MINUTE ITEM

This Calendar Item No. 23 was [illegible] Minute Item No. 23 [illegible] Lands Commission by a vote of 2 to 0 at its 11/30/77 meeting.

11/30/77
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MINUTE ITEM

23. STATUS OF NEGOTIATIONS WITH AMINOIL U.S.A., INC.; OIL AND GAS LEASES; ORANGE COUNTY; W 9938; PRC 425; PRC 426.

During consideration of Informative Calendar Item 23 attached, Mr. Donald J. Everitts, Manager, Energy and Mineral Resources Development, summarized the history of this item and the staff's position and recommendation.

Mr. Joseph H. Loeb, Regional Counsel for Aminoil U.S.A., Inc., appeared voicing Aminoil's objection to the State's compromise offer of a flat secondary royalty rate of 30%. (Mr. C. D. Howald, Division Program Engineer, Aminoil U.S.A., Inc., appeared but did not speak.) He stated that 23% is the maximum Aminoil could offer the State based on the economics of the operation

At the conclusion of the discussion, Acting Chairman Sid McCausland stated it is the intent of the Commission to maximize the State's return from its leases and suggested that the staff and Aminoil continue their negotiations in the hope of reaching a compromise agreement.

Attachment: Calendar Item 23. (2 pages)

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INFORMATIVE
CALENDAR ITEM

11/77
W 9938
Willard

23.

STATUS OF NEGOTIATIONS WITH
AMINOIL USA, INC.

Aminoil USA, Inc., operator of State Oil and Gas Leases PRC 425 and PRC 426, Orange County, has been negotiating with staff since early 1976 for the amendment and unitization of the leases to provide for primary and secondary recovery of oil from Fault Block 28, Jones pool in Huntington Beach offshore field. This pool, although coreholes have been drilled through it, has not yet been produced.

Oil and Gas Leases PRC 425 and PRC 426 require oil royalty payments to the State based on the calculation of graduated royalty rates determined by formula from the rates of production of the wells. The required capital investment and additional operating costs for a secondary recovery waterflood program could not be justified by the lessees if the calculation of graduated royalty rates were also to be applicable to augumented production resulting from a waterflood program.

Section 6830.1 et. seq. of the Public Resources Code provides that the Commission and the lessee under State oil and gas lease may agree to modify the terms of such lease for the purpose of maximizing the recovery of oil and gas through secondary recovery operations.

After a detailed economic evaluation of the proposed primary and secondary development of Fault Block 28, the staff advised Aminoil that a recommendation would be prepared for Commission consideration regarding the amendment and unitization of the leases. The recommendation would have provided that royalties on primary oil would be determined in accordance with the existing lease provisions and that the flat percentage royalty for oil produced during the secondary period would be the weighted average royalty rate of the primary oil plus fifty percent (50%) of the net profits. The staff's position for this recommendation was that the offer provided for maximum oil recovery, while providing an equitable return to the State and the lessees. The net profits concept was designed to (1) provide the most equitable balance of profit distribution to the State and working interests in an area of economic uncertainty, (2) minimize the risk burden to the operator by requiring higher State participation only after the payout of capital

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investment had been assured and (3) maximize on the ultimate recoverable reserves by reducing the gross royalty burden near the economic limit.

Aminoil rejected this offer and the concept of sharing in the net profit, and as an alternative proposed a minimum flat secondary royalty rate of 23%. The minimum "guaranteed" percentage during the secondary period represents the best engineering estimate of the primary rate projections at this time, and as such is the minimum rate required under the statutes.

Following Aminoil's offer the staff made a compromise proposal of a minimum flat secondary royalty rate of 30%. Our data indicated that the gross royalty of 30% provides an economic return to the working interest and the State equivalent to a 23% gross royalty plus 25% of the net profits. Therefore, because it is our position that the maximum oil recovery should be obtained, while providing an equitable return to the State and the lessees, it was further suggested that Aminoil might want to reconsider its position on the net profits concept.

On October 27, 1977, Aminoil advised that the compromise offer was unacceptable. They further advised that the minimum royalty of 23% is the maximum they would offer the State to assure the development of both primary and secondary reserves of Fault Block 28, Jones pool. The alternative, outlined by Aminoil, is to develop the primary production and attempt negotiation of a secondary royalty adjustment, per existing statues, at a later date.

We propose to advise Aminoil that the State remains open to negotiation of an equitable settlement of the royalty difference; and, further, should Aminoil elect to proceed with development of the primary production of Fault Block 28 and negotiate later for a secondary recovery royalty rate adjustment, we would also remain open to discussion of such adjustments on the same bases we had previously proposed.