Meeting Date: 08/23/22
Work Order Number: W 41006
Staff: S. Meshkati
E. Tajer

Staff Report 39

PARTY:

California State Lands Commission

PROPOSED ACTION:

Request delegation of authority for the Executive Officer or her designee to solicit for consultant services, negotiate fair and reasonable prices, award and execute agreements, and take any other steps reasonably necessary to prepare cost studies pursuant to Budget Item 3560-002-0001 in SB 154 (Skinner), of the 2022 Budget Act, to estimate the fiscal impact of a voluntary relinquishment by the lessees of their remaining interests in actively producing offshore oil and gas leases in state waters.

BACKGROUND:

The 2022 Budget Act appropriated $1 million to the Commission to conduct an offshore oil and gas lease cost study to support pending legislation, AB 2257 (Boerner Horvath). AB 2257 would require the Commission to develop and submit to the Legislature, by December 2024, a cost study that evaluates the fiscal impact of a voluntary relinquishment by the lessees of their lease interests in actively producing state offshore oil and gas leases. The cost study would consider the expected duration of oil production at the time of leasing, state revenues received to date, evaluate expected remaining life of the reservoir based on proved reserves, reasonably anticipated unrealized lessee revenues and profits, reasonably anticipated unrealized state revenues, and the lessees decommissioning and restoration costs. The cost study must also include recommendations to advance the end of offshore oil and gas development.

AB 2257 would require the Commission to hold at least one public hearing related to the cost study and by December 2023, to submit a status update on the cost study to the Governor and Legislature that includes an outline of the cost study elements, identified data gaps, preliminary analysis, conclusions, and recommendations, and any public comments the Commission has received.

Although, in 1994, California banned new offshore oil and gas leases through the California Coastal Sanctuary Act, the remaining offshore oil and gas leases continue if the lessee either produces or is capable of producing oil in paying quantities—that is to say—the offshore leases lack an end date. Three producing platforms, all managed pursuant to a state lease, remain in state waters—Esther, Eva, and Emmy—on eight producing oil and gas leases, all of which were issued in the 1940s and 1950s. Two other offshore leases unassociated with a platform are drilled from onshore sites in Ventura County and the remaining lease is produced from Island Chafee in Long Beach. The Long Beach Unit, which includes four oil islands and the West Wilmington operation (a reservoir primarily located under the Port of Long Beach) is operated by California Resources Corporation and managed by the City of Long Beach. Long Beach Unit and West Wilmington operations are net profit contracts, not leases, and therefore are not included in AB 2257.

California's coastal economy employs 12.3 million people annually, earning a total of almost $883.5 billion and equating to over $2 trillion in gross domestic product. The risk of an oil spill, and the economic and environmental catastrophe that could follow, coupled with the fact that fossil fuels exacerbate climate change, call for California to seek out ways to quicken the end of offshore oil and gas development. A cost study that assesses the fiscal impact of voluntary relinquishment by the operators of their remaining lease interests in the State's actively producing offshore oil and gas leases is consistent with that goal. It is also consistent with California's role as a global leader in the fight against climate change.

In October 2021, an underwater pipeline operated by Amplify Energy Corp. ruptured, spilling nearly 25,000 gallons of oil into the Pacific Ocean, and causing beach closures, damaging the environment, and harming the regional and state coastal economies. The spill triggered an outcry from elected officials, environmental groups, and others to end offshore oil and gas development. The Legislature held three hearings focused on the spill and to learn more about state and federal offshore oil and gas development and decommissioning options. In October 2021, just after the spill, Senator Dave Min announced that he would introduce legislation to ban all existing oil and gas operations in state waters. Governor Newsom has also called for California to phase out oil extraction across the State by 2045, and several major oil companies have committed to zero net carbon emissions by 2050.

A cost study that assesses the fiscal impact of voluntary relinquishment of the remaining interests in the State's actively producing offshore oil and gas leases will provide the knowledge necessary to embark on a formal effort to resolve offshore oil and gas development. The cost study can also assess ways the State can propel oil and gas companies toward voluntarily ending offshore oil and gas production as a component of a credible strategy to reach zero net carbon emissions by 2050 or sooner.

DESCRIPTION:

The Commission manages offshore oil production facilities and leases within 3 miles off the coast, including oil-producing islands and offshore platforms.

AB 2257 would require the Commission to develop, on or before December 31, 2024, a cost study to evaluate the fiscal impact of a voluntary relinquishment of any lease interests in the 11 producing oil and gas leases in state waters through voluntary negotiations with each lessee/operator. AB 2257 would require the Commission, on or before December 31, 2024, to submit the cost study to the Governor and the Legislature and to make the cost study available on the Commission’s website. The cost study shall consider, but not be limited to, the following factors:

1. Expected duration of oil production at the time of leasing
2. State revenues received to date
3. Expected remaining life of the reservoir based on proven reserves
4. Reasonably anticipated unrealized lessee revenues and profits
5. Reasonably anticipated unrealized state revenues
6. Lessees’ decommissioning and restoration costs

AB 2257 would also require the Commission to hold on or before December 31, 2023, at least one public hearing related to the cost study. The bill would require the Commission, on or before December 31, 2023, to submit a status update on the cost study to the Governor and the Legislature.

The status update, due before December 2023, shall include the following information:

1. A proposed outline of the cost study elements
2. Identified data gaps

3. Preliminary analysis, conclusions, and recommendations
4. Any public comments received by the Commission

The cost study will require a comprehensive engineering and economic analysis of unrealized state revenues, reasonably anticipated lessees' lost profits, life of the reservoir based on proved reserves, well and facilities abandonment, lessee decommissioning costs, and potentially, the surface land value for facilities and wells located onshore on privately-owned lands. The timeline for presenting the final report is ambitious and requires the analytical work to begin as soon as possible. The work required to develop a comprehensive and meaningful study is highly specialized and requires retaining consultants with specific expertise. Determining the monetary value of each lease is a complex and data driven process that requires expertise from a reservoir engineer, economist, and an appraiser. The study would involve arranging for a reservoir engineer to determine what reserves remain and are likely to be produced. It will also involve economist and appraisal analysis to assess the price of oil and trajectory of production, as well as the costs the operators bear to produce oil and gas offshore. The work involved in estimating the Lessees' decommissioning and restoration costs also requires proven engineering knowledge in this field and requires consultants with specific expertise in this area. The 11 offshore oil and gas leases date back to the 1940s and 1950s and include nuanced lease terms and physical infrastructure that make assessing the elements included in AB 2257 incredibly complex, resource intensive, and time consuming. The Commission lacks staff with the expertise necessary to do these analyses and therefore must retain consultants to develop the cost study.

Staff recommends that the Commission delegate authority to the Executive Officer or her designee to retain consulting services to conduct the cost study. The Commission is experienced with securing engineering services to assess complex oil and gas reservoir information. Staff would use all information yielded from the study, as the foundation for a methodical and data driven negotiation strategy with each offshore operator to end offshore oil and gas production. The Commission's leases and statutory authority enable the Commission to obtain the specific information necessary to ensure that the study reflects the unique situation relative to each lease.

Consultant selection will be conducted pursuant to current law, including the Public Contract Code, State policies and procedures, the Commission's regulations. and the State Contracting Manual requirements. Consultant selection will be based on demonstrated competence and professional qualifications necessary to perform the services required. Staff will ensure that the process is fair and open to a wide applicant pool, including small business and veterans, and that successful applicants are qualified to fulfill the cost study objectives.

STAFF ANALYSIS AND RECOMMENDATION:

AUTHORITY:

Public Resources Code sections 6005, 6106, 6216, 6301, 6890, 6895, 6897, 6898, and 6899; Government Code sections 4526 and 19130 subdivisions (b)(3) and (10).; Public Contract Code sections 6106, 10335, and 10340(b)(3)(A); State Contracting Manual, Volume. 1, Chapters 3 and 11; California Code of Regulations, title 2, sections 2000, 2003, and 2980 et seq., and title 14, section 15045 Chapter 43, Statutes of 2022, known as the "The Budget Act of 2022;" Item 3560-002-0001.

PUBLIC TRUST AND STATE'S BEST INTERESTS:

The climate crisis and its effects on the ocean, land, and people are among the most urgent issues of our time. A just transition from fossil fuel to renewable energy sources is becoming more realistic as technologies advance. California is a global leader in the fight against climate change and strives to phase out oil and gas production, which exacerbate climate change, in exchange for greener and cleaner energy sources. However, there are currently 11 operating oil and gas leases offshore California which lack an end date. These leases, issued in the 1940s and 1950s, allow operation as long as the lessee either produces or is capable of producing oil in paying quantities. Ending offshore oil production will eliminate the risk of an oil spill which can have catastrophic economic and environmental impact for California.

The Commission lacks the authority to unilaterally terminate existing leases, absent an identified breach of the lease term, without incurring significant liabilities. The only viable path to ending California's offshore fossil fuel production is through negotiations with the operators and offering buy back options so the operators voluntarily end offshore production. The proposed cost study will yield the information necessary to initiate negotiations to responsibly shut down offshore operations without incurring additional legal costs, uncertainties, and delays. The study's follow up negotiations will also help advance Governor Newsom's call to phase out oil extraction across the State by 2045.

CLIMATE CHANGE:

The climate crisis is an existential threat, and the need to reduce greenhouse gas emissions grows more urgent each passing day as California is already beginning to feel the impacts of climate change. According to a report by the Legislative Analyst's Office, the years from 2014 through 2020 (except for 2019) experienced the six highest annual average temperatures ever recorded in the State. The summer of 2021 set the State's record for hottest average summer temperatures, beating the previous record that was set only a few years prior in 2017. In addition to hotter temperatures, California is also already experiencing more frequent and intense droughts, setting numerous drought records over the past decade. The warming and drying climate has also created conditions that lead to high-severity wildfires. Seven of the 20 most destructive wildfires in the State's history occurred in 2020 and 2021. The extreme temperatures, drought, wildfires, and other impacts of climate change will continue to worsen if greenhouse gasses are not drastically reduced in the coming decades.

While advances in clean energy development are enabling California to transition from fossil fuels to clean energy and reduce greenhouse gas emissions, California will require much deeper greenhouse gas emissions reductions to reach its 2030 target of 40 percent below 1990 levels, and carbon neutrality no later than 2045, or sooner. California banned new offshore oil and gas leases in 1994; however, the remaining offshore oil and gas development in state waters continues to emit greenhouse gasses and occasionally experience damaging oil spills. Oil spills can negatively impact marine and coastal ecosystems that provide important climate mitigation and resilience benefits.

The risk of an oil spill, and the economic and environmental catastrophe that could follow, coupled with the fact that fossil fuels exacerbate climate change, call for California to seek out ways to quicken the end of offshore oil and gas development.

The cost study will provide the knowledge necessary for informed decision making and practical solutions to end offshore oil and gas development, which, from a climate change, environmental, and public health perspective, is vital.

CONCLUSION:

For the reasons above, staff believes the proposed delegation of authority to the Executive Officer or her designee to, through appropriate Procurement Approach(es), solicit for consultant services, negotiate fair and reasonable prices, award and execute agreements, is in the State's best interests.

OTHER PERTINENT INFORMATION:

1. AB 2257 is pending on the Senate floor—as of the date of this Staff Report.

2. Authorization to solicit proposals through the appropriate Procurement Approach(es) for consultant services is not a project as defined by the California Environmental Quality Act because it is an administrative action that will not result in direct or indirect physical changes in the environment.

   Authority: Public Resources Code section 21065 and California Code of Regulations, title 14, section 15378, subdivision (b)(5).

3. This delegation of authority is consistent with the "Leading Climate Activism," and "Meeting Evolving Public Trust Needs," Strategic Focus Areas of the Commission's 2021-2025 Strategic Plan.

RECOMMENDED ACTION:

It is recommended that the Commission:

1. Find that the tasks within the project scope are highly specialized and only needed for a short term. To implement the urgent tasks under a civil service personnel classification would delay their implementation and frustrate their purpose.
2. Find that the selection of consultants under this process does not affect small businesses as defined in California Government Code section 14837, subdivision (d)(1)(B) because they will be accorded equal opportunity to submit statements of qualifications and performance data.
3. Find that the selection of consultants under this process for professional services to conduct a cost study to estimate the fiscal impact of a voluntary relinquishment of the remaining lease interests in actively producing offshore oil and gas leases in state waters is consistent with procedures and policies adopted by the Commission as specified in Government Code section 4526 and California Code of Regulations, title 2, sections 2980 et seq.

AUTHORIZATION:

Authorize the Executive Officer or her designee to solicit for consultant services, negotiate fair and reasonable prices, award and execute agreements, and take any other steps reasonably necessary to prepare a cost study pursuant to Budget Item 3560-002-0001 in SB 154 (Skinner), of the 2022 Budget Act, to estimate the fiscal impact of a voluntary relinquishment by oil and gas operators of their remaining lease interests in actively producing offshore oil and gas leases in state waters.