

MINUTE ITEM

This Calendar Item No. 21
was approved as Minute Item
No. 21 by the State Lands
Commission by a vote of 3
to 0 at its 9/25/86
meeting.

MINUTE ITEM

21

09/25/86
W 15060
Pace

IMPLEMENTATION OF ASSEMBLY BILL 2568 (Elder)

During consideration of Calendar Item 21 attached, Mr. Robert H. Austin, Attorney for the Long Beach Oil Royalty Owners, and Ms. Rose Buchholz, President of the Long Beach Oil Royalty Owners, appeared to ask the Commission to accept their proposal for implementing the provisions of AB 2568.

It was explained that the oil companies were unwilling to accept cost burdens necessary to implement the plan. Without the consent of the oil companies and other parties in the unit, the Commission could not implement the proposal of the Long Beach Oil Royalty Owners.

Mr. Austin requested that some guidelines be established to assist the Long Beach Oil Royalty Owners in developing an acceptable proposal.

Acting Chairman McCarthy assured Mr. Austin that staff would assist the Royalty Owners in this matter.

Upon motion duly made and carried, the resolution in Calendar Item 21 was approved, as presented, by a vote of 3-0.

Attachment: Calendar Item 21.

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A 57, 58

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09/25/86
W 15060
Pace

IMPLEMENTATION (OF ASSEMBLY
BILL 2568 (ELDER))

At its meeting on November 21, 1985, the Commission agreed to consider approval of a reduction in the rate of retroactive equity adjustments pursuant to the provisions of AB 2568 provided that all statutory prerequisites were met. The Commission wanted comments from the affected Long Beach Unit Participants on how the Unit might implement a procedure that would reduce the rate at which the Townlot Royalty Interest Owners and Working Interest Owners other than producing oil companies pay back to Tract 1 the retroactive adjustment due as a result of the most recent equity change increasing Tract 1's equity share. The Commission also wanted whatever approved agreements by the Participants that were necessary to implement such a procedure.

The City of Long Beach as Unit Operator contacted the Participants as requested by the Commission. The comments received reveal that one of the several major problems appears to be the cost of implementing a procedure. The major oil company Participants in the Townlot refuse to agree to any procedure that would require them to incur additional costs in making their royalty payments. Royalty payments are the responsibility of each Working Interest Owner and are handled outside of the Unit accounting procedures. Therefore, any additional cost in making royalty payments would be the responsibility of the Townlot Working Interest Owners and could not be charged to Unit Expense. However, the major oil companies do not want to incur these costs.

AB 2568 allows a reduction in the rate of retroactive adjustments from the Townlot if consistent with the Unit Agreement and applicable law. Accordingly, it does not contemplate, and certainly does not require, any retroactive adjustments to which any Participant objects or any procedure

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involving additional Unit Expense or reductions in State oil revenues. Furthermore, AB 2568 does not provide legislative authority for the Commission to incur additional costs for the State, in terms of oil revenue reductions beyond those resulting from the delays in receiving retroactive adjustments, in connection with the implementation of the bill.

The Long Beach Oil Royalty Owners, the organization of Townlot Royalty Interest Owners that was behind AB 2568, has proposed a method for implementing the bill. The proposal (attached as Exhibit "A") is that the Townlot Working Interest Owners supply to the Unit Operator the information necessary for calculating the royalties due all Townlot Royalty Interest Owners. A computer program would have to be written so that the Field Contractor could provide each month to the Working Interest Owners the necessary royalty calculations and data for their royalty owners checks. The cost for doing these royalty calculations would be charged as Unit Expense. Therefore, each Unit Participant would pay its participating percentage of these costs which have been estimated as follows:

1. Initial set-up cost \$425,000
2. Monthly costs first two years \$59,250 and
3. Monthly costs after first two years \$43,100

Based on these estimated costs, the State's share, which would be in the form of a reduction in oil revenue, would be \$1,588,000 during the first two years and \$444,600 for each year thereafter.

Counsel for the Long Beach Oil Royalty Owners suggests that this procedure does not require an amendment to the Unit Agreement nor further legislative authority for the Commission to accept. Staff counsel and the Attorney General disagree. Under the terms of the Unit Agreement, calculation and payment of royalties is not a Unit responsibility and, therefore, not a part of Unit operations and not within the definition of Unit Expense. To charge such costs to Unit Expense would require an amendment to the Unit Agreement which requires the consent of the State, the City, the Minority Voting Participants and all Working Interest Owners owning parcels of an acre or more. There is no consensus among these parties for such an amendment. For instance, in their letter dated March 4, 1986, Chevron expressed the desire to be compensated for the lost time value of money associated with the temporary reduction in crude oil allocations if AB 2568 were implemented. In

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addition, AB 2568 provides that the Commission may accept a procedure for reduction in retroactive adjustments "to the extent permitted by law and the unit agreement." Therefore, the Commission has no authority to accept a procedure requiring an amendment to the Unit Agreement and, in addition, has no directive from the Legislature to commit itself to an amendment that would result in additional costs to the State. Furthermore, there is no logic for the Unit, and the City and State as the major Participants, to accept the duty and attendant costs of calculating royalty payments which are normal responsibilities of the Townlot oil companies.

As the Commission is aware, AB 2568 permits a reduction in the rate of retroactive paybacks down to ten percent from the current 50 percent. With the current depression in oil prices, the payback at the current 50 percent rate is taking a very long time. A large reduction in the payback rate likely will create a situation where the State will not receive the full retroactive adjustment from all parties. Therefore, the Commission must approach any proposal for implementation of AB 2568 with care to insure that there is not a permanent loss of these revenues.

AB 884: N/A.

EXHIBIT: A. Proposal of Long Beach Oil Royalty Owners for Implementation of AB 2568.

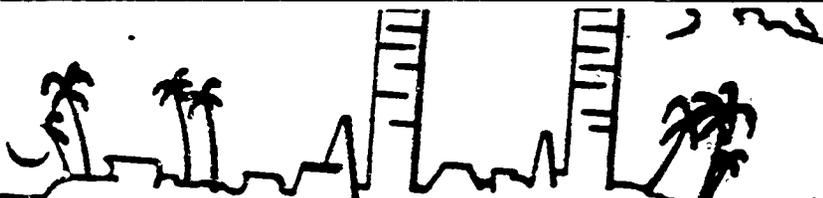
IT RECOMMENDED THAT THE COMMISSION:

1. REJECT THE PROPOSAL OF THE LONG BEACH OIL ROYALTY OWNERS FOR IMPLEMENTING AB 2568 BECAUSE ITS IMPLEMENTATION REQUIRES AN AMENDMENT TO THE UNIT AGREEMENT AND SUCH AN AMENDMENT HAS NOT BEEN OBTAINED AND DOES NOT APPEAR TO BE OBTAINABLE.
2. REITERATE ITS WILLINGNESS TO CONSIDER A PROPOSAL TO IMPLEMENT AB 2568 THAT IS CONSISTENT WITH THE TERMS OF THE UNIT AGREEMENT AND APPLICABLE LAW AND IS IN THE BEST INTERESTS OF THE STATE.

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LONG BEACH OIL ROYALTY OWNER'S, INC.

James Hemphill, Director
Department of Oil Properties,
333 West Ocean Boulevard
Long Beach, California 90802

8-29-86

RE: Proposal for implementation of
AB2568

Dear Mr. Hemphill:

We submit herewith a proposal for implementation of AB2568 (attachment 1). AB2568 permits the State Lands Commission to accept reduced retroactive adjustments for prior over allocation of crude oil to the Townlet Tracts, but at no less than 10%, if the Commission finds that the reduction would apply only to royalty interest owners and working interest owners other than producing oil companies.

We are of the opinion that the implementation of AB2568 does not require a formal amendment to the Unit Agreement, because AB2568 constitutes an amendment to Chapter 138 and the Unit Agreement is not to be construed applied in contravention of the provisions of Chapter 138. A more detailed statement of reasons on this point is attached hereto as Attachment 2.

In summary, we propose that the State Lands Commission, in the exercise of the discretion conferred by AB2568, accept retroactive payback adjustments of 10% of the hydrocarbon substances allocated to any average tract from which such retroactive adjustments are required to be made. The producing oil companies would provide THUMS with the necessary information to calculate adjusted royalties. THUMS would perform all necessary royalty calculations and provide the information to the appropriate producing company, which would distribute the royalty checks to its royalty interest owners. The expenses connected with such calculations incurred by THUMS would constitute a unit expense. An opinion addressed to that proposition is attached hereto as Attachment 3.

As you know, AB2568 was passed (approximately one year ago) as an urgency measure. To date absolutely nothing has been done by way of implementation, and we would, therefore, ask that this proposal be transmitted to the State Lands Division and be placed on the agenda for the next regular meeting of the State Lands Commission.

Yours very truly,


ROBERT G. AUSTIN,
Legal Counsel for Long Beach
Oil Royalty Owners', Inc.

P.O. Box 30807, Long Beach, CA 90853 (213) 439-8026

SEP 2 1986
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CALIFORNIA DEPARTMENT OF OIL PROPERTIES
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PROPOSAL FOR IMPLEMENTATION OF AB2568

ATTACHMENT 1

PAYBACK ADJUSTMENT:

Under AB2568 the State Lands Commission is empowered to accept retroactive adjustments for over allocation of crude oil to the Townlet Tracts of not less than 10% of the hydrocarbon substances allocated to any average tract from which such average adjustments are required to be made. The relief provided under AB2568 applies to those royalty interest owners and working interest owners who are not producing oil companies. Therefore, the following Townlet Working Interest Owners of the Long Beach Unit are considered to be producing oil companies:

- a) ARCO Oil and Gas Company
- b) Chevron USA, Inc.
- c) Phillips Petroleum
- d) Armstrong Petroleum Corporation
- e) Union Oil Co. of California (we believe this is now Unocal)
- f) Chevron Petroleum Company

It is proposed that, in view of the legislative intent to afford relief to the royalty interest owners and working interest owners, other than producing oil companies, the retroactive adjustments for over allocation be reduced to 10%. However, we recognize that under AB2568 it is a matter within the sound discretion of the State Lands Commission as to the magnitude of reduction that should be made.

CALCULATIONS:

It is proposed that the various oil companies involved provide THUMS with a tabulation of royalty interest owners, showing the decimal interest of each such owner by tract, the total unit participation of the royalty interest owners per each tract, and the total royalty interest for the particular producing oil company. The underage royalties should be grouped and totaled separately from the average royalties. The payback status, i.e. the amount still owed, of each royalty owner should also be provided.

THUMS would put together the computer program to perform the calculations to determine the amount to be paid to each royalty interest owner and working interest owner coming within the provisions of AB2568 and provide the information to the appropriate oil company for use in distributing checks.

THUMS would calculate the additional oil that each company should receive to pay its royalty interest owners and those working interest owners who are now producing oil companies, for distribution to the oil company working interest owners.

THUMS would provide the State Lands Commission with a monthly tabulation of average and underage working interest owners by tract, showing the unit participation there and the payback status of each working interest owner.

**ATTACHMENT 1
PROPOSAL FOR IMPLEMENTATION OF AB2568
Page 2**

DISTRIBUTION OF PAYMENTS:

Upon receipt from THUMS of the amount to be paid to each of its royalty interest owners, the producing oil companies would distribute the royalty interest payments to its royalty interest owners.

Each producing oil company would provide State Lands Commission with a monthly certification letter stating that it had passed through all of the benefits derived from the decision of the State Lands Commission pertaining to the retroactive adjustment per acre allocation of crude oil to the Townsite Tracts.

THUMS would distribute in kind the additional oil it calculated to be received by the oil company working interest owners.

COSTS:

The costs connected with the implementation of AB2568 would be treated as a unit expense.

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ATTACHMENT 2

The question presented is whether the Unit Agreement requires formal amendment in order to implement AB2568. We are of the opinion that no formal amendment is necessary for the reasons which follow.

First, AB2568 is an act amending Chapter 138, and Chapter 138 and the Unit documents, i.e. Unit Agreement and Unit Operating Agreement are integrated. The Unit Agreement makes reference to Chapter 138 throughout and contains language which states, in substance, that in the event of conflict between the provisions of Chapter 138 and the unit documents, the provisions of Chapter 138 shall govern. In other words, the Unit Agreement should not be interpreted so as to exclude any provision of Chapter 138. The Unit Agreement is to be construed and applied so as to give effect to all of the provisions of Chapter 138, and any amendments thereto.

Secondly, inasmuch as AB2568 is an amendment to Chapter 138 and appears to provide a procedure which is at variance with section 5.4 of the Unit Agreement, we believe that under section 18.5 of the agreement, the Unit Agreement could be reformed so as to be consistent with AB2568 and carry over the legislative intent as evidenced by that enactment, regardless of whether or not there is unanimity of opinion of whether a formal amendment is required. Since the Unit Agreement could, by its express terms, be reformed so as to further the legislative intent behind AB2568, there appears to be no reason not to proceed and apply section 5.4 observing the provisions of AB2568. The Legislature intended that relief to royalty interest owners be provided immediately, otherwise AB2568 would not have been passed as an urgency measure.

ATTACHMENT 3

The question presented is whether the cost of implementing AB2568 can be treated as unit expense. We believe that such costs constitute an expense of operation of the Long Beach Unit, and hence are chargeable as unit expenses.

The Unit Agreement, section 1.52(f), defines "Unit Expense," in part, as including "all other costs, charges, expenses and liabilities arising out of, resulting from, or connected with the Unit Operation or expressly made chargeable as Unit Expense by the provisions hereof or of the Unit Operating Agreement." This omnibus clause in the definition of Unit Expense is sufficiently broad to cover the costs incurred by THUMS in the implementation of AB2568.

Exhibit F to the Unit Operating Agreement (Section 5.12) provides that the cost of electronic data processing services in connection with unit operations is considered to be a chargeable cost, i.e. Unit Expense.

There can be no doubt that when an interim Area Assignment is adopted by the Equity Committee that such action is just as much a part of unit operations as any action of the Voting Parties, Engineering Committee, etc. The provisions of AB2568 and the cost involved in carrying out its provisions in the making of adjustments for prior over allocation is also part and parcel of total unit operations. The costs involved come squarely within the scope of section 1.52(f) of the Unit Agreement.



CITY OF LONG BEACH

TIDELANDS AGENCY—DEPARTMENT OF OIL PROPERTIES

328 WEST OCEAN BOULEVARD • LONG BEACH, CALIFORNIA 90802 • (310) 433-2244

July 11, 1986

L. O. McCamish
Chevron Oil and Gas
Post Office Box 606
La Habra, California 90631

Subject: IMPLEMENTATION OF AB 2568

Dear Mr. McCamish:

At the July 9th meeting of the Long Beach Unit Participants and the Long Beach Royalty Owners, Inc., we agreed to prepare a draft implementation proposal to submit to the State Lands Commission.

In your letter dated March 4, 1986, you stated "For the purposes of the Seventh Equity Revision only, if the State were to agree to modify Chevron's Non-Operator/Field Contractor Agreement in order to fully compensate Chevron for any economic losses incurred, Chevron should reconsider its position concerning implementation of the proposed bill."

Please prepare a recommended amendment to the Non-Operator/Field Contractor Agreement, that if approved, would allow you to support the bill.

We plan to meet in mid-August to discuss any proposal. We intend to send a draft proposal to the interested parties at least a week before the meeting. Therefore, we request that you provide the necessary data by July 31st.

Please contact Mr. Roy Koerner at (213) 590-6284 if you have any questions.

Sincerely,

James R. Heathill
Director

W. A. Smith, Assistant Director

JRH:WAS:slg

ARCO Oil and Gas Company
Western District
Post Office Box 147
Bakersfield, California 93302
Telephone 805 833 4000



cir:JRH:Vault
cc:JRH:RKK 8-13-86

August 12, 1986

RECEIVED
DEPT. OF OIL & GAS INDUSTRIES

AUG 13 10 35 AM '86

James R. Hemphill, Director
Department of Oil Properties
333 West Ocean Boulevard
Long Beach, California 90802

Re: Implementation of AB 2586, Long Beach Unit

Dear Mr. Hemphill:

You requested in your meeting on July 9, 1986 and again in your July 11, 1986 letter that we provide you with a list of royalty owners and their revenue decimal interests totaled by tract. To be included are the totals for both the overage and underage groups. Additionally, you asked that we estimate what it would cost to implement and administer the Elder Bill.

We have compiled and I have in my office the name and address of each of our royalty owners with their decimal interest by tract. They total approximately 7,500. THMS should have the numbers for the overage and underage groups. Your last request, to estimate the cost of administration of this Elder Bill, is where we have a problem. It has never been our intention to administer the Elder Bill. After several thousand layoffs over the past year throughout our company, we find it impossible to handle additional responsibility. Because it has never been our intention to administer this bill, it follows that we do not understand what it would cost.

We will be able to provide you the names and addresses of our royalty owners with their revenue decimal interests when it is decided who will administer the bill.

Sincerely,

G. B. Shafter
Area Landman

CBS/pl

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ARMSTRONG PETROLEUM CORPORATION RECEIVED
POST OFFICE BOX 1547
NEWPORT BEACH, CALIFORNIA 92663 UG 7 8 50 AM '86
TELEPHONE (714) 639-4000

August 4, 1986

Mr. Roy Koerner
City of Long Beach
Department of Oil Properties
333 West Ocean Blvd.
Long Beach, CA 90802

Subject: IMPLEMENTATION OF AB 2568

Dear Mr. Koerner:

Enclosed are the royalty interest owners and their
decimal participation in their tracts as you
requested.

If you have any questions please feel free to
contact me.

Sincerely,

Cheryl A. Sparrow

Cheryl A. Sparrow
Accounting Supervisor

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PHILLIPS PETROLEUM COMPANY

DENVER, COLORADO 80237-3998
8088 EAST TUFTS AVENUE PARKWAY, PHONE: 303 880-3000

circ:JRH:Vault
cc:JRH:RKK 8-4-86

RECEIVED

DEPT. OF OIL & GAS PROPERTIES

AUG 4 12 33 PM '86

July 30, 1986

Mr. James R. Hemphill
City of Long Beach
Tidelands Agency - Department
of Oil Properties
333 West Ocean Blvd.
Long Beach, CA 90802

Re: Implementation of Assembly
Bill 2568

Dear Mr. Hemphill:

In regards to your letter dated July 11, 1986, requesting an estimate of the costs to implement and maintain Assembly Bill 2568, we submit the following:

Initial Costs	\$1,000
Monthly Costs	\$ 325

These estimates are based on the assumptions noted in your letter and on the fact that Phillips disburses to forty-four royalty owners and non-oil producing companies.

Enclosed is the list of these owners and their decimal ownership. We request that this list only be used in the determination of the amount of additional oil to be shipped to Phillips for the royalty owners and non-oil producing companies in connection with their decreased payback.