MINUTE ITEM
This Calendar Item No. 43
was approved as Minute Item
No. 43 by the State Lands
Commission by a vote of 2
to 0 at its 9-23-87
meeting.

CALENDAR ITEM

A 58

S 37

43

09/23/87
PRC 3033
L. Smith
Trout
W 40182

ROYALTY ADJUSTMENT - UNOCAL - PRC 3033
PLATFORM "EVA" - HUNTINGTON BEACH OFFSHORE FIELD
ORANGE COUNTY

On December 16, 1982, the State Lands Commission approved a resolution regarding a long standing royalty dispute with the Union Oil Co. of California (now UNOCAL) concerning the inclusion of low oil producing wells in the sliding-scale royalty formula calculations, for State Oil and Gas Leases PRC 3033 and PRC 3414, and authorized the Executive Officer to execute an agreement effecting this resolution.

The agreement, signed December 16, 1982 with Union, included the provision that:

> "2. After the power water system is fully installed and operational and for the remaining life of the leases, the royalty rate shall be calculated under the sliding-scale formula provided in the leases by excluding as a producing well for use in the formula any well that during the month for which the calculation is made fails to produce an amount of oil and gas, exclusive of royalty, sufficient to pay its direct lifting costs as determined by the State using generally accepted industry accounting standards."

The power water system, installed pursuant to another provision of the December 16, 1982 agreement, went into service on July 1, 1983. A number of adjustments and modifications were necessary to establish smooth operations.

During the period from February 1984 through May 1985, numerous production operations meetings and communications occurred regarding well test equipment, procedures and data reporting

and also regarding defining of and reporting well direct lifting costs. This culminated in a letter agreement of July 26, 1985 to Union, setting forth guidelines for determining production data and costs for marginally economic producing wells.

Union, in accordance with the aforementioned agreement, recalculated the royalties for lease PRC 3033 for the period starting July 1, 1983 through August 1985, using the new guidelines. Their letter dated November 12, 1985 said that Union had overpaid the State by $487,788.79. By letter dated November 25, 1985, Union was advised that the State planned to audit their claim. A further calculation by Union showed that the total overpayment for the period July 1, 1983 through December 31, 1985 was $562,360.07.

From January 1986 through December 1986, an audit of Union's claim was conducted by Commission. Numerous meetings and communications were held with Union personnel. Calculation errors by Union were found and corrected. A complete review of supporting documents was made for each of 3 months (of the entire 30-month period): December 1983, August 1984 and July 1985.

Although instances of poor accounting record keeping were evident by Union, it was staff's conclusion that further audit work was not justified. Staff agreed that Union's latest corrected calculation (12-18-86) of royalty overpaid by them of $553,156.73 is essentially correct.

Monies for the reimbursement are already in a "suspense" account, accumulated from royalty oil "sell-off" payments from Lease PRC 3033.

The agreed cost accounting procedures for determining the economics of marginal producing wells were put into effect January 1, 1986. Since that time Union has been supplying staff monthly with cost details for the marginally economic wells. This information is reviewed by the Operations Unit. Additionally, Huntington Beach Field Inspectors have been for several years witnessing well tests weekly, and then at month-end reviewing all marginal well test results with Union's Platform "EVA" foreman to reach agreement on the validity of these tests.

In conclusion, the claim and overpayment of royalties by Union for the period from July 1, 1983 thru December 31, 1985, as finally corrected December 12, 1986, is justified. Since December 31, 1985, staff has monitored the production and lifting costs of the marginal wells to insure that no repetition of such overpayment (or underpayment) of oil royalties occurs.

AB 884: N/A.

IT IS RECOMMENDED THAT THE COMMISSION:

1. FIND THAT THE ACTIVITY IS EXEMPT FROM THE REQUIREMENTS OF THE CEQA PURSUANT TO 14 CAL. ADM. CODE 15601 BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY P.R.C. 21065 AND 14 CAL. ADM. COED 15378

2. AUTHORIZE THE REFUND OF $553,156.73 TO UNOCAL FOR OVERPAYMENT MADE TO THE STATE FOR THE PERIOD FROM JULY 1, 1983 THROUGH DECEMBER 31, 1985, FOR PRODUCTION FROM LEASE PRC 3033.

3. DIRECT UNOCAL TO SUBMIT THE CLAIM TO THE BOARD OF CONTROL FOR APPROVAL.

4. AUTHORIZE THE STAFF OF THE COMMISSION TO TAKE SUCH OTHER STEPS AS MAY BE NECESSARY TO CARRY OUT THIS AUTHORIZATION.

(REVISED 09/22/87)