

THE AMERICAN OIL & GAS REPORTER®

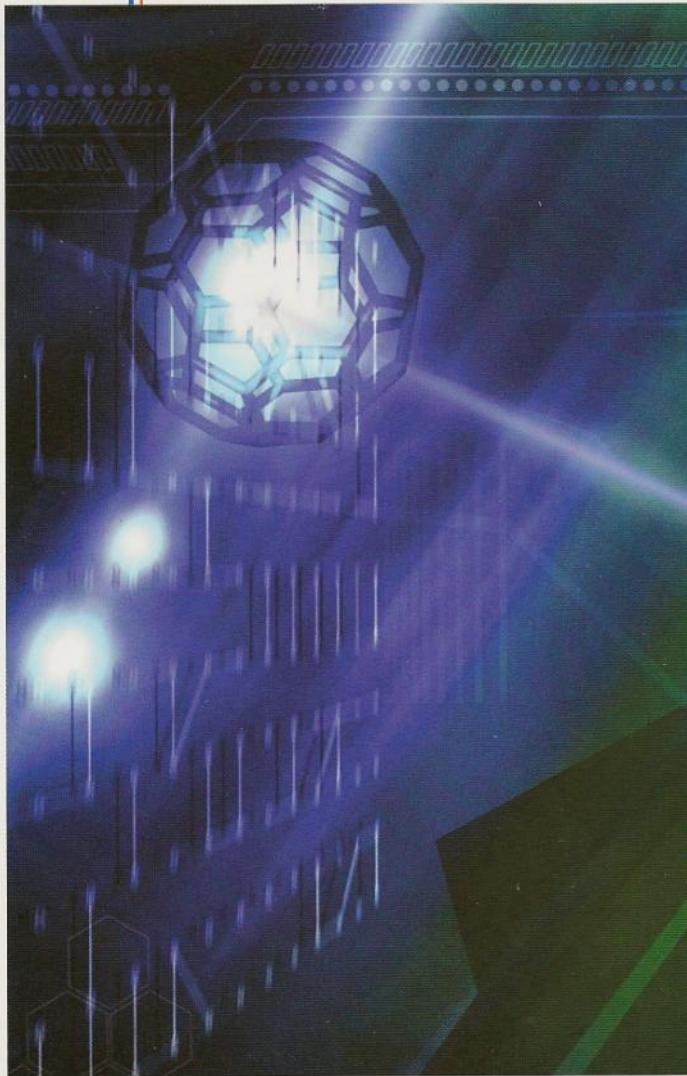
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The "Better Business" Publication Serving the Exploration / Drilling / Production Industry

New Technology

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Robert G. Armstrong
President IPANM

"We make every effort to conduct operations in an environmentally sound way, but anti-development groups prefer we do nothing at all."

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Stephen N. Castle
TIPRO Chairman

"If you are going to regulate something, you need to understand that industry or product."

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Perceptions Of Industry Pivotal For Its Future

By Gregory DL Morris
Special Correspondent

INCLINE VILLAGE, NV.—Distance can provide perspective, especially in unsettling circumstances. At a time in which California was wrestling with epic budgetary shortfalls and the domestic oil and gas industry faced unprecedented scrutiny, attendees at the California Independent Petroleum Association annual meeting, June 4-6, got a couple hundred miles' perspective from Sacramento on the ever-green hills of Lake Tahoe.

For the association itself, times were good, reported outgoing chairman Halbert Washburn, founder and chief executive of Los Angeles-based Breitburn Energy. In his welcome remarks he credited Hank Bennett and the membership committee with raising membership more than 15 percent this year, from 409 to 473.

CIPA will need all those hands to the wheel, Washburn indicated, because "There are people who don't like us and don't want us to be in business. But the state needs us to do what we do. Without us California does not really work. We just have to focus on getting our message out. That is not something that we have done well."

The need to communicate better with stakeholders is clear, he noted, when the industry has to deal with issues like repeated proposals for severance taxes, and continuing regulatory processes. "Our organization has driven a lot of issues," Washburn stated. "It has really protected our backs both in Sacramento and in Washington."

Washburn's comments were a brief valedictory, because later in the evening Hormoz Ameri, president of Naftex Operating Company of Bakersfield, Ca. and CIPA treasurer, formally accepted the gavel as chairman. Taking Washburn's words as a charge, CIPA announced at the annual meeting that it had launched a new Web site, www.energyforcalifornia.com. Rock Zierman, chief executive of CIPA, encouraged all members to post material to the site. "Now that we know what we have to do, how do we do it?" he asked. "We have an awful lot of ground to cover."

Zierman then turned to two of the many CIPA people who had brought the

Web site development to the launch point.

"The new message is that we are not the same as the deepwater developers," explained CIPA Director Dave Kilpatrick. "We are safe operators, and we are local businesses."

Chris Angelo, project manager for Ramsgate Engineering, noted that the Web site existed "to provide facts, debunk myths, and to allow people to interact. We are passionate about our industry, and we do not want to be perceived as evil." That is why, he said, it was so important for

members to upload information to the site and participate in the process. "It's simple," he said. "Go to the Web site and click on 'submit content.' Submissions are reviewed by CIPA and appear on the site."

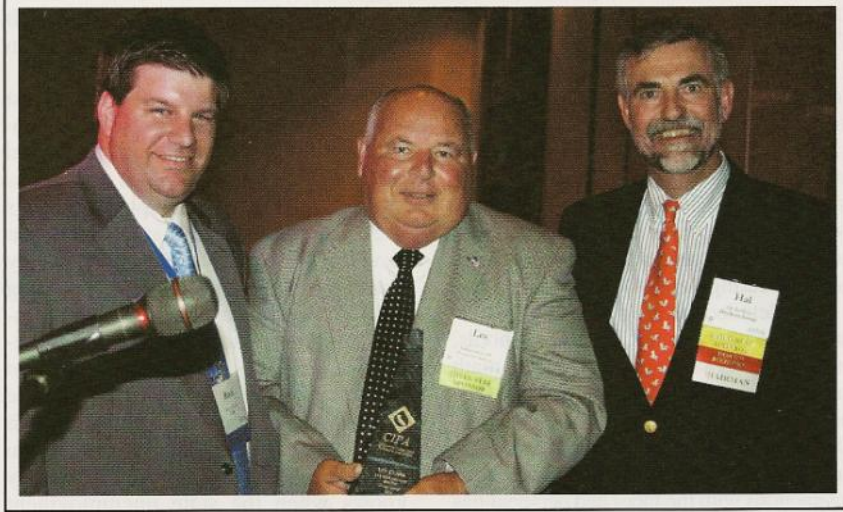
An equally important feature of the new Web site allows users to share content through social networking sites, such as Facebook and Twitter, he added.

Learn Something Old

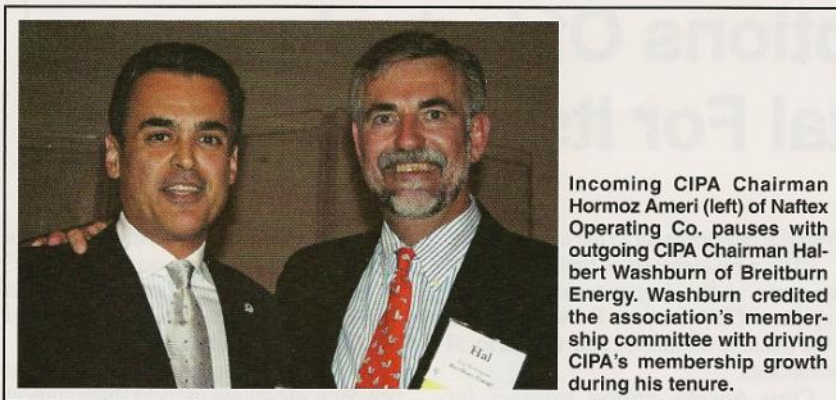
Bruce Wells, executive director of the American Oil & Gas Historical Society,



RIGHT: CIPA Chief Executive Rock Zierman (right) presents Assemblywoman Jean Fuller with the association's CC "Bud" Albright Award, awarded to an individual outside the oil and gas industry who has contributed significantly to the viability of CIPA and the industry. **BELOW:** Zierman and outgoing CIPA Chairman Halbert Washburn (right) present Les Clark with CIPA's 2010 Lee McFarland Award, given to an associate member of the association who has who has contributed greatly to the industry.



Convention Coverage: California Independent Petroleum Association



Incoming CIPA Chairman Hormoz Ameri (left) of Naftex Operating Co. pauses with outgoing CIPA Chairman Halbert Washburn of Breitburn Energy. Washburn credited the association's membership committee with driving CIPA's membership growth during his tenure.

added urgency to the comments of Washburn and Zierman by noting ruefully that if the industry does not do a better job of communicating its importance and its heritage to officials and voters, then they will get their information elsewhere. "Because of the tragic events in the Gulf of Mexico, the public is getting more of an education about our industry than it has during the past 20 years."

Even the highest levels, Wells related, exhibit a surprising ignorance of the energy industry. "Years ago, I was on an oil field tour with a congressional delegation," he recalled, "and as we were passing a pump jack one young staff member leaned over to ask me: 'What octane is that producing?' And that person's boss served on an energy-related committee!"

On a more positive note, Wells stressed that "our communities are intensely proud of their oil and gas industry and its heritage. There are more than 100 oil and gas museums and petroleum exhibits in the country, three of them in California; two in Kern County and one in Santa Paula. There are also major ones in El Dorado, Ks., near Wichita; in Midland, Tx.; and two in Beaumont, Tx.

Addressing the challenge on the education front, Gayle Pratt, a volunteer with the Central Coast Education Collaborative, gave a spirited briefing about getting the message across. "Your information has to be relevant," she remarked. "Know your audience, provide the basic facts and how they cause a direct impact. Then keep repeating your story."

She detailed the programs that the collaborative operates in California schools, as well as its seminars, grants for math and science programs, and contests. One notable example she mentioned was the Derricks to Desks seminar, a "three-day crash course in our industry that allows interactions with the faces and personalities

that make our industry work."

Electoral Discontent

The message that independent producers are trying to communicate is all the more difficult against a backdrop of budgetary crisis and a surly electorate. "Only about 25 percent of Californians approve of the job that Governor Arnold Schwarzenegger is doing according to a recent poll," reported Daniel Weintraub, columnist and editor of the Web site HealthyCal.org. "But if you think that is bad, the same poll found that only about 16 percent of the state's citizens approve of the job the legislature is doing. Some other polls have found the legislative approval rating in single digits."

The reasons are not difficult to discern, Weintraub related. "Unemployment in the state is hovering at 12.5 percent, and the budget deficit is on the order of \$20 billion," he detailed. "Eight out of 10 voters think the state is going in the wrong direction. This summer, as we approach elections for governor and senator, the only story is the shortfall of \$19 billion-\$20 billion out of a \$90 billion budget. It is going to be a long, hot summer in Sacramento, with a lot of frustration."

Weintraub said that one of the most important matters on the ballot in November would be AB8032, which would suspend the greenhouse-gas provisions of AB32 until state unemployment falls to 5.5 percent and stays at or below that level for four consecutive quarters. "Many voters support a delay in implementing AB32," Weintraub reported. "They understand the economic impact that compliance with the Kyoto Protocol would mean for business in the state at a time when unemployment is so high. But with a trigger at 5.5 percent, the suspension might as well repeal AB32. Nobody knows when the state unemployment

level will get that low again."

CIPA and other business interests have campaigned to delay AB32, with some success. But Weintraub remarked that the opposition's message would be a zinger: "This is brought to you by the people who brought you the Gulf oil spill."

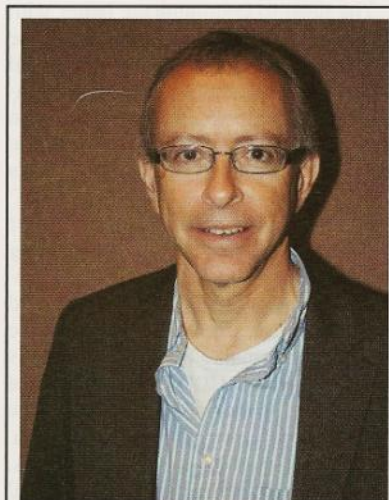
He cautioned that in recent years both tobacco and insurance interests had mounted big campaigns to fight taxes and regulation in California, only to have the efforts backfire. "They were demonized," Weintraub warned. "With very little money, opponents brought them down, in part by saying that they were spending so much money."

Structural Repairs

Drilling into the causes of the yawning budget chasm in Sacramento, Thomas L. Sheehy, California undersecretary of state and consumer services, called on his long experience in state government for several administrations, most notably as chief deputy director of finance.

"Not often enough do state officials stop to recognize how important your industry is to California and the nation," Sheehy admitted. "The companies in this room represent thousands of well-paying jobs, and if we could unleash you to do more of what you do well, we could have more of those jobs."

He went on to offer a concise, incisive analysis of what he called the state's structural budget problem. He noted that 55 percent of state revenue came from personal income taxes, 30 percent from



With a \$20 billion deficit and the approval of a mere 16 percent of the state's citizens, the 2010 California General Assembly faces a long, hot summer, suggests columnist Daniel Weintraub.

Convention Coverage: California Independent Petroleum Association

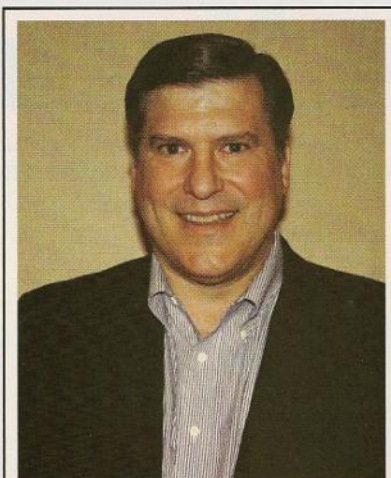
sales taxes, 10 percent from corporate taxes, and that miscellaneous taxes and fees provided the balance.

Zooming in on personal income taxes, he further noted that capital gains taxes constituted an unpredictable revenue stream.

"The dirty little secret of state revenue is that the top 1 percent of the population pays about 50 percent of the taxes," he intoned. "In California that 1 percent represents only 136,000 returns."

Magnifying the budgetary problem, Sheehy showed historical data that demonstrated how those personal income taxes, especially capital gains taxes, were highly volatile from year to year.

"The whole problem is the spending ratchet. When tax revenues exceed expectations, legislators and governors increase spending," he described. "But when revenues come in under expectations, there are impediments to reducing spending. Some of them are legal, most of them are political, but all of them are real."



California derives about half of its tax revenue from the top 1 percent of earners, notes California Undersecretary of State and Consumer Services Thomas L. Sheehy. He said that left the state vulnerable to large swings in state income because capital gains collections were volatile.

The problem crossed partisan lines, he stressed, as legislators and governors of both parties had proven incapable of not spending every dime on the table. "One-time revenue bumps are turned into permanent spending increases in the budget," he warned. "We have reached the point where the fish mouth has opened, and it will never close on its own."

Sheehy estimated that between \$7 billion and \$9 billion of the budget deficit was structural. "When the economy recovers and tax receipts increase, we still will never catch up without either cutting spending or finding new revenue," he intoned. He urged producers to support changes similar to those proposed on several occasions by Governor Schwarzenegger, although those had been spurned by the legislature or voters.

"If we enact structural reforms, you will not have to worry about the legislature coming back at you for fees and taxes every few years," he concluded. □

Rules Seek To Formalize Processes

INCLINE VILLAGE, NV.—In a detailed and comprehensive afternoon panel discussion at the California Independent Petroleum Association annual meeting, June 4-6, a panel of experienced industry attorneys brought conference delegates up to the moment on several related legal and regulatory developments that are expected to change the relationship between producers and government officials.

These related developments, they said, include:

- A California appeals court decision involving the California Division of Oil, Gas & Geothermal Resources, entitled *Termo v. Luther*;
- Pending regulations for implementing AB 1960, the state's statutory revision of DOGGR regulations; and
- AB 2453, legislation pending in the California legislature that would extensively modify the procedure for operators' administrative appeals of DOGGR orders.

According to David A. Ossentjuk, an attorney with Musick Peeler & Garrett LLP, the litigation's net effect for independent producers likely will be a more formal relationship with DOGGR. *Termo*, he said, addressed the enforceability of a DOGGR order under Public Resources Code Section 3237 that had commanded

an operator to abandon 28 oil wells. Ossentjuk explained the court's holding that the operator was entitled to a review of DOGGR's administrative decision under the independent judgment standard, instead of the more common substantial evidence. He highlighted the court's statement that recognized "the right to continue to operate existing oil wells and to extract oil is a fundamental right, of particular importance in the current economic climate."

Ossentjuk said the result of the *Termo* decision was that DOGGR proposed legislation in AB 2453 that would create new procedures, policies, and processes to replace what historically had been a relatively informal regulatory environment. "The legal question is should the trial court in such situations give deference to decisions or rulings by DOGGR. At the moment, the case law says no, but there is now pending legislation to address that," Ossentjuk said.

Regulatory Solution

All three panelists agreed that while producers might view the new administrative policies and procedures as an additional burden, they would appreciate the clarity and consistency of a detailed and formal DOGGR review and ruling

process.

"AB 1960 was passed and is law," observed Jack Quirk, an attorney with Bright and Brown. "Now there are new regulations proposed in draft to implement that legislation. CIPA has reviewed and commented on the draft. DOGGR has said it would have revised regulations issued by autumn and final regulations in place by the end of the year."

Quirk related that the combined effect of the *Termo* case, AB 1960 and the draft regulations caused him to ask "What is a regulator?"

He went on to suggest, "We know a regulator can be a ladder or a wall for its regulated community. We often complain about regulations, but police and fire departments are regulators—they control our behavior in part—but we do not complain much about them because they also keep us safe. We accept that trade-off as desirable."

Quirk held that for many producers DOGGR historically had proven more of a ladder than a wall. But stung by the *Termo* rulings the division is issuing new rules and procedures, and is rumored to be centralizing authority from district offices and individual inspectors to the central organization. "I am not inferring any motive from conduct," Quirk emphasized. "I simply am noting that there is a fear

among the regulated community that the central authority has less knowledge of the industry and less appreciation of its good faith.”

As DOGGR proceeds with its rule making, Quirk suggested the industry assess itself. “How do we deal with bad operators?” he asked. “What can we do about that? That is a legitimate concern of DOGGR.”

He also reviewed briefly an alternative to the rule making. “There is, of course, a market solution,” he mentioned. “We require that all operators take out huge insurance policies and trust the insurers to contractually ensure safe operations. But the premiums would be beyond belief, and it would be a big diversion of capital into insurance premiums and profits that should have gone to oil and gas exploration and production.”

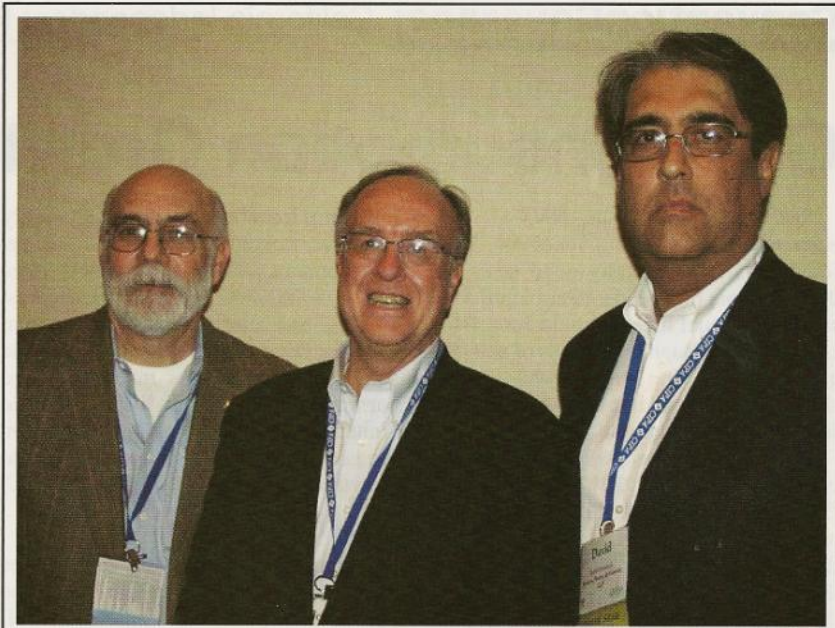
Quirk acknowledged the irony that the most efficient solution was not from the free market, but the government, although he did not endorse the original legislation wholeheartedly. “The problem with AB1960 is that there remains a tremendous amount of uncertainty in AB 1960 and the proposed regulations about how the amount of civil penalties will be determined and how decisions will be made to require life of well and life of facility bonds and their amounts.”

Nevertheless, Quirk concluded that AB1960 was likely the best way forward, but held that the regulated operations needed to pay attention to DOGGR orders. “Fines of \$5,000 for signage not strictly in compliance or for untimely filings are one thing,” he commented. “But when the fines become \$25,000, you want very specific terms to ensure fairness across the board.”

Formal Processes

John Harris, an attorney with Meyers Nave Riback Silver & Wilson, discussed AB 2453, legislation sponsored by DOGGR, which was designed to address procedural and due process problems identified in the *Termo* case.

Following up on Ossentjuk’s observation regarding operators’ relatively informal relationship with DOGGR, Harris posed a question. “Why do we have to deal with this now, when the existing procedures have prevailed for nearly 100 years?” he asked. “The answer is that there has been until now very little litigation. When there is litigation, the court needs a complete administrative record to review. Otherwise, the court is just second-guessing a regulator’s findings.” Under California’s relatively informal administrative appeal process set forth in



A panel of attorneys made up of, from left, Jack Quirk with Bright and Brown, John Harris of Meyers Nave Riback Silver & Wilson and David A. Ossentjuk with Musick Peeler & Garrett LLP, discussed the trends toward formalizing the industry’s dealings with the California Division of Oil, Gas & Geothermal Resources. Despite those developments, the panelists all encouraged operators to maintain personal relationships with technical staff in DOGGR’s district offices.

the PRC, Harris explained, “There is no detailed procedure for handling an administrative appeal of a DOGGR order, nor for determining the factual and legal basis for DOGGR orders. AB 2453 establishes those formal processes to address the specific procedural issues identified by the court in the *Termo* case.”

Harris noted that there was no formal opposition to AB 2453, and added that he expected the measure to be signed into law in 2010 or 2011.

Looking ahead, Harris cautioned producers to be aware of the new rules’ specific processes. “It is important to appreciate that an appeal hearing either before an administrative law judge or an informal hearing before a representative of the DOGGR supervisor may be an operator’s only opportunity to present its defense to a DOGGR order. You don’t get a second chance to come back later to explain things or present evidence in a court trial, since a court’s review is limited to the administrative record developed in the DOGGR appeal process.

“Also,” he continued, “AB 2453 would confirm that a court would not independently review the evidence in the administrative record and make an independent determination whether the DOGGR order was supported by the evidence and the law, but rather would apply the substantial evidence standard.”

Under that standard, Harris said, a court reviewing a DOGGR order would

not make independent factual findings based on the record, but rather would be restricted to confirming whether DOGGR’s factual findings were supported by substantial evidence in reviewing the whole record. He also emphasized the importance of operators promptly determining whether any correspondence or directive from DOGGR could be considered an order to which the operator would be statutorily compelled to file an immediate administrative appeal in 10 days at the risk of later being found to have waived his rights. As DOGGR increases its enforcement activity to implement AB 1960, the usual informal process of resolving issues may not fully protect an operator’s rights, Harris warned.

Ossentjuk cast the changes at DOGGR against a national regulatory backdrop and noted that, “the Minerals Management Service is being broken into pieces because there is a perception that it was too chummy with the regulated community. We have to be aware that there is some of the same perception at some levels in California regarding DOGGR and producers.”

Ossentjuk acknowledged that the new rules would prove an additional operational burden and expense. “So you may have to lawyer up and spend a bunch of money,” he advised. “But the benefit is that you know the rules, and so does everyone else. If you violate the rules, you do so at your own peril, and you deserve what you get.” □