MINUTE ITEM
This Calendar Item No. 9
was approved as Minute Item
No. 9 by the State Lands
Commission by a vote of 3
to 0 at its 4/27/82
meeting.

W 40185
Trout
Everitts

CALENDAR ITEM

09

SUPPLEMENTAL REPORT TO THE LEGISLATURE ON PROPOSED
OIL AND GAS LEASE SALE PROGRAM
PT. CONCEPTION/PT. ARGUELLO, SANTA BARBARA COUNTY

The Commission is now presented with the opportunity to lease tide and submerged lands in the Pt. Conception/Pt. Arguello area for exploration and possible development of oil and gas. Not since the 1969 blowout of Union's Platform A in federal waters has the Commission considered additional offshore leases. Over the past three years Commission staff has directed a geophysical and geologic exploration program, provided for a geologic hazard/cultural resource survey and contracted for a leasing program Environmental Impact Report.

Resource data from Commission conducted activities together with information and bidding experience in adjacent federal waters have led the staff to conclude that in the 40,000 acre area offshore between Pt. Conception and Pt. Arguello there are sufficient favorable geological conditions and potential hydrocarbon resources to warrant a renewed leasing program. This area includes at least six significant geologic structures.

Ultimately the Commission may make a decision to lease. That decision will follow the EIR process which is now underway, and which is expected to be completed in July. Before that, however, the Commission must review its options and chart a tentative course of action at this time to meet the needs of the Legislative budget committees. For the 1982-83 fiscal year the Commission's budget

(Added 4/27/82)

request contains $425,000 for continuation of the offshore oil and gas development program. Initially, this money was proposed for an exploratory drilling EIR and a site specific geologic hazard/cultural resource study.

In the Legislative Analyst's office review of the budget item recommendation was withheld pending submittal of the Commissions report requested in supplemental budget language the 1981-82 fiscal year. Legislative budget language asked the Commission to report "... on the advantages, disadvantages, costs and benefits of engaging in exploratory drilling or other pre-leasing strategies for offshore oil and gas development. Any needed changes in law should also be presented."

An initial report was prepared on the proposed lease sale in response to the Supplemental Budget language. This report was sent to the Legislature on March 5, 1982. Included in the report was an overview of pre-leasing strategies and alternative bidding systems. However, because the extent of the potential resource was less clearly known than today, no specific discussion could be made about the area or appropriate leasing schemes. Now a more supplemental report has been prepared and is attached as Exhibit "1" to this calendar item.

(Added 4/27/82)

The supplemental report discusses the current market situation for oil and gas, the possible extent of the hydrocarbon resources for several levels of certainty and some methods for leasing. Staff discusses the advantages and disadvantages of the potential leasing methods, illustrates some possible parcelizations appropriate to the bidding formats and suggests some typical revenue impacts for the State.

As mentioned above, staff concludes that the possibility exists for commercial quantities of oil and gas under the land. If the decision is to proceed with a leasing program, the Commission then should consider a number of issues.

Assuming the Commission chooses to conduct a leasing program, it then needs to consider what the goals of such a program would be. Examples of the leasing choices which appear to be available are:

(Added 4/27/82)

1. Maximizing short term income with relatively small annual revenues from production.

2. Maximizing the long revenue stream with no or minimal front end revenue

3. A balanced trade-off of moderate short term up front revenue and a moderate run-of-production revenue stream.

Considerations for revenue have equivalent risk considerations for the State. Early revenue from leasing, that is revenue prior to exploration and production, (as derived from a cash payment "up front") provides little risk to the State and maximum risk for the lessee given the possibility that insufficient hydrocarbon quantities exist for commercial development. In effect, the State may get something for nothing, but because of the attendant risk to the bidder, something less than full value for the resource. In addition, the payment of such a bonus, when no resource is found would, in the long run, not be in the best interest of the people of the State.

Alternatively, the State can assume the full risk of the development. The State can conduct the basic exploration of the apparent geologic structures and thus provide potential lessees with some knowledge of the geology and resources. In this event if no hydrocarbons are found, the State has paid the full cost of exploration with no revenue being obtained. In either case the consumer will

(Added 4/27/82)

ultimately pay for the exploration either through the price of products purchased from a lessee or through the revenue collecting avenues of the State.

Finally, the State can assume a partial risk by using a bid system that requires no "front" money, with the bid factor being some sort of contingency payment (% net-profits, sliding scale royalty, flat royalty). If production occurs, the State will likely receive full value for its resource. If there is no production, the lessee will have assumed the exploration cost, the state will have foregone up-front cash payments. Obviously, there are varying combinations of the foregoing which will temper the attendant effects.

Both the revenue flow decision and the risk decision must be tempered by knowledge available about the quantity of resources which may be present. The greater the likelihood of the resource may be, the more likely that risk is minimal, and the greater the opportunity is for flexibility in revenue option.

Any actual decision to lease or not must await the review process for the Environmental Impact Report prepared pursuant to the California Environmental Quality Act. Hearings on the EIR have been scheduled in Santa Barbara on April 30 and May 15. It is expected that Commission action on the EIR will be calendared for June or July this year.

(Added 4/27/82)

A related issue in the Analyst's Report is management of the new leases if issued by the Commission. The Analysts' office recommended that prior to budget hearings the Commission report on how it proposes to manage the exploration and development of Point Conception. Management of the area will vary according to the lease options selected by the Commission.

Staffing augmentation will be required under any of the lease choices. Depending on the development schedule these staff will be phased in over a number of budgets. The number and type of expertise will vary according to the lease method with more staff required for the net-profits alternative. It should be recognized that this staffing will be required if any exploration is pursued and should be viewed as a commitment by control agencies.

IT IS RECOMMENDED THAT THE COMMISSION

1. Approve the report "Supplemental Report to the Legislature on Proposed Oil and Gas Lease Sale Point Conception/Point Arguello, Santa Barbara County.

2. Authorize its transmittal to the legislature and

3. Request the legislature to provide broad authority to the Commission in implementing an oil and gas leasing program in the best interest of the State.

(Added 4/27/82)