MINUTE ITEM
This Calendar Item No. C81 was approved as Minute Item No. 81 by the California State Lands Commission by a vote of 3 to 0 at its 08/21/96 meeting.

CALENDAR ITEM
C81

A 37

S 33

08/21/96
PRC 91.1
PRC 163.1
PRC 425.1
PRC 426.1
E-392
A. Willard

INFORMATIONAL
REPORT ON ADDITIONAL $450,000 REVENUE FROM THE APPLICATION OF NEW PRICE SLIDING SCALE ROYALTY FOR STATE OIL AND GAS LEASES NOS. PRC 91.1, PRC 163.1, PRC 425.1, PRC 426.1 AND E-392, HUNTINGTON BEACH OFFSHORE FIELD, ORANGE COUNTY

LESSEE:

CalResources L.L.C.
Attn: Mr. Tom W. Broom
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Bakersfield, California 93389

BACKGROUND:

On May 3, 1995, the Commission determined that continued production from the Huntington Beach Offshore Field, specifically State Leases Nos. PRC 91.1, PRC 163.1, PRC 425.1, PRC 425.1, and E-392, was in the best interests of the State and approved an innovative price sensitive sliding scale royalty formula for the leases. The subsequent use of the formula has resulted in an additional $450,000 in revenue to the State.

The subject State Oil and Gas leases were issued between September 1938 and February 1950, with various sliding scale royalty structures. The current lessee is CalResources L.L.C. (CalResources).

Some of the production zones were previously modified to fixed rates when a secondary recovery operation (waterflood program) was commenced.
The leases were again modified for a new secondary recovery operation when, on April 28, 1993, the Commission approved an expansion of the waterflood program to include the Upper Main Zone reservoir. Concurrent with that approval and, as allowed by statute, the royalties for all reservoirs were amended to various fixed rates. The average of the fixed rates for the leases after the modification was approximately 15-1/2 percent.

In 1994, the lessee initiated discussions with Commission staff for renegotiation of the royalty on these leases, claiming that at present and anticipated future production rates, and the then current oil price, proceeding with the waterflood program was uneconomic. The lessee provided staff with the economics of the operation to justify a proposed royalty modification. Significant in the analysis was a study by Shirley C. Anderson, Ph.D., California State University, Northridge, showing that this field provided 407 jobs, with annual wages of $11 million, and provided $6.88 million per year to the State's General Fund and $2 million per year as direct tax revenue to Los Angeles and Orange Counties.

Commission staff developed various new sliding scale royalty formulas based on price, and after a number of negotiating sessions, the parties agreed on the royalty schedule attached as Exhibit "A". Included in the approval was a required timetable for specific capital investments for implementation of the waterflood by the lessee. Based on staff's recommendations, and, among other things, the claim that with the new royalty structure "it is anticipated that over the remaining life of the field, the State will receive considerably more royalty revenue under the price sensitive schedule than under the present fixed royalty rates," the Commission approved the new royalty structure on May 3, 1995.

Informational Update:

Since the royalty modification approval, the royalty rate has averaged 16-2/3 percent, or about 1.2 percent over the previous fixed rate of 15.5 percent. Commencing in March, 1996, crude oil prices surged upward, moving steadily to a peak price for Huntington Beach oil of $20.35 (April 12, 1996 posting).

Under the approved royalty schedule the average price during April was $19.52, which is equivalent to 18.91 percent royalty or over three percent (3%) higher than under the old royalty schedule.
While these prices have not continued to increase at the same rate, and have settled at about $16, it is significant to note that the Commission's decision to approve the sliding scale formula was sound, and of benefit to the State. Since approval of the royalty modification the State has received $450,000 over the amount that would have been received under the previous royalty schedule. Attached as Exhibit "B" is a graph of the oil price and royalties since inception of the new program. Staff will continue to provide periodic reports on this matter.

The Commission also recently approved a staff request to take the State's royalty oil in kind from these leases, and, beginning June 1, 1996, Enron Capital & Trade Resources has agreed to take this oil and pay the State an additional $0.26 per barrel bonus (over posted price). This will have the added effect of raising the royalty rate, since the royalty rate is based on the highest price actually paid, including any bonus over the posted price.

AB 884:

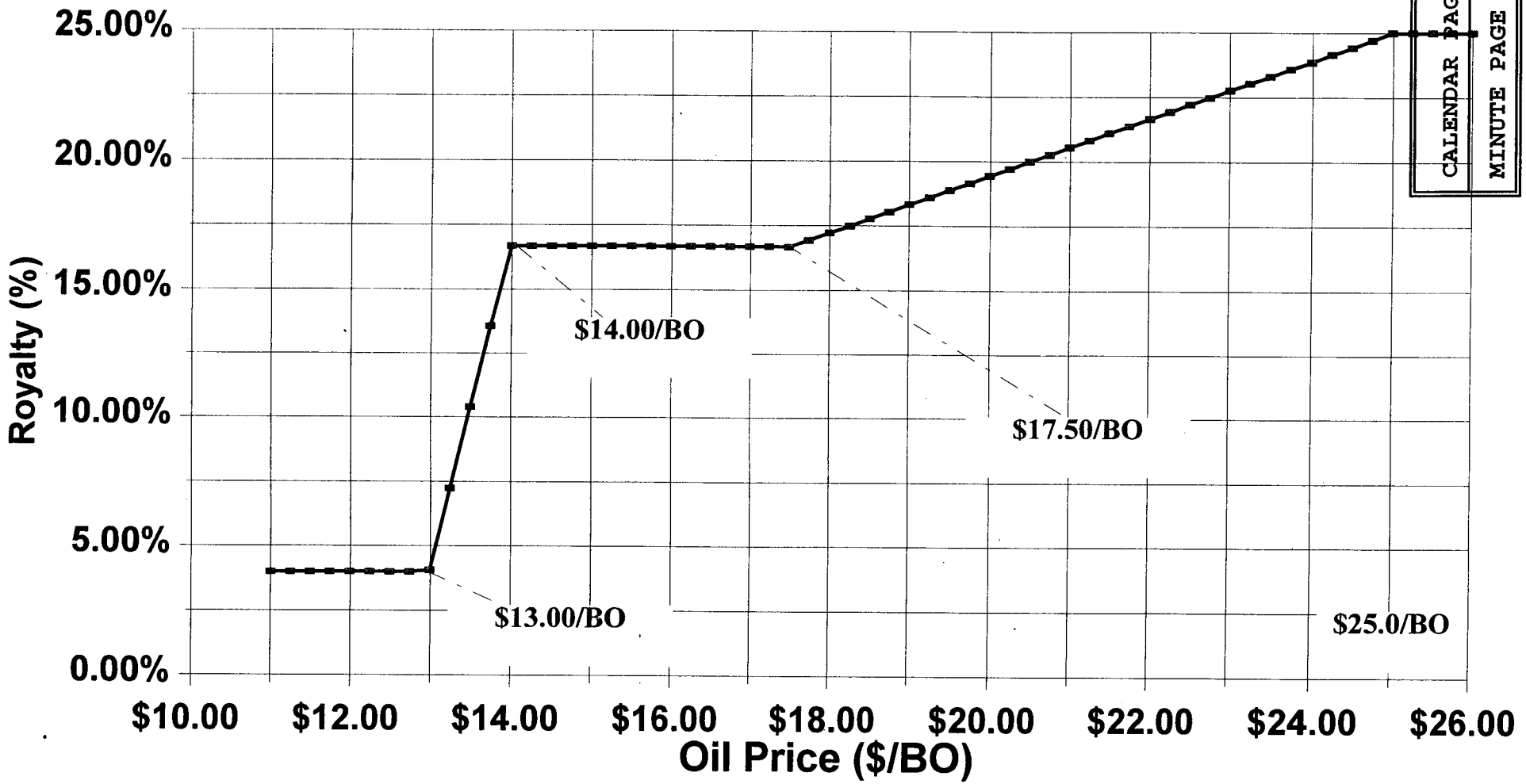
N/A

EXHIBITS:

A. Royalty Schedule
B. Oil Price and Royalties

Calresources

Royalty Rate Schedule

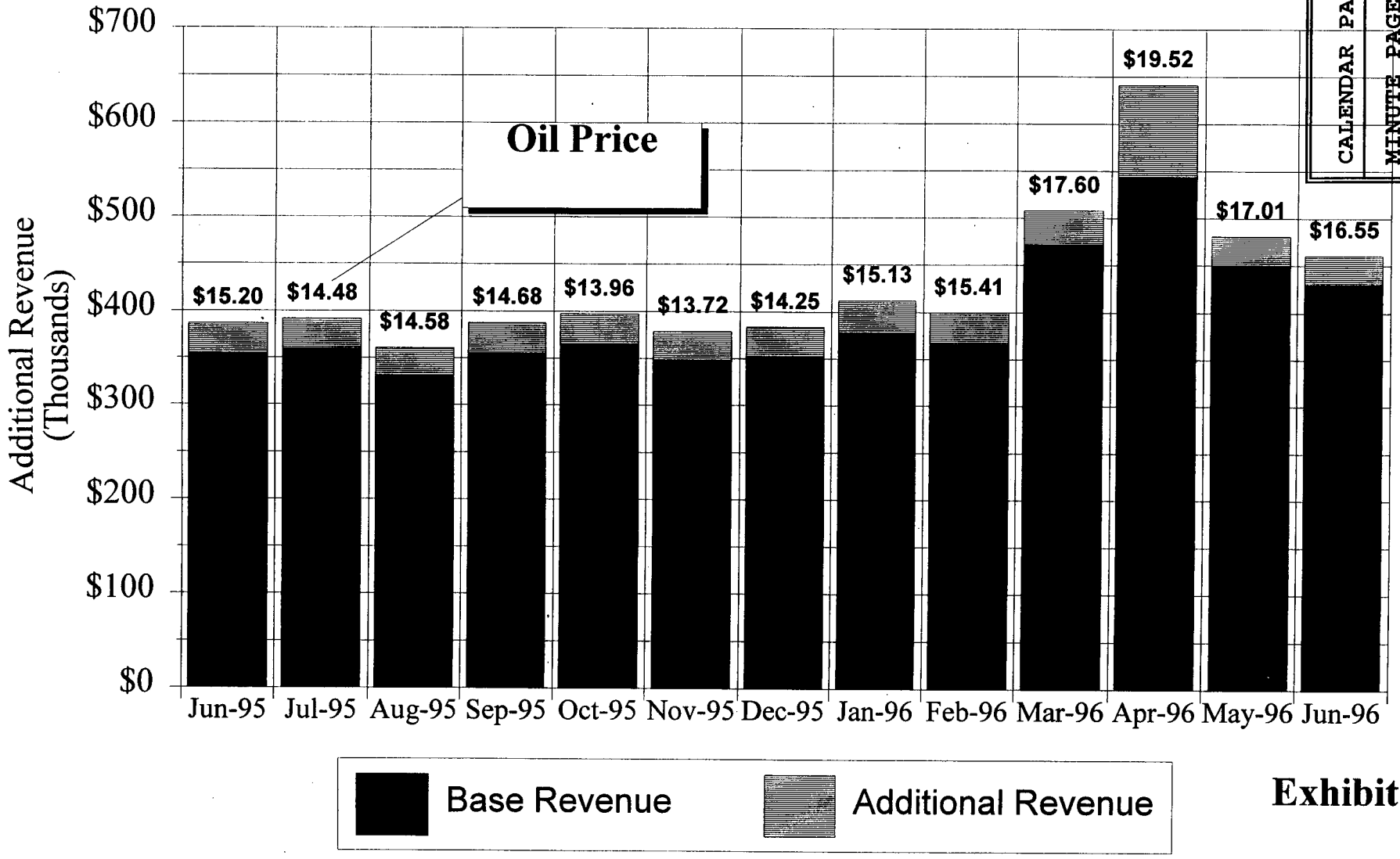


CALENDAR PAGE 768
MINUTE PAGE 062251

Exhibit "A"

Huntington Beach Field

Additional State Revenue



CALENDAR PAGE 769
MINUTE PAGE 062252

Exhibit "B