil and gas production operations because there were no viable alternatives to transport their product to market. The result of this prolonged period of nonoperation coupled with the significant decline in oil prices created a situation under which Venoco could not meet its ongoing credit obligations.

On March 18, 2016, Venoco announced that it had reached an agreement with its senior lenders to restructure the company's debt. To facilitate the financial restructuring, Venoco filed a voluntary petition for reorganization, made in the United States Bankruptcy Court for the District of Delaware (Case No: 16-10655), under Chapter 11 of the Bankruptcy Code.

Venoco's decision to restructure under Chapter 11 of the Bankruptcy Code allowed the company's senior lenders to take primary ownership of the company. The three (3) largest lenders included Candlewood Investment Group LP, Apollo Global Management, LLC, and MAST Capital Management. Following the reorganization, Apollo became the owner/operator of Venoco. The existing executive level employees remained unchanged, as did most operations personnel.

During this time Venoco sought an adjustment of the lease boundary of PRC 3242 to encompass a greater amount of the South Ellwood Field, pursuant to Public Resources Code § 6872.5. Venoco filed an application to that end with the Commission and the Commission proceeded to develop an Environmental Impact Report to analyze the proposed project. Venoco's application was never formally considered by the Commission.

In early April 2017 Venoco and Commission staff discussed Venoco's ongoing financial difficulties and the possibility that Venoco was looking at another bankruptcy filing. Given the exigent nature of the information the State Lands Commission convened a Special Meeting on April 4, 2017, so that the Commission could be advised of the potential impacts if Venoco did in fact file for bankruptcy.

On April 12, 2017, Venoco's Chief Operating Officer sent an email to the Commission's Executive Officer stating that "*Venoco sees no economically viable future or market value for these assets, and the Company will soon be unable to continue meeting its obligations under the South Ellwood Field Leases.*" Based on this statement, Commission staff contacted the surety bond company, Aspen-

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Insurance, to begin the process to call on the bond. That process is still unfolding, as discussed below.

On April 13, 2017, Venoco's Board of Directors voted to quitclaim the Leases and to return the Leases to the State on the grounds that the Leases created unsustainable negative cash flow positions that endangered the net value of Venoco's estate in bankruptcy. This course of action shifted liability for plug and abandonment (P&A) and subsequent decommissioning of the offshore leases to the State, with comparable impacts to the local governments for Venoco's onshore facilities. Venoco has other leases with the Commission, including Leases PRC 3904 (Ellwood Marine Terminal, Santa Barbara County), PRC 5515 (Ellwood Pier, City of Goleta), PRC 3150 (Paredon, City of Carpinteria), and PRC 8990 (Inland Gas Lease, near Joice and Grizzly Islands, Solano County). Venoco has only quitclaimed the Leases associated with Platform Holly and the Ellwood Beach Piers. The Commission does not have any ownership or jurisdiction over Venoco's upland assets or facilities, including the EOF in the City of Goleta.

On April 17, 2017, Venoco served the Commission with quitclaims for the Leases. Later the same day, Venoco also filed a voluntary petition with the United States Bankruptcy Court, for the District of Delaware (Case No: 17-10828), under Chapter 11 of the Bankruptcy Code. Venoco anticipates filing a liquidating plan, under Chapter 11, to divest the company of its assets and to address its outstanding debts, before the company's legal dissolution.

In response, Commission staff issued a letter to Venoco identifying their quitclaim as a breach of their lease obligations, a violation of Commission regulations, and reminding Venoco that their obligations to plug, abandon and decommission Platform Holly and the Ellwood Beach Piers survive the quitclaim. Commission staff also notified Venoco that it intended to file a claim against Venoco in the current bankruptcy action for the costs associated with the plug, abandonment and decommissioning costs. Additionally, the Commission issued a Press Release and Fact Sheet to enhance transparency and provide the public with information and context surrounding Venoco's quitclaims and bankruptcy. Commission staff continues to update information to the Commission's website.

On April 19, 2017, Commission staff served Aspen-Insurance, the surety company, with a formal request to release Venoco's \$22 million bond, in favor of the Commission, so that work to secure Platform Holly and the associated facilities could be undertaken. Commission staff is working with Aspen-Insurance to finalize payment to the Commission in fulfillment of the surety's obligations.

It was during this time, in an abundance of caution, that Commission staff began seeking emergency funding to cover the costs of immediate staffing for Platform Holly and its associated facilities in case the Commission did not receive

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payment from the Surety in a timely manner. Commission staff succeeded in securing \$3 million in emergency funding. Additionally, the State's 2017-18 Budget, recently approved by the Legislature and awaiting the Governor's signature, includes funds of up to \$19 million to ensure that any payment needed to cover the startup costs for the P&A work will be available.

Staff's very preliminary estimates include up to \$80 million for ongoing operation/plugging and abandoning work on the 32 wells situated on Platform Holly and at the Ellwood Beach Piers. In addition, staff estimates that it will cost approximately \$12 million for baseline costs for operation of the facilities during the decommissioning of Platform Holly and its associated pipelines, Ellwood Beach Piers and the Ellwood Marine Terminal. It will cost an additional \$33 million to decommission/remove the platform and the Ellwood Beach Piers, including developing an EIR pursuant to CEQA. This brings the total preliminary cost estimate to approximately \$125 million. This cost estimate takes into account the complexity of the 32 offshore wells and includes baseline operation costs, decommissioning of Platform Holly and the Ellwood Beach Piers, the Ellwood Marine Terminal, and the EIR costs.

In addition to the Commission's bond, the Department of Conservation's Division of Oil, Gas and Geothermal Resources (DOGGR) holds two bonds totaling \$1.25 million to cover the P&A of wells. Furthermore, Commission staff believes that Mobil, the prior lessee and assignor, may be liable to cover the costs and obligations associated with Venoco's default under the leases. Commission staff is currently in discussions with Mobil on the extent of their liability. The Commission is also an active participant in Venoco's bankruptcy proceedings as a creditor with claims against the Venoco estate.

DECOMMISSIONING PROCESS:

There are three general phases to the decommissioning process of Platform Holly and the Ellwood Beach Piers, including:

- **Phase 1:** Ensure continuous staffing at Platform Holly and the EOF to provide Commission staff with time to seek qualified engineering firms to P&A the wells on Platform Holly and the Ellwood Beach Piers. This phase should be concluded by July 31, 2017.
- **Phase 2:** Once a contractor is selected, begin the P&A process on the 30 wells on Platform Holly and the 2 wells at the Ellwood Beach Piers. This phase is expected to require roughly 20-36 months, depending on conditions. Once complete Platform Holly and the Ellwood Beach Piers will be rendered largely safe.
- **Phase 3:** The final decommissioning and removal of offshore infrastructure. The specifics for this phase have not yet been developed and is highly dependent on funding, but Commission staff anticipates

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beginning the development of the decommissioning plan in approximately 18 months from the beginning of the P&A process.

Based on Venoco's precarious financial situation and prior to the quitclaim, Commission staff worked to negotiate an agreement with Venoco (Temporary Services Agreement), to ensure that certified operators remain onsite at Platform Holly, Ellwood Beach Piers, and the EOF to ensure the safety of the facilities and the maintenance of Venoco's permit obligations. The agreement effectively began on May 1, 2017. Through the Temporary Services Agreement the Commission has agreed to provide the funds Venoco needs in order to retain staff on the facilities and keep them safe. The original term of the Temporary Services Agreement is until Venoco is transitioned out or June 30, 2017, whichever occurs first. This termination date has since been revised to July 31, 2017 in order for the Commission to solicit and acquire an engineering firm to take over the operations as detailed below. The Temporary Services Agreement provides Commission staff the opportunity to seek a third-party contract to maintain Platform Holly and the time to assess whether any need exists to continue the use of facilities ancillary to the platform.

On May 17, 2017, Commission staff published a Solicitation for Statements of Interest for an "Offshore Oil & Gas Facilities Engineering consultant" perform the engineering, operations and administrative services, to hire or contract essential personnel to continue the safe daily operations of Platform Holly and the EOF at the current baseline conditions. In addition, the selected firm will develop plugging and abandonment plans for the 30 offshore wells on Holly, and for the two near-shore Ellwood Beach Pier wells, and hire the subcontractors to perform the work under the plans (including but not limited to drilling contractors, rental equipment, service companies, water/electric/gas services, hiring of related vessels such as crane barges and equipment barges). Other routine or required inspection services (including but not limited to rig inspection, Level 1 structural inspection, crane inspections, and hydrotesting of pipelines) will also be continued under the consultant. The selected firm must have licensed professional engineers that are familiar and experienced with offshore California oil platforms and associated oil and gas production facilities and who will be responsible for preparing and carrying out the work, supervising any other required ancillary work and other special projects required for the decommissioning process as further described and detailed in the solicitation. Prior work in plugging and abandonment and decommissioning of California offshore oil and gas facilities by the selected consultant firm, and its sub-contractors, is required.

A mandatory meeting relating to the Solicitation for Statements of Interest was held on May 23, 2017. At least twelve integrated engineering companies were

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represented. The proposals are due to the Commission on or before June 19th, and the review of the bids and interviews (of the three highest ranked bidders) will occur thereafter. It is staff's intent to choose the successful bidder and negotiate the primary contract by the first part of July and have the company in place on or before mid-July.

Additionally, a separate Solicitation for Statements of Interest was published on June 5, 2017, to retain a Project Manager for the entire decommissioning project (through the ultimate disposition of Platform Holly), to act as the Commission "Representative" performing project management oversight for all schedule management, administrative functions including contract administration, public relations, conflict resolution, labor and permitting compliance, ensuring all regulations are adhered to, and to direct the prime contractor to cease operations if unsafe operations arise or are observed. The timetable for the selection of this consultant is scheduled on or before the end of July. The firm selected may or may not be the same as the firm selected above for the well plugging and abandonment phase of the project.

Once the P&A work is completed on all of the wells, the ultimate disposition of Platform Holly and other offshore infrastructure will be evaluated under the California Environmental Quality Act as well as the Public Trust Doctrine and will be considered by the Commission at a future properly noticed, public meeting.

OVERVIEW OF PRESENT FACILITIES AND OPERATIONS:

Platform Holly is a drilling and production platform located 1.8 miles off the California coast near the city of Goleta. The platform was installed in 1964 at a water depth of 211 feet, and is supported by steel piles driven into the seabed. The platform consists of a drilling deck, production deck, and mezzanine deck, which serve 30 completed oil and gas wells.

The wells produce hydrogen sulfide gas (H₂S) within the oil and natural gas. Sufficient staffing of Platform Holly and the EOF, with certified H₂S operators, is necessary to draw the gas off the platform and to incinerate it so that the H₂S levels do not reach lethal concentrations. Failure to properly handle H₂S gas can be lethal and operations in and around the platform and the EOF could result in significant harms to public health, including death. Even though the platform production equipment is not operational, the operating systems and safety equipment must be continually manned, serviced, and maintained in a safe and secure condition. Venoco operating personnel are currently performing these functions continually (24 hours a day/7 days a week) through the Temporary Services Agreement with the Commission, described above.

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The drilling rig on the platform was designed and installed specifically for drilling wells from Platform Holly into the Monterey formation. It will be necessary to use this rig for well abandonment operations. All rig structural members and operating components must undergo thorough inspection to determine what repairs will be necessary to conduct safe plugging and abandonment operations on the wells.

Two subsea product pipelines serve platform Holly, consisting of one 6-inch diameter produced oil emulsion line and one 6-inch diameter produced gas line. Two auxiliary utility lines, one used to provide fresh water to the platform also serve the platform. A hydrostatic pressure integrity test of the 6-inch diameter produced oil line will be necessary prior to utilizing the line for oil and well fluid transport during well abandonment operations. A 16.5 kV subsea electric power cable from shore provides power for electrical components on the platform.

The EOF serves to receive, separate, treat, store, and transport all oil, water, and gas produced from platform Holly. The EOF has equipment to separate the oil, water, and gas, as well as to separate and treat the H₂S that is produced, and the equipment necessary to measure and sell and ship the produced oil and gas. The storage capacity of the EOF is approximately 5,000 barrels (210,000 gallons) of oil.

The infrastructure serving the Ellwood Beach Piers consists of two concrete well caissons in the surf zone adjacent to the Sandpiper golf course in the city of Goleta. Each caisson is accessible by a short wooden pier connected to an earthen roadway that is accessed from the EOF. PRC 421 well No. 1 is a water disposal well, and PRC 421 well No. 2 is an oil well completed in the Vaqueros Sand oil reservoir. No production equipment is on the No. 2 well. The wells were shut in in 1994 following an onshore pipeline leak under the nearby golf course.

PUBLIC OUTREACH:

The lease quitclaims by Venoco effectively ends commercial oil and gas production in state waters at this location in the Santa Barbara Channel and returns operational control of these assets to the Commission. California's Coastal Sanctuary Act prohibits the Commission from issuing new offshore oil and gas leases. Additionally, the Commission is sensitive to the significant impact this situation has on Venoco employees and contractors and the local economies of the City of Goleta and Santa Barbara County. Since 1997, Venoco has generated approximately \$160 million in state revenue from royalties and rent, without any significant oil spills on state property. Given the substantial public interest in this situation, the Commission has made public outreach and transparency a top priority.

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Commission staff has been actively engaged in community and statewide outreach on the issues surrounding Venoco's quitclaims and bankruptcy. In addition to the Press Release and Fact Sheet released on April 17, 2017, Commission staff has actively sought opportunities to coordinate with the local communities, local and regional governments, regulatory agencies, state legislative representatives, and non-government organizations.

On April 25, 2017 Commission staff traveled to the City of Goleta and met with representatives from the City of Goleta, the County of Santa Barbara, the Santa Barbara Air Pollution Control District, and the DOGGR. This initial meeting was an opportunity for the affected local government entities to discuss what was happening, to discuss a basis for future cooperation and to open channels of communication that will be critical throughout all phases of work to be done.

On April 26, 2017, the Commission's Executive Officer gave a presentation to the Ocean Protection Council about the situation revolving around Venoco's Leases quitclaim and associated bankruptcy. On May 10, 2017, the Commission's Executive Officer gave a similar presentation to the California Coastal Commission. On May 25, 2017, Commission staff participated in a telephone discussion hosted by the Environmental Defense Center (EDC) and the Environmental Coalition to discuss what had happened and how the Commission was planning to move forward. The call was an excellent opportunity for Commission staff to engage with Santa Barbara's well informed environmental advocacy community as well as staff to local and state lawmakers.

Most recently, Commission staff held a Town Hall meeting in the City of Goleta. The Town Hall meeting was very well attended by local citizens and provided Commission staff an opportunity to respond to a wide variety of questions and laid the foundation for additional community engagement. The Commission maintains a robust and comprehensive webpage that is continuously being updated to include the most recent developments involving the decommissioning of the facilities, Venoco's bankruptcy, and other related matters (<http://www.slc.ca.gov/Info/SouthEllwood.html>).

OTHER PERTINENT INFORMATION:

The Commission's actions, as described in this staff report, are consistent with Strategy 1.1 of the Commission's 2016-2020 Strategic Plan to deliver the highest levels of public health and safety in the protection, preservation and responsible economic use of the lands and resources under the Commission's jurisdiction; Key Action 1.1.4 to identify and abate hazards and associated liability on sovereign and school lands.

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EXHIBIT:

- A. Site and Location Map

RECOMMENDED ACTION:

It is recommended that the Commission acknowledge the following prior authorizations:

- 1) Authorize the Executive Officer, or her staff, to call on Venoco's bonds to ensure that the interests of the State of California are protected.
- 2) Authorize the Executive Officer, or her staff, to enter into all contracts and agreements and take any and all necessary or appropriate action on behalf of the Commission to ensure that the subject Leases [PRC 3120.1, PRC 3242.1, PRC 421.1] are safe and that all lease obligations are met.

EXHIBIT A

State Oil and Gas Leases PRC 3120.1, 3242.1, and 421.1

