INFORMATIONAL
CALENDAR ITEM
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	W 40740
	PRC 91.1
	PRC 163.1
	PRC 425.1
	PRC 426.1
	E-392
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STAFF REPORT ON THE STATUS OF THE IMPLEMENTATION OF THE SLIDING SCALE ROYALTY FOR OIL AND GAS LEASE NOS. PRC 91.1, PRC 163.1, PRC 425.1, PRC 426.1 AND E-392, HUNTINGTON BEACH OFFSHORE FIELD, ORANGE COUNTY

APPLICANT:

California State Lands Commission
100 Howe Avenue, Suite 100-South
Sacramento, CA 95825-8202

BACKGROUND:

On May 3, 1995, the California State Lands Commission (Commission) determined that it was in the State's economic interest to receive the State's share of the revenue from the Huntington Beach Offshore Field, and specifically Lease Nos. PRC 91.1 (589 acres), PRC 163.1 (640 acres), PRC 425.1 (835 acres), PRC 426.1 (640 acres) and E-392 (835 acres), utilizing a price sensitive sliding scale royalty schedule. There are approximately 850 wells developing the leases. About fifty of the wells have been drilled from Platform Emmy with the remainder drilled from onshore sites.

The enumerated oil and gas leases were issued between September 1938 and February 1950, with various royalty structures. The current lessee is AERA Energy. Some of the production zones were previously modified to fixed rates,

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when a secondary recovery operation (Waterflood Program) was commenced. The leases were again modified for a new secondary operation, when on April 28,1993, the Commission approved the 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 approached the Commission staff to renegotiate the royalty on these leases, claiming that at the present and anticipated 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.

After evaluating many different types of profit sharing arrangements, Commission staff developed new and innovative sliding scale royalty schedules based on price. After a number of negotiating sessions, the parties agreed on the royalty schedule, attached hereto, as Exhibit A. Included in the approval was a required $7 million capital investment over a five year period for implementation of the Waterflood Program by the lessee. Based on staff's recommendation, and, among other things, the claim that the new royalty structure was estimated to provide the State more royalty revenue than the fixed 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 (see Exhibit B, attached hereto). 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, the State has received over $40 million. The sliding scale royalty approval provided the State about $15 million (in royalty revenue) more than what would have been received under the previous fixed rate royalties. Over the next 15 years, the State is forecasted to earn an additional $80 million or about $120 million total*. Exhibit C, attached hereto, is a graph of total incremental State Revenue since the inception of the new program.

EXHIBITS:

A: Sliding Scale Royalty Schedule
B: Normalized Royalty Rate
C: Royalty Revenue: Incremental State Revenue

PERMIT STREAMLINING ACT DEADLINE:

N/A