MINUTE ITEM NO. 14
APPROVED 12/1/75

CALENDAR ITEM

14.

12/75
PRC 3120
PRC 3242
KBY

APPLICATION FOR DEHYDRATION AND TREATING
COST ALLOWANCE ON ROYALTY OIL PRODUCED FROM
STATE LEASES 3120 AND 3242

On May 3, 1974, the Atlantic Richfield Company filed an application to deduct from the State's royalties, the costs of dehydrating and treating the State's royalty share of "sour" crude oil (crude oil containing hydrogen sulfide) produced under State leases PRC 3120 and PRC 3242. Although both leases provide for an allowance of actual cost not to exceed five cents per barrel for royalty oil dehydrated or treated, the lessee had not deducted these costs from royalty payments in the past.

As part of their application, lessee has submitted financial information indicating that their cost to dehydrate and treat crude oil is $.0247 per barrel, and that their cost to treat "sour" crude oil (crude oil containing hydrogen sulfide) is in excess of an additional $.12 per barrel. The total cost which they may deduct, however, is limited to $.05 per barrel.

In accordance with the State Lands Commission action taken on July 24, 1975, the Commission must approve the deductions from State royalties of the costs of dehydrating and treating "sour" crude oil. That is, the costs that are incurred in removing any foreign substances from produced oil other than basic sediment and water. This approval is subject to either of the following conditions:

1. The oil is not marketable unless treated; or

2. The price of the oil would be lowered if it were not treated, and the State would benefit by sharing in the treating costs, i.e., the incremental price increase per barrel of oil exceeds the costs of treating.

In their application, the lessee states" "...However, in the case of the "sour" production, as is currently being developed from the Monterey Zone, normal dehydration or treating consists of not only chemical addition and heating, but also reduction of hydrogen sulfide to accomplish the same objective of making the oil salable..." (Emphasis added) Also, at a meeting held on January 23, 1975, between members of the State Lands staff and Atlantic Richfield, a member of their engineering staff stated that their sour crude is not salable, and that the Standard refinery has notified ARCO that Standard would not take the sour crude "as is". The staff has reviewed the applicant's claim and concurs that the royalty oil as produced from the Monterey Zone is in an unsalable condition and requires treatment for the removal of hydrogen sulfide.

A 36
S 24

1385

As produced, this crude oil contains 20,000 ppm hydrogen sulfide. Upon treatment for removal of the hydrogen sulfide the oil is delivered by tanker to the Standard Oil Company refinery at El Segundo, and transport practices require that the hydrogen sulfide content be less than 70 ppm. This is necessary because of corrosion problems and toxicity. Additionally, few local refineries are equipped to meet air pollution control requirements if the crude oil to be refined has a high hydrogen sulfide content. While alternate transportation and markets are available, they impose a severe penalty (in excess of $.50 per barrel) on the value of the sour crude.

In accordance with the uniform policy for transportation and dehydration costs adopted by the Commission on July 24, 1975, the deductions of these costs would be retroactive to April 1, 1974. This retroactivity is being allowed to the beginning of the month preceding the filing of the application since the lessee meets the following criteria: (1) they are currently producing, but are not deducting dehydration costs, and (2) they had an application for dehydration on file at the time of the July 24, 1975 Commission action.

IT IS RECOMMENDED THAT THE COMMISSION:

1. APPROVE ATLANTIC RICHFIELD COMPANY'S APPLICATION FOR THE DEDUCTION FROM STATE ROYALTIES, THE STATE'S SHARE OF THE COSTS TO DEHYDRATE AND TREAT "SOUR" CRUDE OIL (CRUDE OIL CONTAINING HYDROGEN SULFIDE) PRODUCED UNDER LEASES PRC 3120 AND PRC 3242. THE STATE'S SHARE OF THE DEHYDRATION AND TREATING COSTS TO BE LIMITED TO FIVE CENTS PER ROYALTY BARREL OF CRUDE OIL SO DEHYDRATED AND TREATED, ANDTTO BE SUBJECT TO ADJUSTMENT AS A RESULT OF STATE AUDIT.

2. GRANT ATLANTIC RICHFIELD COMPANY RETROACTIVITY FOR THESE DEDUCTIONS TO APRIL 1, 1974.