

**STAFF REPORT
INFORMATIONAL**

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A	37	08/17/17 PRC 145.1 PRC 410.1 PRC 1466.1 J. Planck
S	19	J. Fabel

STAFF REPORT ON THE RECENT HISTORY OF OPERATIONAL COMPLIANCE BY RINCON ISLAND LIMITED PARTNERSHIP; THE STATUS OF ONGOING CHAPTER 11 BANKRUPTCY PROCEEDINGS; AND, AN UPDATE ON A SETTLEMENT BETWEEN THE COMMISSION AND ATLANTIC RICHFIELD COMPANY, A PRIOR LESSEE; STATE OIL AND GAS LEASE NOS. PRC 145.1, PRC 410.1, AND PRC 1466.1, VENTURA COUNTY

SUMMARY:

This staff report provides the Commission and the public with information concerning the operational and legal history, since 2014, of State Oil and Gas Lease Nos. PRC 1466.1, PRC 145.1, and PRC 410.1 (the Leases) operated by Rincon Island Limited Partnership (RILP) offshore Ventura County; the status of RILP's chapter 11 bankruptcy proceedings in Dallas, Texas; and, a settlement recently reached between the Commission and the Atlantic Richfield Company (ARCO), a prior operator of the Leases.

In November 2014, regulatory violations were discovered on RILP's largest lease, PRC 1466.1, (Rincon Island) that staff believe posed, and continue to pose, a threat to public health and safety and the environment. Rincon Island has not produced oil since 2008; however, two oil wells of questionable structural integrity were discovered to be pressurized with fluid and gas. Additionally, RILP lacked the equipment on Rincon Island to safely relieve well pressures or fully respond to an oil emergency if one were to occur.

For 2½ years, staff of the Commission and the Division of Oil, Gas, and Geothermal Resources (DOGGR) worked continuously to compel RILP to fully resolve well and facility violations on Rincon Island. After missing key compliance deadlines and making only minimal progress to address well pressurization concerns and other safety and regulatory deficiencies, staff scheduled a recommendation for the Commission to terminate the Leases at its August 9, 2016 meeting. However, on August 8, 2016, RILP declared bankruptcy in Texas, and staff removed the item from consideration based on advice from the Attorney General's Office. By filing for bankruptcy, federal bankruptcy law provided RILP

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with a protective stay against all creditor actions, including the Commission, against its property. Staff, working with the Attorney General's Office and outside bankruptcy counsel, has actively participated in and sought dismissal of the bankruptcy proceedings.

On June 17, 2017, the bankruptcy court appointed a chapter 11 trustee to oversee RILP's business operations, and the Commission successfully moved the court to set a deadline of October 30, 2017, for RILP to successfully reorganize or sell its assets. Failure by RILP to meet the deadline will lift all bankruptcy protections over the Leases and effectively end the bankruptcy proceedings. Throughout the process, Commission and DOGGR staffs have maintained a daily presence on Rincon Island and have engaged actively with all parties to force a permanent and responsible resolution to the outstanding safety concerns on Rincon Island.

Separately, in early 2017, Commission staff and ARCO, a prior lessee of the Leases, negotiated a cooperative settlement of ARCO's potential abandonment liability pursuant to a previously approved assignment from ARCO. Under the settlement, ARCO agreed to pay \$8 million to the Commission to offset potential costs that may be improperly borne by the State if the State were forced to abandon very specific improvements on the Leases. Staff believes that the settlement, approved by the Commission during the closed session of its April 20, 2017 meeting is a fair representation of ARCO's potential liability, provides money for the Commission in the event that emergency action on Rincon Island is required, and avoids costly, protracted and uncertain litigation.

BACKGROUND:

The Leases consist of Lease Nos. PRC 145.1 and 410.1 (Shoreside Leases) originally executed in 1944 and 1949, respectively, and Lease No. PRC 1466.1 (Rincon Island), executed in 1955. The Shoreside Leases have been developed by means of wells directionally drilled from onshore sites primarily located on private property landward of U.S. Highway 101. Rincon Island is an artificial island constructed in 1959 for the purposes of well drilling and oil and gas production. Rincon Island is located approximately 3,000 feet offshore in water 55 feet deep and is connected to the shore by a causeway. RILP has been the operator of the Leases since 1995.

Lease No. PRC 145.1 contains 12 producing wells and one well used to reinject produced water back into the production formations. Only one of those 12 wells has recent production, and the injection well is inactive and currently inoperable. Lease No. PRC 410.1 contains nine production wells and three injection wells. Only three wells have recent production, and only one injection well is active. The wells produce into a common tank battery on the premises, which, while keeping

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the production from each lease segregated, removes produced water and prepares the crude oil for shipping through a common sales meter to a third-party transportation pipeline.

Rincon Island houses 69 well slots: 19 remain unused, 34 wells have been completed as producing wells, 13 have been completed as injection wells, and three have been completed as brackish water source wells. In addition, a subsea well was drilled approximately 3,000 feet west of the island. Production from the subsea wellhead was connected to the island by subsea flowlines. The well served as a water injection well over its last few years before being shut-in. The island also hosts storage tanks, oil processing equipment, and other appurtenant facilities.

Rincon Island has not produced oil or gas since October 2008 due in part to the condition and integrity of the causeway that connects the island to shore. During the winter of 2007, severe storms caused the shoreside abutment of the causeway to erode and fail. At the direction of staff, RILP secured the island by shutting down oil production, electrical power, and the oil shipping pipeline attached to the causeway. After obtaining an emergency California Coastal Commission permit and approval from Commission staff, RILP completed the emergency repairs in the late spring of 2008. From 2008 to 2015, RILP made repairs to two-thirds of the causeway; however, progress was slower than staff considered appropriate and reasonable. Construction deadlines and benchmarks established by both staff and RILP were repeatedly missed during the period. RILP made only temporary repairs to the remaining one-third of the causeway before ceasing repair work in 2015. As a result, one-third of the causeway cannot be used to support more than 20,000 pounds. Larger emergency vehicles and equipment necessary to perform well repairs and abandonment, such as a rig or mud pump, all weigh more than that, and therefore cannot be transported across the causeway.

The causeway is the primary access route for delivering equipment to the island necessary to maintain oil and gas production and to respond to an emergency. Further, the oil and gas pipelines run along, and are supported by, the causeway. The gas pipeline has been out of service since 2009 because of considerable corrosion. The oil pipeline, which is in serviceable condition, requires annual testing pursuant to Commission regulations to certify that it is safe for continued use. Production from the Shoreside Leases has declined over the last decade and is currently marginal (5 to 15 barrels of oil/day).

LEASE COMPLIANCE HISTORY SINCE 2014:

The discussion that follows primarily concerns issues on Lease No. PRC 1466, Rincon Island. Although staff had found regulatory violations on the Shoreside

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Leases, those concerns have in most part been resolved. The violations identified on Rincon Island persist and have been a primary reason for the actions taken by Commission staff.

Discovery of Natural Flow on Rincon Island Wells

Since 2008, production on Rincon Island had been shut-in and oil has not been produced in commercial quantities. In November 2014, during a routine inspection of the island and its facilities, staff discovered that at least two wells were capable of natural flow (meaning oil capable of flow without mechanical assistance). The pressure in these wells raised substantial concerns among staff engineers that a wellhead failure on one of these wells could result in an uncontrolled flow of oil at the surface. On November 20, 2014, staff sent a letter regarding the potential natural flow of certain wells to RILP. The letter stated that the criticality of the situation had increased because many wellheads on the island were in a severely deteriorated condition, many casing and tubing valves were inoperable, and the island causeway was not expected to be serviceable. Compounding the problem was the intermittent availability of the oil shipping pipeline along the causeway—the only means for transporting fluids to shore—because of corrosion issues and ongoing pipeline and causeway repairs. In addition, the fire pump on Rincon Island had recently failed, and RILP's ability to respond and contain a fire on the island was doubtful. The staff letter required immediate development of a contingency plan to respond to a wellhead failure. Since the island's wharf would be needed to mobilize equipment in a marine response to such an incident, the letter also required immediate inspection, load and mooring capacity assessment, and repair of the wharf as needed to enable such a response.

A series of meetings, letters, and planning sessions between Commission and RILP staffs ensued, marked by continued delays, lack of progress, and failure of RILP to meet agreed deadline commitments. An exchange of letters and discussions continued until pressure relief achieved by the flow tests on wells 8A and 50A was finally accomplished between July 10 and July 24, 2015. The tests showed that the wells were capable of natural flow but the deteriorated wellbore conditions may have limited the degree of pressure relief from the operations. Although the flow relieved the pressures on the wells at the time, the pressure on both wells soon returned to pre-test pressures confirming Commission staff's concerns that the situation was not an isolated occurrence, and that the reservoirs are re-pressurizing. The presence of natural flow triggered additional regulatory and safety requirements on the island that RILP was obligated to address.

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On December 9, 2015, Commission staff again met with RILP to discuss the status of compliance with the milestones established in early 2015 to remediate violations on the island. The discussion included RILP's incomplete response to staff concerns with the fire system restoration and unfulfilled requirements of a Spill Contingency Plan Addendum in its Operations Manual, Pressure Relief Plan, Wellhead Repair Plan, Wharf Structure Repair Plan, Causeway Repair Project, and the need to increase the performance bond for its operations. In addition, RILP informed staff that with the low price of oil, it was not planning on starting the final permanent causeway repair work for at least another 2 years.

By letter dated February 17, 2016, Commission staff directed RILP to remedy violations arising from the lack of subsurface safety valves on wells capable of natural flow and to repair or replace wellhead flanges incapable of supporting, securing, or sealing a blowout prevention stack due to extreme oxidation and corrosion, and to replace nonfunctioning wellhead casing and tubing valves. RILP issued a strongly worded response dated February 22, 2016, disputing that the violations created a public health and safety hazard, that certain Commission regulations were inapplicable, and that the lack of production from the Leases was justified.

On March 30, 2016, RILP emailed a proposed "Wellbore Blowdown Operations Equipment List" that identified the equipment necessary to address Rincon Island's recently re-pressurized Wells 8A and 50A. Staff responded by letter dated April 8, 2016, approving the use of the equipment listed in the March 30 email and noting that the procedures used for the pressure relief operations followed in July 2015 to address Lease No. PRC 1466.1 Wells 8A and 50A were acceptable, subject to 12 specific conditions. For example, staff's response letter emphasized that individual well work would only be approved on a case-by-case basis, and encouraged RILP to submit a prioritized list soon to reduce risk.

The Commission's April 11, 2016 Default Notice

Because of the failure to timely repair deficiencies and permanently remediate the natural flow concerns identified in November 2014, on April 11, 2016, Commission staff sent a Default Notice to RILP. The Default Notice invoked the default provisions of the Leases, giving RILP 60 days to remedy, or take good faith steps to remedy, the identified defaults including, but not limited to, significant state regulatory violations as well as express provisions of the Leases, the failure to comply with both Commission and DOGGR orders, and the failure to comply with RILP's contractual obligation to increase the required performance bond.

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On April 29, 2016, RILP submitted a letter identifying a schedule for additional pressure relief operations on the island over a 140-day period. The letter lacked sufficient details on how or when the pressure relief operations would commence. In addition, RILP's letter did not address any of the defaults identified in staff's April 11, 2016, Default Notice. Staff's May 11, 2016, reply detailed these omissions and further provided a list of prerequisites necessary to performing any safe pressure relief operation, including repair of the island's fire suppression system, certifying the causeway carrying capacity, and testing the oil transportation line. On June 9, 2016, RILP replied, indicating that it was working toward meeting staff prerequisites for a future pressure relief procedure; however, the letter did not include an overall timeframe for when RILP would complete those prerequisites or provide staff with a detailed plan for the associated operations. Additionally, the letter declined to commit to make, or provide a plan for making, the repairs identified in the Default Notice.

On June 14, 2016, Commission and DOGGR staff conducted a joint inspection of the Leases and found that RILP had addressed violations relating to well corrosion by painting wellheads and installing valves and gauges on many of the wells; however, the inspection showed no progress on remedying violations relating to oil production safety. Serious violations persisted such as the lack of subsurface safety valves on wells capable of natural flow, inoperable wellhead master valves, an inoperable primary fire suppression system, and RILP's failure to update its operations manual or oil spill contingency plan. Additionally, the inspection demonstrated that Lease No. PRC 1466.1 is, now and for the foreseeable future, incapable of oil or gas production due to the disrepair of the island's flaring system, tankage, fire suppression, and wellheads. More specifically, many of the wellheads lack flow lines or an ability to attach blowout prevention devices which are needed for both subsurface well repair, preparation for production, and for emergency well repairs in the event of an uncontrolled release of oil.

To understand and anticipate the potential costs to fully plug and abandon the wells and to decommission the facilities and causeway on Rincon Island, the Commission engaged a professional engineering firm, InterAct, to provide a cost estimate. InterAct concluded that full decommissioning of Rincon Island's oil infrastructure and removal of the causeway could cost as much as \$50.5 million.

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RILP Declares Bankruptcy as Staff Prepares a Recommendation to Terminate the Leases

As a result of the June 14, 2016 inspection, staff prepared a report for the Commission's August 9, 2016 public meeting recommending termination of the Leases. The proposed basis for termination was the failure to cure the lease defaults: ongoing and persistent regulatory violations; a failure to increase the performance bond as required under the Leases; and, the failure to produce oil and gas as required under the Leases. At RILP's request, on Friday, August 5, 2016, staff met with RILP and its counsel at the Commission's Sacramento office. RILP indicated that it was contracting to perform significant well work and taking other measures it considered to be proof of substantial compliance with the Commission's Default Notice. RILP asked that Commission staff delay its termination recommendation until the Commission's October meeting. Staff asked RILP to show evidence that it would make necessary repairs before staff would consider RILP's request. On Sunday, August 7, 2016, RILP submitted documents amounting to estimates for work and parts; however, no construction contracts, proof of payments, or other firm commitment to perform the repair work was provided. On Monday, August 8, 2016, Commission staff met again and informed RILP that staff would not remove Calendar Item 57 from the August 9, 2016 meeting agenda. RILP filed for Chapter 11 bankruptcy in Dallas, Texas, later that day.

Because bankruptcy provided RILP with a protective stay against any and all creditor actions against its property, Commission staff, upon the advice of the Attorney General's Office (OAG), removed Item 57 from the August 9, 2016 meeting agenda and began preparing to force compliance, or termination, through the Texas bankruptcy court.

Post-Bankruptcy Operations on Rincon Island

Since RILP declared bankruptcy on August 8, 2016, it has performed certain upgrades and repairs on the island to improve safety; however, the significant downhole well repairs that largely prompted staff's concerns and the Default Notice remain outstanding.

On August 8, 2016, DOGGR issued emergency order No. 1114 ordering RILP to install and maintain 24-hour security, place a workover rig on the island, and importantly, install plugs in wells 8A and 50A to contain well pressures and install valves and pressure gauges on all other wells. That same month, RILP installed a video surveillance system for 24-hour security monitoring of the island. RILP has also performed clean up and removal of out-of-service equipment; installed a working deluge fire

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suppression system; and conducted work to strengthen the wharf structure to accommodate the offloading of a rig onto the island.

Due to the deficient load capacity of the causeway, a workover rig necessary to perform well work (e.g., installing plugs) had to be moved to the island by barge. An attempt to barge the rig to the island failed in September 2016 due to miscalculations of the wharf height. It wasn't until February 25, 2017, that a rig was finally placed on the island; however, substantial well work has yet to occur because additional necessary equipment, such as a mud pump, has not been moved to the island. With RILP's insolvency (discussed below) such equipment is not likely to be transferred in the immediate future.

Between March 10 and March 14, 2017, RILP performed the first pressure relief or "blow down" operation since July 2015 on wells 8A and 50A. Between both wells, 140 barrels of oil (5,880 gallons) naturally flowed over a period of 8 hours. Since the operation, well pressures resumed to their previous level. These findings validate staff's long-held concerns that the flow rates, combined with the deteriorated well conditions, could lead to an uncontrolled release of oil in the event of an accident.

Throughout this period, both Commission and DOGGR staffs have been actively engaged through inter-agency coordination and a daily presence on Rincon Island. Staffs remain concerned with RILP's delays and have communicated the problems on Rincon Island to the bankruptcy court and the recently appointed chapter 11 trustee (discussed below). On July 17, 2017, in consultation with DOGGR, Commission staff sent the chapter 11 trustee a listing of minimum actions that the trustee must take to ensure the safety of the island during the period of trustee control. Commission staff is continuing its communications with the trustee and bankruptcy court to ensure longstanding compliance issues are resolved in the near term.

RILP'S BANKRUPTCY PROCEEDINGS:

Commission staff along with the OAG have actively participated in, and provided testimony for, RILP's chapter 11 bankruptcy proceedings (*In re Rincon Island Limited Partnership*, N. Dist. Texas, No. 16-33174). The Commission has aggressively contested various motions by RILP to remain operator of the Leases and with the consent of the OAG and has retained experienced Texas bankruptcy counsel to provide onsite representation during numerous hearings. The Commission has twice filed motions to end the case; the first being denied in part and the second being granted. As a result of the second motion by the Commission, a chapter 11 trustee was appointed to operate RILP and has until

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October 30, 2017 either to have a court approved plan to reorganize its business or to find a new prudent operator for the Leases. If either of these events do not occur by or on that date, unless extended by the consent of Commission staff, the bankruptcy protections automatically lift and the Commission may take any actions on the Leases within its authority.

RILP's Preliminary Actions to Keep the Shoreside Leases

The first substantive hearings in the bankruptcy proceedings concerned RILP's motion to keep (or "assume") the Shoreside Leases, Lease Nos. PRC 145.1 and 410.1. During hearings on October 17, 2016, and January 24, 2017, represented by the OAG and Texas counsel, Commission staff provided testimony in opposition to RILP's motion to assume the Shoreside Leases. Commission attorneys argued that the court should consider whether RILP should assume all three Leases all at once, not individually; that RILP had not provided its required bond and therefore was in breach of all Leases; and, that a temporary cessation in production on the Shoreside leases caused those leases to expire by their own terms. The court ruled that RILP could assume the Shoreside Leases and keep operating them if and only if RILP provided the Commission with a \$10.38 million bond. While the order granted RILP the ability to continue operating the Shoreside Leases, it affirmed staff's interpretation of the required bond amount, a point disputed by RILP since February 2016. The bond requirement ordered by the court also set the stage for the Commission's subsequent motion to lift the automatic stay.

The Commission Retains Experienced Dallas Based Bankruptcy Counsel

After the first substantive hearing in Dallas on October 17, 2016, Commission staff, in consultation with the OAG, concluded that local, experienced bankruptcy counsel would be needed to fully protect the State's interests in RILP's bankruptcy proceedings. Texas-specific court rules required the physical attendance of witnesses and counsel at monthly hearings and that each party provide multiple paper copies of each exhibit submitted as evidence—a rule that requires presenting volumes of printed documents. This differs from California practice where witnesses may provide testimony by signed declaration and counsel may participate fully by telephone. The Texas rules required Commission and OAG staff to travel to Dallas monthly, posing a significant time and resource burden to each agency.

In November 2016, staff retained the services of the Law Offices of Judith W. Ross in Dallas. Ms. Ross has over 30 years of bankruptcy experience, and upon recommendation by the OAG, has provided competent

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representation, in coordination with the OAG, and provided expert counsel on technical bankruptcy matters and local rules of practice. Funding for continued representation was approved as a line item in the 2017-2018 state budget passed by the Legislature in June 2017.

End Date to RILP's Bankruptcy Proceedings

The Commission has twice formally asked the court to dismiss RILP's bankruptcy proceedings. In December 2016, the Commission filed a motion to dismiss RILP's proceedings on the grounds that the bankruptcy was filed with the improper purpose of frustrating the Commission's ability to consider termination, that the Leases had already expired by a lack of production and should not be considered an asset of RILP, and that RILP's poor finances made it unlikely it could successfully reorganize. Over 2 days of hearings on February 7 and 8, 2017, Commission and DOGGR staffs presented testimony supporting the Commission's request. In an order dated February 23, 2017, the court denied the Commission's motion, but acknowledged the condition of Rincon Island and invited the Commission to seek court ordered compliance deadlines if progress to cure ongoing violations did not occur.

On May 1, 2017, in response to RILP's lack of progress in making well repairs on Rincon Island and the failure to increase the bond, as ordered by the court in February, the Commission filed a motion to lift the automatic stay. The motion requested that the court establish deadlines for RILP to increase its bond and to approve a plan of reorganization, a necessary step to successfully exiting bankruptcy. During a hearing held June 13, 2017, the court granted the Commission's motion establishing deadlines for RILP to increase its bond and have a plan of reorganization approved, or else have the automatic stay be lifted; however, by request of UBS AG Bank, RILP's largest secured creditor, the court modified its order. The modified order required RILP to increase the bond held under the Leases to \$10.38 million by June 15 or else a chapter 11 trustee would be appointed to oversee RILP's business. Further, regardless of whether the bond order was met, RILP or the trustee would need a plan of reorganization approved or the Leases conveyed to another operator by October 30, 2017, or else the bankruptcy protections over the Leases would end. The court-ordered deadlines create certainty on when the case might end and when the Commission's full authority over the Leases will be restored.

On June 14, 2017, RILP sent a certificate to Commission staff indicating that it had increased its performance bond to \$9.65 million. During a status conference with the court on June 16, 2017, the court held that the

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increased amount was \$730,000 short of the previously ordered amount and that, as a result, a chapter 11 trustee would be appointed to oversee RILP's business. On June 28, 2017, Jason Searcy, an attorney based in Dallas, was appointed as the chapter 11 trustee and now manages RILP's estate. After the Court's order, Commission staff accepted the increased bond.

RILP is Currently Under the Control of the Chapter 11 Trustee

To Commission staff's understanding and knowledge, UBS AG Bank will fund the work of the chapter 11 trustee and ongoing operations on the Leases through October 30, 2017. In addition, the chapter 11 trustee will attempt to market RILP's Leases and assets to a responsible third-party operator. The bankruptcy process provides the court and trustees with the power to dispose or assign assets for the benefit of the estate. Staff has not objected to the chapter 11 trustee's plan to market the Leases; however, the Commission has reserved all rights to fully object to any assignment that may involve an inexperienced, undercapitalized, or imprudent operator. Commission staff has engaged and communicated with the chapter 11 trustee regarding the compliance expectations on Rincon Island. A letter dated July 17, 2017, developed in consultation with DOGGR staff, informed the chapter 11 trustee of the Commission's minimum expectations during the trusteeship period including: maintaining 24-hour monitoring; staffing the Leases with experienced operators with the resources to respond to an emergency; performing additional blow-down procedures as necessary; and, performing permit, inspection, and facility compliance on the Leases. Staff are currently awaiting notification from the chapter 11 trustee awarding a bid for an independent operator to begin managing the Lease premises. Throughout this process staff is continuing daily inspections of the facilities.

THE ARCO SETTLEMENT:

After the Commission issued its Default Notice to RILP in April 2016, Commission staff contacted prior lessees that staff believed retained some degree of abandonment liability. As a result of these and subsequent communications, on April 20, 2017, the Commission and ARCO entered into a settlement agreement whereby ARCO has paid the State \$8 million to aid in any abandonment costs the State might incur on the Leases in exchange for releasing ARCO from further lease liability.

ARCO was the original lessee for Rincon Island and operated the lease from 1955 until 1982 when it assigned its interests to Norris Oil Co. ([Item 26, July 22, 1982](#)). At that time, ARCO was relieved of all future abandonment liability by the Commission. This express release was consistent with language within Lease

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No. PRC 1466.1 releasing assignors of future obligations. Through subsequent acquisitions, ARCO reacquired a 50 percent interest in Rincon Island, which it then assigned to Berry Petroleum Company (Berry) in 1992. ([Item 26, January 8, 1992](#)). Under the 1992 assignment to Berry, ARCO expressly retained abandonment liability for the physical removal of the island and connecting causeway, while Berry retained the obligation to plug and abandon all of the oil and gas infrastructure. In 1995, Berry assigned its interest in Rincon Island to RILP. ([Item 84, October 17, 1995](#)).

Staff initially reached out to British Petroleum (BP), ARCO's parent company, in April 2016 to notify BP of the Commission's Default Notice against RILP and to inform BP that it may retain abandonment liability. In December 2016, after the Commission filed its motion to dismiss RILP's bankruptcy proceedings, ARCO contacted staff to discuss how RILP, ARCO, and other parties could resolve the Commission's outstanding concerns on Rincon Island. On January 5, 2017, ARCO met with staff and proposed to organize a non-binding mediation among staff, RILP, ARCO, and UBS AG Bank. A mediation was held at the JAMS Mediation Services offices in San Francisco on March 3, 2017. Staff attended the mediation with the goal of identifying areas of cooperation with ARCO, UBS AG Bank, and RILP to resolve staff's concerns on Rincon Island.

The parties attending the mediation were unable to develop a global proposal satisfactory to staff. While ARCO denied that it retained any remaining liability under the Leases, it negotiated cooperatively and in good faith with staff to settle potential claims as a matter of business judgment. As a result, staff and ARCO separately negotiated a cooperative proposal where ARCO would pay the State \$8 million to aid in any abandonment costs the State might incur in exchange for releasing ARCO from further abandonment liability under the Leases. The release of liability extends only to abandonment liabilities stemming from the Leases and does not waive liability under any other source of federal or state law. The terms were drafted into a settlement agreement that was approved by the Commission during closed session at its April 20, 2017 meeting.

The settlement achieves three critical objectives: 1) to guarantee a firm amount to offset some of the State's costs related to abandoning Lease No. PRC 1466, including immediate funding for staff to take emergency actions on Rincon Island if necessary; 2) to guarantee contribution from ARCO despite its contentions that its liability was only contingent; and, 3) to avoid lengthy and costly litigation with ARCO with uncertain results.

Importantly, staff believes that \$8 million reasonably approximates the likely value of ARCO's liability in the event that liability was triggered. RILP, as the current lessee, is liable for removing all oil and gas production facilities and

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improvements in the event the lease terminates or is quitclaimed. Previous operators are liable only in the event RILP fails to uphold these obligations and only to the extent that it was agreed they be held liable. Unlike in assignments covering other state oil and gas leases, where a previous assignor retains the full obligation to abandon all facilities and improvements, the liability ARCO retained in 1992 was limited to physical removal of the island and causeway, and only if removal of those improvements were ordered by the Commission. The \$8 million value approximates the cost to remove the causeway as estimated in the report prepared for the Commission in June 2016 by InterAct. Those funds are now guaranteed and available to the Commission to offset costs that may otherwise accrue to the State in securing and abandoning Rincon Island, if necessary.

Between the \$8 million received in the ARCO settlement and the \$9.65 million performance bond held by the Commission under the Leases, the Commission holds approximately \$17.65 million in security against abandonment costs on the Leases. Staff are working to preserve claims against other parties who also may share abandonment responsibility.

EXHIBIT:

- A. Site and Location Map

EXHIBIT A

PRC 145.1
PRC 410.1
PRC 1466.1

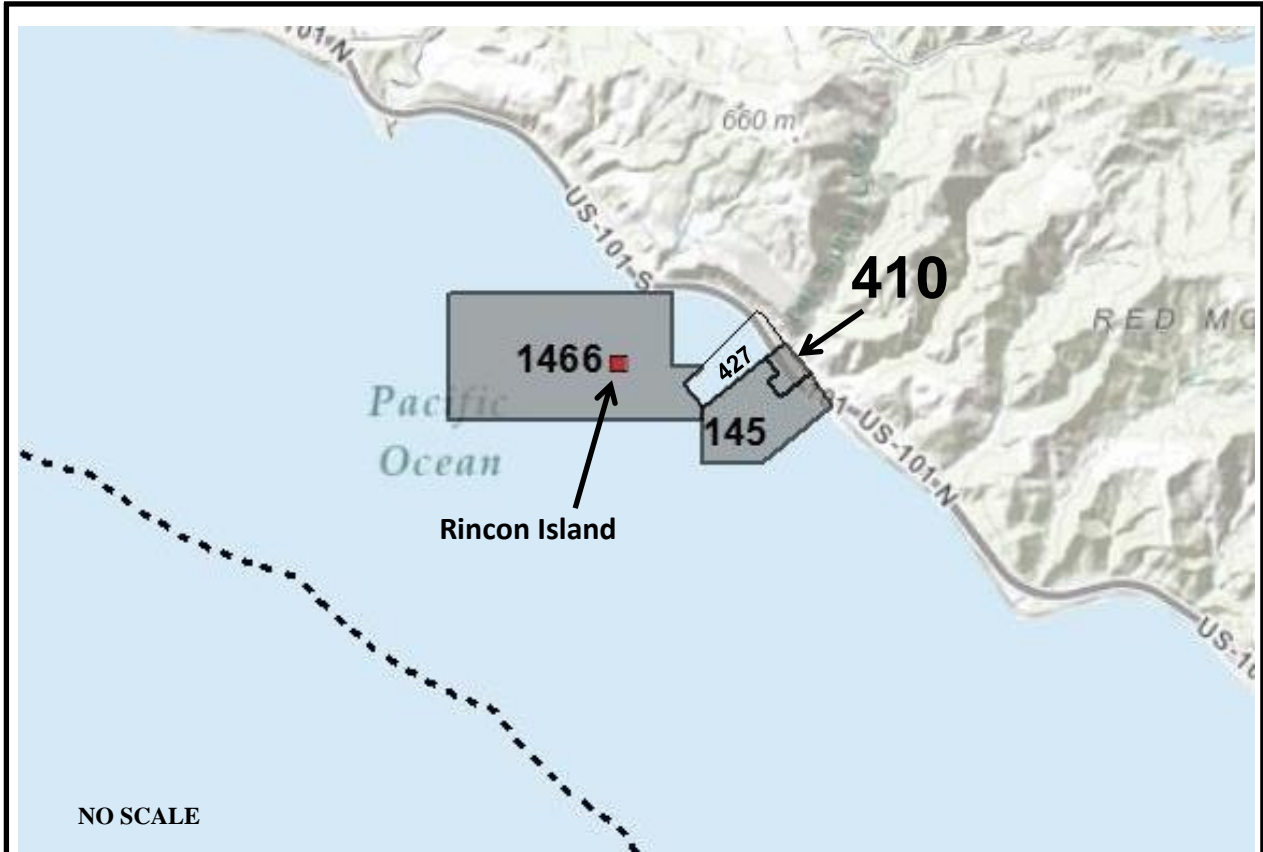


EXHIBIT A
PRCs 145.1, 410.1, 1466.1
Rincon Island Limited Partnership
Oil and Gas Leases
VENTURA COUNTY



This Exhibit is solely for purposes of generally defining the lease premises, is based on unverified information provided by the Lessee or other parties and is not intended to be, nor shall it be construed as, a waiver or limitation of any State interest in the subject or any other property.