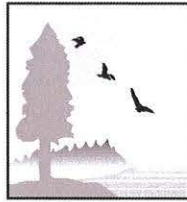


CALIFORNIA STATE LANDS COMMISSION

200 Oceangate, 12th Floor
Long Beach, CA 90802-4331



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JENNIFER LUCCHESI, *Executive Officer*
(916) 574-1800 Fax (916) 574-1810
California Relay Service TDD Phone 1-800-735-2929
from Voice Phone 1-800-735-2922

Contact Phone: (562) 590-5291
Contact Fax: (562) 590-5210

July 28, 2016

File Ref: PRC 145.1
PRC 410.1
PRC 1466.1

Via Electronic & US Mail

smw@greka.com

Ms. Susan Whalen
Sr. VP and General Counsel
Rincon Island Limited Partnership
P.O. Box 5489
Santa Maria, CA 93456

**Subject: State Oil and Gas Lease No.s PRC 145.1, PRC 410.1 and PRC 1466.1 –
Outstanding Violations and Failure to Cure**

Dear Ms. Whalen:

Following a lengthy review of the violations assessed during the joint site inspections of Rincon Island Limited Partnership's (RILP) State Oil and Gas Leases, PRC 145.1, PRC 410.1, and PRC 1466.1 (hereafter Leases), by Commission staff and Division of Oil, Gas, and Geothermal Resources (DOGGR) staff on February 23, 2016, and February 24, 2016, and the joint re-inspections on June 14, 2016, and June 22, 2016, to assess the progress made by RILP in response to the April 11, 2016, Notice of Default, Commission operations and inspection staff have identified a total of 120 outstanding violations that were identified, but not cured. These items have been cataloged throughout the various correspondence and were most recently identified again in Commission staff's July 19, 2016 letter to RILP.

Pursuant to the Default Notice, RILP was given 60 days to take steps to cure the identified defaults. These included critical wellhead violations, the absence of subsurface safety valves, the need for operations manual updates, and the non-working firefighting systems on the island. Additionally, RILP was directed to bring its blanket bond up to \$10.48 million plus a \$400,000 Guaranty, consistent with the November 1, 1995, Amendment to the Leases.¹

¹ Please refer back to the April 11, 2016, Notice of Default for more detail, as needed.

On June 9, 2016, RILP responded to the Commission's Default Notice claiming, among other things, that it had taken good faith steps to remedy the identified defaults, as illustrated by DOGGR's willingness to stay its enforcement order/administrative hearings, and that it was therefore not in default.² However, Commission staff categorically disagrees with RILP's characterization that it has taken good faith steps to remedy the identified defaults and Commission staff has not agreed at any point that RILP's actions constituted good faith steps under the Leases. Commission staff maintains that the bulk of violations corrected by RILP since February are of a housekeeping nature and do not constitute good faith steps to remedy remaining critical defaults within the required timeframe. More specifically, RILP failed to take good faith steps to remedy the 120 remaining operational deficiencies by the June 10, 2016, deadline, or to provide any detailed plan or timeframe for doing so. In fact, RILP's attempt to conflate the more than 250 individually identified defaults into a single violation and to claim then that a series of minor repairs is sufficient to avoid termination under the Leases is unpersuasive and does not constitute good faith steps to remedy the various defaults.

As a reminder, since the discovery, in late 2014, that wells on PRC 1466.1 were capable of natural flow, Commission staff has attempted to work with RILP to resolve this serious condition and bring the Leases into compliance. During these discussions, RILP agreed, in its January 2015 "Multi-Prong Plan to Ensure Public Safety and Environmental Protection During Causeway Repairs": 1) by February 6, 2015, to use its best efforts to submit a plan for checking and reducing wellhead pressure across PRC 1466.1; 2) by April 1, 2015, to use its best efforts to submit a plan to repair all wellheads with inoperable casing and tubing valves; and, 3) by March 1, 2015, to use its best efforts to submit to Commission staff an updated spill contingency plan that meets staff requirements. In addition, in early 2015, staff directed RILP: 1) by April 1, 2015, to restore the primary fire suppression system on PRC 1466.1 (still inoperable 15 months later); 2) by March 1, 2015, to submit a plan to repair the wharf on Rincon Island sufficient to offload a drill rig; and, 3) by March 1, 2015, to submit a plan to restore the gas transportation pipeline between Rincon Island and shore. Not only has RILP failed to meet any of these milestones, but, as of the date of this letter, all of these items, save for the recently submitted wellhead pressure reduction plan, are still outstanding. RILP's failure to achieve compliance with the Leases and Commission regulations over the past year and a half raised significant operational and safety concerns that informed Commission staff's preparation of the Default Notice and continue to inform Commission staff's actions.

On June 27, 2016, 17 days after the close of the cure period, RILP submitted a plan for wellhead pressure reduction and repair of six high priority wells. However, it wasn't until July 22, 2016, 42 days after the close of the cure period and more than 17 months after RILP's initial agreement, that RILP submitted a plan for wellhead pressure


² See June 9, 2016, letter from Ms. Susan Whalen to Commission Chief Counsel, Mark Meier.

reduction and repair for the bulk of the wells on PRC 1466. This timeframe does not support RILP's claim that it has taken good faith steps to remedy the default within the cure period as required under the Leases. RILP has failed, to date, to submit and commence work to install necessary subsurface safety valves and other well safety repairs; to submit an updated spill contingency plan, given the lack of access to the island; to take good faith steps to secure an appropriate firefighting system within the timeframe of the cure period, which RILP is only now anticipating delivery and installation of this critical infrastructure; or to resume any repair activities on the causeway or, in the alternative, to provide a plan for marine access to the island to ensure that a broader maintenance plan could be effectuated. Additionally, RILP has taken no steps, good faith or otherwise, to increase its bond consistent with the requirements of the Leases. Rather, RILP has outright refused to increase the bond on theories that are simply untenable. As my July 7, 2016, letter explained, the failure to provide the increased bond constitutes an independent default sufficient to support termination of the Leases.³

Finally, due to RILP's failure to remedy the significant deterioration of the operation and production facilities associated with the Rincon Island, PRC 1466.1 has not produced oil or gas since 2008. Leases PRC 145.1 and PRC 410.1 stopped producing oil and gas in any quantity in January 2016—production being a necessary condition for RILP to hold the Leases. The failure to produce oil and gas from the Leases over the last seven months to eight years is antithetical to their purpose and, by their own terms, is sufficient to terminate the Leases.

Commission staff believes that the subject leases remain in default, as previously noticed, and that no steps were taken within the 60 day cure period to remedy the *outstanding* wellhead and operations violations or to increase the bond as directed by Commission staff.

As such, Commission staff will be recommending that the Commission find RILP in default of its lease obligations and authorize termination of State Oil and Gas Lease Nos. PRC 145.1, PRC 410.1, and PRC 1466.1 at the Commission's August 9, 2016 public meeting, tentatively scheduled to begin at 11 am in the Los Angeles area. The agenda, including the specific meeting location, will be available on our website by close of business July 29, 2016 (www.slc.ca.gov).

Sincerely,

for Mark A. Meier
Chief Counsel

³ Please refer back to the January 7, 2016 Letter from Mark Meier, Chief Counsel, to Susan Whalen.

Ms. Susan Whalen

July 28, 2016

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cc: Mr. Alex Demitrijevic, President of Greka/RILP
Ms. Jennifer Lucchesi, Executive Officer
Mr. Ken Harris, Division of Oil, Gas, and Geothermal Resources/Sacramento