

MINUTE ITEM

This Calendar Item No. 32
approved as Minute Item
No. 32 by the State Lands
Commission by a vote of 3
to 0 at its 12/16/82
meeting.

CALENDAR ITEM

: 52

12/16/82
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Hager

RESOLUTION OF ROYALTY DISPUTE WITH
UNION OIL COMPANY OF CALIFORNIA,
PRC 3303 AND PRC 3413,
HUNTINGTON BEACH FIELD,
ORANGE COUNTY

Under the sliding-scale royalty formula contained in the State's Cunningham-Shell leases, the royalty rate is dependent upon the average production of oil per well per day from the lease lands and varies inversely with the number of producing wells on the lease. Consequently, the rate will be lower when there is a greater number of producing wells. For many years the staff has contested the inclusion by Union Oil Company of California of certain wells in calculating the sliding-scale royalty rate. Union has contended that so long as a well is producing any amount of oil, it qualifies as a producer for inclusion in the sliding-scale calculation. The staff maintained that only economic wells, or those that produce an amount of oil sufficient to pay their direct lifting costs, should be included in the calculation.

Compounding the problem is Union's use on Platform Eva, from which the oil from the leases is produced, of a hydraulic pumping system utilizing crude oil as a power fluid. Power oil is lost from this system and is produced along with whatever oil, if any, is obtained from the reservoir. This makes it impossible to determine whether marginal producers are actually producing economic quantities of oil from the reservoir. Being of the opinion that measuring equipment is incapable of measuring with reasonable accuracy losses

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S 36 (Added 12/14/82)

-1-

CALENDAR PAGE	133
MINUTE PAGE	3377

of power oil of less than five barrels per day, the staff took the position that Union should not include any well in the royalty calculation unless it produces an average of at least five barrels of oil per day. Since October 1978, the staff has demanded that Union pay royalties at the rate calculated under the formula by excluding all wells not producing an average of at least five barrels of oil per day. Union paid under protest the difference between the calculation excluding all wells producing an average of less than five barrels per day and the calculation including all wells producing any amount of oil. This difference is about \$2 million to date.

The staff, working with the Attorney General's office, and Union have reached an agreement that resolves their dispute concerning the inclusion of producing wells in the sliding-scale royalty calculation. The major elements of the agreement are as follows:

1. Union will install on Platform Eva a power water system to replace the power oil system. A power water system poses less risk of harm to persons and to the environment and will eliminate the inability to determine with any degree of accuracy whether a well is actually producing oil from the reservoir.
2. After the power water system is fully installed and operational and for the remaining life of the leases, Union shall calculate the royalty rate under the sliding-scale formula by including for any month only those wells which in that month produce an amount of oil and gas, exclusive royalty, sufficient to pay their direct lifting costs as determined by the State using generally accepted industry accounting practices.
3. The approximately \$2 million paid by Union under protest will be split between the State and Union with the State receiving 75 percent of all such protest payments and Union receiving 25 percent. Interest will follow principal.
4. Royalties due the State between the effective date of the agreement and the installation of the power water system or July 31, 1983, whichever comes first, shall be paid at the rate determined by Union's method of calculation plus 75 percent of the difference between the rate determined by excluding all wells producing an average of less than five barrels per day. In other

(Added 12/14/82)

CALENDAR ITEM NO. 32 (CONTD)

words, the method for sharing the disputed royalties since October 1978 will be continued until the power water system is installed or July 1, 1983, whichever is earlier.

The staff and the Attorney General's office believe that the settlement is reasonable and in the best interests of the State and urge its approval by the Commission.

AB 884: N/A.

IT IS RECOMMENDED THAT THE COMMISSION:

1. APPROVE THE RESOLUTION, AS SET FORTH IN THIS CALENDAR ITEM, OF THE ROYALTY DISPUTE WITH UNION OIL COMPANY OF CALIFORNIA CONCERNING THE INCLUSION OF PRODUCING WELLS IN THE SLIDING-SCALE ROYALTY CALCULATION FOR STATE OIL AND GAS LEASES PRC 3303 AND PRC 3413, AND THAT THE COMMISSION AUTHORIZE THE EXECUTIVE OFFICER TO EXECUTE THE AGREEMENT EFFECTING THIS RESOLUTION.

(Added 12/14/82)

-3-

CALENDAR PAGE	133
MINUTE PAGE	3379