

MINUTE ITEM

36

03/26/87
W 40441
Gonzalez

Union Oil Company

Calendar Item 36 was pulled from the agenda prior to the meeting.

Attachment: Calendar Item 36

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CALENDAR ITEM

36

03/26/87
W 40441
PRC 2879
Gonzalez

APPROVAL OF A FINDING OF DEFAULT
BY THE LESSEE
WITH TERMS OF STATE OIL AND GAS LEASE PRC 2879.1

LESSEE/OPERATOR:

Union Oil Company of California
Attn: J. S. Attebery
District Land Manager
P.O. Box 6176
Ventura, California 93006

AREA, TYPE LAND AND LOCATION:

State Oil and Gas Lease PRC 2879 contains approximately 5,653 acres of tide and submerged land, located south and offshore Point Conception and Government Point, at the western end of the Santa Barbara Channel, Santa Barbara County. (See Exhibit "A").

LEASE SUMMARY:

State Oil and Gas Lease PRC 2879 was issued to Union Oil Company of California on April 26, 1962, and contains a continuous drilling provision of not more than 120 days between wells.

The lease is located in State waters south and east of Point Conception, Santa Barbara County. Exploratory drilling on the lease from 1962 to 1967 resulted in the discovery of at least two hydrocarbon bearing structures, one near shore, the other more than two miles offshore. The near shore, Point Conception field, was developed and is produced from onshore directionally drilled wells. Total production to date from this field is approximately 1.2 million barrels of oil.

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The Point Conception Field consists of six wells with surface locations onshore at two production sites. Four of these wells are completed on PRC 2879.1. One of the four wells, #11-6, is currently producing. Of the three remaining wells, two are shut-in due to low volume production and the third is down because a pump failure. The other two wells in the Point Conception Field are completed on Union's Federal Coast Guard Lease and both are currently shut-in based on a suspension of production granted by the Bureau of Land Management. Production from this field is collected into tanks onsite and then transferred to a barge for transport to the Los Angeles area for processing.

Further offshore is the Cojo Field which has not been produced, however additional drilling in 1983 helped to delineate that field. As a result of that drilling Union as operator, has submitted a plan of development application to develop the Cojo Field oil and gas resources from a drilling and production platform "HAYLEY" to be located approximately 2.75 miles offshore.

The major components of the proposed Cojo project are:

- Platform Hayley with 48 well slots,
- Two subsea pipelines (oil and gas) from the platform to a landfall at Damsite Canyon,
- Two onshore pipelines (oil and gas) from the landfall to the PAPCO/PANGL interconnect point, or a new oil line to Lompoc,
- Subsea power cable between the platform to Gaviota a associated electrical substation and
- Expansion of Union's Lompoc Dehydration Facility if oil is transported to Lompoc.

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Union's application for approval of the Cojo plan of development has not been deemed complete by the State Lands Commission pending further definition of the project.

PRESENT STATUS OF LEASE PRC 2879:

In separate applications, Union has requested SLC consideration of the following lease matters:

1. Reduction of the lease royalty rate to a flat one-sixth (16 2/3%), 2. Suspension of production from the Pt. Conception field of the lease, 3. Suspension of permitting work on the Cojo Project Plan of Development. The details of these applications are as follows:

- A. Union Oil Company of California requests that the current sliding scale royalty formula of State Oil and Gas Lease PRC 2879 be amended to provide for a flat one-sixth (16 2/3 percent) royalty.

The current royalty varies with the production from 16 2/3 percent minimum at zero to 100 barrels per day production to 50 percent maximum royalty at 500 barrels over per day.

On December 5, 1986, representatives of Union met with State Lands staff in Long Beach and presented Union's economic findings in support of their proposal to reduce the royalty payable to the State to a rate which would, Union claims, prevent premature abandonment of the lease and encourage future development of additional reserves.

The economic data demonstrate, according to Union, that continued and new production from PRC 2879.1 is unfeasible under the current royalty formula. Pursuant to California Public Resources Code Section 6827.2, Union, therefore as Lessee of PRC 2879.1, requests that the royalty formula be amended.

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- B. Union states that it has diligently operated the Point Conception Field since 1968, realizing a modest profit until 1985. Union says that the combination of declining production rates, lower oil prices and significant increases in operating expenses has resulted in a net loss to Union for the field of \$117,000 for 1985 and \$316,000 for 1986.

Union also states that an evaluation of the Point Conception Field, using reasonable projected parameters for decline rates, oil price and operating expenses, shows there is no reasonable operating scenario which would yield a future profit for the Point Conception Field operating alone. In the plan that Union has submitted to the State Lands Commission to develop the Cojo Field from proposed Platform Hayley located on the southern one-third of PRC 2879.1, the production from Platform Hayley will be transported to an onshore facility by pipelines.

Future production from the Point Conception Field could be gathered in this Cojo Field pipeline more economically than the current shipping arrangement thereby extending the life of the Point Conception Field.

Union is proposing to suspend production from the Point Conception field until such time that the proposed Cojo Field pipeline is operational or economic conditions for the Point Conception Field standing alone improve to a level which would enable Union to derive a reasonable return therefrom, whichever shall first occur.

- C. On January 5, 1987 Union requested that all application processing of Union's plan of development for the Cojo prospect and Platform Hayley on Lease PRC 2879 be suspended until the State agrees to a

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reduction of the current sliding scale oil and gas royalty to a flat rate (1/6) royalty. Union states that the economics of the Cojo Project must be enhanced by a lease royalty adjustment before the project may continue.

STAFF ANALYSIS: The staff of the State Lands Commission finds that Union is not in compliance with the lease continuous drilling operations clause found in Section B of Exhibit "A" of the subject lease. Whether or not royalty adjustments are being considered or production shut in, Union must abide by the other lease terms and conditions - one of which is the continuous drilling provision of 120 days between wells. While Union was actively pursuing the permitting and environmental studies necessary to implement the Cojo Project Lease Development Plan, the drill string obligation was in suspension. With this application effectively withdrawn by Union, the lease is now subject to the continuous drilling obligation and without an application for further exploratory drilling the staff must recommend that the issue a notice of default pursuant to Section 6 of the lease. Upon written notice of default Union will have ninety (90) days to comply with the drill string obligation.

On May 29, 1980, the State Lands Commission approved Union's application to resume drilling operations on State Oil and Gas Lease PRC 2879. On March 23, 1983, after obtaining approvals from other agencies, Union commenced its exploratory drilling and drilled exploratory well 18-6.

In a letter dated March 9, 1984, Union stated that the data obtained from well 18-6 had been evaluated and a decision made to proceed with the preparation of a plan of development for the Cojo offshore field State Lease PRC 2879; however additional time was needed to prepare the plan. On May 7, 1984, the Commission granted Union a deferment of further drilling until October 25, 1984, to submit a development plan.

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On October 24, 1984, Union submitted a Development Plan to the staff. Pending staff review of the plan, the Commission, on October 25, 1984 granted a deferment of the drilling obligation of the subject lease until December 31, 1984. After preliminary review of the plan and discussion with Union the application was withdrawn to revise the scope of the project. The Commission, consequently on December 20, 1984, granted a three-month deferment until March 31, 1985 to enable Union to continue work on the Development Plan.

The Commission subsequently granted Union a further deferment of the drilling obligation until June 30, 1985, to submit the Cojo Plan of Development. This plan was submitted to the SLC on June 28, 1985. Withdrawal by Union of the Application for approval of the Plan of Development effectively ends any deferral or suspension of the drilling obligation.

In the matter of the request for royalty adjustment, fluctuations in the price of oil do not appear to the staff of State Lands Commission to warrant permanent reduction of the State's royalty formula of this lease. Other temporary measures such as deferment of drilling obligations, payment of compensatory shut-in royalty, further exploratory drilling rather than development of the lease may allow the Lessee to await an improved economic situation. A quitclaim of the lease can relieve the Lessee of further expenditure.

Reductions of the State's royalty share are used to provide economic incentive to a Lessee to perform enhanced oil recovery operations (waterflood) on a producing field requiring substantial capital investment or to allow the prolonging of recovery of oil from nearly depleted reservoirs. However, the royalty reductions are allowable only when there will be a net total gain of revenue to the State.

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ENVIRONMENTAL INFORMATION

Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (14 Cal. Adm. Code 15061), the staff has determined that this activity is exempt from the requirements of the CEQA because it is not a "project" as defined by CEQA and the State CEQA Guidelines.

Authority: P.R.C. 21065 and 14 Cal. Adm. Code 15378.

AB 684: N/A.

EXHIBIT: A. Location Map.

IT IS RECOMMENDED THAT THE COMMISSION:

1. FIND THAT THE ACTIVITY IS EXEMPT FROM THE REQUIREMENTS OF CEQA PURSUANT TO 14 CAL. ADM. CODE 15061 BECAUSE IT IS NOT A PROJECT AS DEFINED BY P.R.C. 21065 AND 14 CAL. ADM. CODE 15378
2. FIND THAT UNION OIL COMPANY OF CALIFORNIA IS IN DEFAULT OF THE TERMS OF STATE OIL AND GAS LEASE PRC 2879.1, IN PARTICULAR, THE REQUIREMENT FOR CONTINUOUS DRILLING OPERATIONS TO BE CONDUCTED ON THE LEASE AS STATED IN SECTION 3 OF EXHIBIT "A" OF THE SUBJECT LEASE.