MINUTE ITEM

This Calendar Item No. 23 was approved as Minute Item No. 23 by the State Lands Commission by a vote of 2 to 0 at its 10-30-80 meeting.

MINUTE ITEM

10/80
PRC 3120
PRC 3242
Willard

23. PROPOSED SETTLEMENT OF ROYALTY ACCOUNTING DIFFERENCES, PRC 3120 AND PRC 3242

During consideration of Calendar Item 23 attached, Jack Hundley, offshore Manager for Arco, appeared. Mr. Hundley's main purpose for appearing was to comment that it is their feeling the settlement was very successful not only in reaching a mutually acceptable agreement but in being able to consider each others views without butting heads.

Upon motion duly made and carried the resolution as presented in Calendar Item 23 was approved by a vote of 2-0.

Attachment: Calendar Item 23.

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S 18

CALENDAR ITEM

23.

10/80
PRC 3120
PRC 3242
Willard

PROPOSED SETTLEMENT OF ROYALTY ACCOUNTING DIFFERENCES, PRC 3120 AND PRC 3242

The staff and representatives of Atlantic Richfield Company have arrived at a proposed compromise settlement for three royalty accounting problems involving State leases PRC 3120 and PRC 3242, South Ellwood Offshore field, Santa Barbara County.

The first problem concerns gravity pricing for commingled oil production from the Rincon and Monterey zones on the two leases. It is the State's position that the data which ARCO used in calculating the State's royalty were not reliable. Because of the inadequate performance of sampling equipment initially installed at the lease seperators, hand sampling was used by ARCO. The data derived from hand sampling proved to be unreliable because of infrequent sampling, the taking of samples at the wrong location and the lack of provision to measure free water production. Therefore, the State proposed that the only available and reliable gravity measurement for royalty accounting purposes is the commingled shipping gravity. The royalty adjustment due the State using this procedure would be in the amount of $215,000. ARCO does not agree that the data used in its calculations are in error, however, they did establish a method of calculation which they considered to be more precise with respect to Rincon and Monterey Zone oil production. This procedure would be in favor of the State by $28,000. The difference between the two procedures is $187,000. This amount is proposed as a compromise settlement of this problem through December 1978.

The second problem is whether well No. 3120-7 should be included when determining the total well production days for calculating royalty under the sliding scale royalty formula. In 1969, remedial well work was conducted on all producing wells on Platform Holly to cement-off the Monterey Zone for elimination of communication between zones. The casing annulus was opened in all wells to alleviate gas pressure that had built up in the shallow Sisquoc Zone.

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(Added, 10/29/80)

In addition well 3120-7, a suspended well, was re-entered and perforated in this shallow zone to assist in relieving the pressure. Although the approval for the well-work in this well was requested and granted for the purpose of relieving pressure in this shallow zone, ARCO proceeded to classify the well as a Sisquoc producer and included its production days in the royalty calculations. It is the State's position that in order for a well to qualify as a producing well for inclusion in the sliding scale formula, it must be one which has been completed for the primary purpose of producing oil in paying quantities. Although the State is of the opinion that well 3120-7 should not have been classified as a producing well, ARCO has submitted well test data which indicate that the well, at best, could be considered productive during only 34 percent of the period in question. ARCO considers that well No. 3120-7 was in a productive status throughout this period. In settlement of this problem, it is recommended the State's claim ($372,000) for complete elimination of the well for royalty rate calculations be adjusted by 66 percent or $245,000.

The third problem involves pricing Monterey production for royalty purposes during the testing of the Monterey Zone. During this period, ARCO entered into an exchange agreement with Toscopetro Corporation for disposal of the Monterey oil. The problem centers around the interpretation of the value placed on the Monterey crude in this agreement. Under this exchange agreement ARCO was to receive 1.5 barrels of Huntington Beach crude for every barrel of Monterey crude from Ellwood delivered to Toscopetro at Maricopa. It is the State's position that the volume adjustment ratio was for the purpose of offsetting the delivery of the higher gravity Ellwood crude on which ARCO incurred transportation costs in exchange for the lower gravity Huntington Beach crude. ARCO's position in this matter is that the volume ratio had no bearing on establishing the value of the Monterey crude. In view of the firm position of each party, it is proposed to settle the claim of $145,000 for $75,000.

The State's position on the three problems would involve a royalty adjustment in favor of the State amounting to $732,000. The compromise settlement is in the amount of $507,000.

CALENDAR ITEM NO. 23 (CONTD)

IT IS RECOMMENDED THAT THE COMMISSION:

1. AUTHORIZE ACCEPTANCE IN SETTLEMENT OF CERTAIN ROYALTY ACCOUNTING PROBLEMS THROUGH DECEMBER 1978 UNDER STATE OIL AND GAS LEASE PRC 3120.1 AND PRC 3242.1 THE AMOUNT OF $507,000.