MINUTE ITEM

6/26/80
PRC 987
Willard

41. AUTHORIZATION OF LITIGATION, STATE OIL AND GAS LEASE PRC 987.1.

During consideration of Calendar Item 41 attached, Mr. Stephen Meyer, representing Ocean Front Oil Company, appeared and requested that the Commission deny the staff's recommendation or defer its action pending the receipt of a report by their consultant advising whether or not the well should be plugged and abandoned or redrilled. He also requested that the lease be modified to provide a reasonable royalty rate, explaining that their royalty had increased to 200% due to the price sensitive royalty formula and the large increase in oil prices since 1974. He further explained that they had been making payments under protest since that time while also attempting to obtain relief. However, these negotiations have not proven successful. Mr. Meyer suggested that litigation would not be in the State's best interest since the total amount due is only about $48,000.

It was the staff's position that because of the well's low productivity and associated safety problems, it should be abandoned. However, negotiations commenced and staff thought it had reached a mutually satisfactory agreement with the lessee last January. Misunderstandings over the results of that agreement occurred which have not yet been resolved.

Chairman Kenneth Cory inquired whether the Division of Oil and Gas had prepared a safety report on the well. He was advised that DOG had issued a notice for Ocean Front to abandon or repair the well by November, 1980. However, at the present time Ocean Front was not in violation of that order. Mr. Donald J. Everitts, Chief, Division of Energy and Mineral Resources Development, pointed out, though, that the lessee was in violation of the Commission's oil and gas regulations. Executive Officer William F. Northrop also advised the Commission that the lessees in the area had joined in the Unitized Development of this area and that Commission, in consideration of the unitization and conservation of the resource had renegotiated royalty rates to make production more economical. Ocean Front, however, elected not to participate.

At the conclusion of the discussion, the Commission deferred acting on the item and instructed the staff to report back to the Commission at the next meeting on 1) the results of the DOG safety report; and 2) the results of the consultant's report, specifying the options available.

Attachment: Calendar Item 41

CALENDAR PAGE

MINUTE PAGE 1478

CALENDAR ITEM

41.

6/80
PRC 987
Willard

AUTHORIZATION OF LITIGATION
STATE OIL AND GAS LEASE PRC 987.1

State Oil and Gas Lease PRC 987.1 is a one-well lease owned and operated by Ocean Front Oil Company. The well was drilled in 1927 on privately-owned land trespassing into State lands. After court action (State v. Ocean Front Oil Company, Orange County Superior Court Case No. 454667) and payment of a $5,000 fine, the State granted Easement 289 to the operator in 1934. The easement was subsequently renewed in 1954 as State Oil and Gas lease PRC 987.1.

The royalty formula is price sensitive. The royalty rate from 1959 to the latter part of 1973 was 19% to 23% when the price of oil was between $2 and $3 per barrel. With the recent increase in the price of oil, the royalty rate has increased to 80% - 100%.

In 1972, the 91 Main Zone Unit was formed for the purpose of increasing oil recovery through secondary recovery operations. At that time the State renegotiated royalty rates with well owners that joined in the project. However, the lessee under Lease PRC 987.1 elected not to participate in the project.

The well was initially produced in 1933 at 285 BOPD. By 1956, production had declined to 25 BOPD. Currently, the well produces less than 1 BOPD and approximatly 1,000 barrels of water per day. The staff does not believe that the well is capable of producting oil and gas in paying quantities as required by the lease, and the lessee has not contended to the contrary.

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Staff has reviewed the status of the well and has determined that the well is in a hazardous condition and is not being operated within good engineering practices. The casing and well head equipment should be pressure tested to determine if any damage has occurred due to wear or corrosion. A subsurface safety valve and tubing packer should be installed to prevent uncontrolled flow of oil and salt water from the well in the event of damage to the well head. Additionally, production and storage facilities require maintenance and repair.

The lessee has requested that the royalty rate be renegotiated at a lower rate, and since September 1973, has paid under protest oil royalties in the amount of $47,422. The staff has reviewed the request and has met with the lessee on several occasions during the past one and one-half years to resolve not only the protested royalty payments, but the removal of hazardous conditions of the well and production and storage facilities. A compromise agreement for resolution of these problems was reached on January 31, 1980 as follows:

1. Within 30 days the lessee would report to the State its decision whether or not to redrill the well or the subject lease so as to no longer be slant-drilled into State land.

2. Within 30 days the State would draft an agreement between the lessee and the State with basic terms as follows:

   a. An established program for abandonment of the lease.

   b. Payment to the lessee of $17,000 of the oil royalty paid under protest to the State. The right to additional royalty due the State prior to acceptance by the State of a quitclaim of the lease by the lessee would be retained by the State.

3. Payment to the lessee of $262.59 in royalties paid by the lessee for non-crude oil production during the period of January 1977 through March 1979. This non-crude production was from a source other than the subject lease.

As a result of an apparent misunderstanding of what the lessee was to report to the State within 30 days, the time period was extended to March 1, 1980, for submission of a detailed status report on proposed well work and a final descision on what work would be done by April 1, 1980.

The lessee has not communicated the required information even after repeated requests, and it is the opinion of staff that further extension of time is not in the best interests of the State due to the unsafe condition of the well. Therefore, staff recommends authorization to commence litigation against the Ocean Front Oil Company.

IT IS RECOMMENDED THAT THE COMMISSION AUTHORIZE STAFF COUNSEL AND/OR THE OFFICE OF THE ATTORNEY GENERAL TO TAKE ALL STEPS NECESSARY, INCLUDING LITIGATION, TO ENFORCE THE PROVISIONS OF STATE OIL AND GAS LEASE NO. PRC 987.1.