



CITY OF SACRAMENTO

DEPARTMENT OF ENGINEERING
9151 STREET SACRAMENTO, CALIFORNIA 95814
CITY HALL ROOM 207 TELEPHONE (916) 449-5281

CITY MANAGER'S OFFICE
RECEIVED
DEC 2 1981

R. H. PARKER
CITY ENGINEER
J. F. VAROZZA
ASSISTANT CITY ENGINEER

December 2, 1981

City Council
Sacramento, California

APPROVED
BY THE CITY COUNCIL

DEC 8 1981

OFFICE OF THE
CITY CLERK

Honorable Members in Session:

SUBJECT: Proposed Amendment to the Subsurface Oil and Gas Lease with Quadren Corporation to provide for a Drill Site on City-Owned Property at 53rd Avenue and Power Inn Road

SUMMARY:

This report recommends that the City Council instruct staff to negotiate an amendment to the subsurface oil and gas lease with Quadren Corporation that would provide for a gas well drill site at the City-owned property at 53rd Avenue and Power Inn Road.

BACKGROUND:

On September 29, 1981, staff presented to the City Council a report recommending an amendment to the subsurface oil and gas lease between the City of Sacramento and Quadren Corporation to provide a gas well drill site at the City-owned property at 53rd Avenue and Power Inn Road. The City Council heard testimony from Quadren Corporation, City staff, and from concerned citizens. The City Council instructed staff to meet with Union Oil Company to determine if they would approve a subsurface lease with the City upon expiration of the current lease with Quadren Corporation and pay royalties to the City from the beginning of production of the Union gas well. There was also concern from Council members regarding the possibility of a suit for subsidence alledged to be occurring in the Glen Elder area.

The City staff met with representatives of the Union Oil Company and was told by them that they had been impounding royalties attributable to the 16 acres, owned by the City of Sacramento, and that if we were free to sign a lease with Union Oil we would be paid these back royalties. At that time of our conversation with Union Oil, the back royalties amounted to \$5,019.14. They also stated that any of the residents in Glen Elder within the 640 acre pool could sign with the Union Oil Company at their office for a 1/6 royalty and that Union Oil would pay them impounded funds from when the well first started production.

City staff also met with James T. Campion, an oil and gas engineer with the State Division of Oil and Gas. We explored several issues with Mr. Campion, notably the history of subsidence in California contributable to the withdrawal of natural gas. Mr. Campion stated that to his knowledge there is no evidence of subsidence in the entire State caused by the withdrawal of natural gas.

The staff also met with the Quadren Corporation and received from them a cronology of their efforts to seek a drill site at the City of Sacramento Florin Reservior location. In addition, there were some calculations attached to their submittal relating to possible royalties if the City was to allow a drill site on their property and if Quadren Corporation was successful in bringing in a producing well. That report from Quadren Corporation is attached as Exhibit I. Also attached for Council information is the report submitted to Council August 25, 1981 (Exhibit II) and heard September 29, 1981.

FINANCIAL:

As set forth in the background of this report, the accumulated back royalties with Union Oil amounted to \$5,019.14. This is for a 15 month period. The attached report from the Quadren Corporation, under various assumptions, has the amount of possible City royalties varying from \$425,000.00 to \$1,487,500.00.

RECOMMENDATION:

The existing lease will expire on November 13, 1982. The amendment to this lease was first presented to the City Council when there was more than a year left on the existing lease. Therefore, the proposed amendment just amended our current lease and because this is now December and there is less than a year to run on the existing lease, it may be necessary to extend the lease for a short period of time in addition to providing for a drill site.

It is recommended that the Council direct staff to negotiate with the Quadren Corporation and report back with an appropriate amended lease that will provide for a drill site.

Respectfully submitted,



R. H. PARKER
City Engineer

Recommendation Approved:


Walter J. Slife, City Manager

RHP/JFV/hma

att.

CHRONOLOGY OF OIL & GAS LEASE
CITY OF SACRAMENTO-FLORIN RESEVOIR

October 20, 1981

On September 6, 1979, we (Quadren Corporation), and the rest of the natural gas exploration industry in the Sacramento Valley were notified of an invitation to bid on the City's property at the Florin Reservoir. We inquired of Mr. Day's office if a drill site could be included in the offering. He responded that although he had recommended a drill site, the City preferred not to give one until the bidding was concluded since there was an operator in the area with a well already drilled. If they were the successful bidder, there would be no need for a drill site as the City could just be included in their existing unit. However, if we won the lease we could then approach the City for a drill site. With this in mind we proceeded to bid what we felt was a maximum fair value for the lease of 42½%.

In early October of 1979 we were notified by the City that we were the high bidder at 42½% royalty. Prior to issuing the lease we were asked by the City if we had a drill site we could use other than on the City and if we would attempt to pool with Union. We responded that although we preferred to drill ourselves and preferably on the City's parcel, we did have a 12 acre parcel to the southeast of Union's well that we could use to form our own 160 acre unit and use as a drill site. However, if the City desired for us to pool with Union rather than drill ourselves, we would have a much stronger position to persuade Union to agree to a 160 acre unit versus their 640 acre unit, if the City would grant us a drill site. The drill site need never be used and the City's royalty would be subject to a dilution of only a 160 acre unit rather than being included in a much larger unit that included a great amount of land that very probably had no gas under it at all. Mr. Day's office was absolutely correct in not allowing the City's lease out to bid with 640 acre spacing. There isn't a lease given anywhere in the valley with 640 acre spacing if the landowner has the benefit of experienced counsel. And, in addition we certainly did not want to include our 12 acres in such a unit with a lot of "ram pasture" diluting our interest dramatically also. However, the City representatives said no, we must attempt to form a unit without a drill site on the City property. We therefore submitted to Union a proposed 160 acre unit, as shown on the attached plat Exhibit "A", in which the combined City parcel and our 12 acre parcel would be 18% of the unit. We offered to pay 18% of all costs incurred by Union to date and we would pay the 42½% City royalty out of our 18% share of the unit. This would have meant naturally not only no royalty on our 12 acres, but in actuality a "negative" royalty to us. This arrangement would not have affected the royalties paid to the Lessors of Union under their 640 acre unit at that time or any time in the future. Union refused and told us to "drill our own well".

At the time, although we knew Union's well was a directional hole, we did not know exactly where it was bottomed. It later turned out, when the sealed records from the state were released, that it was bottomed just across the street from the City's property. Since we didn't have a drill site on the City parcel, the threat to Union of our drilling on our 12 acre parcel was not as great. Even though our parcel was very close to their well and well within their 640 acre unit (See plat attached as Exhibit "B"), they felt a well on our 12 acres would be wildcatting. This proves conclusively their ready willingness to tie up hundreds of acres they reasonably knew to be non-productive, and yet willing in so doing to dilute dramatically the gas royalties due those who they knew had gas under their property, namely the City and the landowners in the immediate area of the City.

On March 10, 1980, we informed Mr. Day of Union's refusal and respectfully requested a drill site so that we could protect their lands from drainage. Union had not started production but it was only a question of time before they would.

On April 15, 1980 I met with Mr. Varroza and Mr. Day in Mr. Day's office. Mr. Varroza brought maps and we discussed the area most suitable for a drill site.

On April 30, 1980, I met with Mr. Varroza, Mr. Day and Mr. Connolly in the City's offices. Mr. Connolly wanted to know why we couldn't make a deal with Union. I explained the above chronology to him. I explained that Union adamantly refused to let us absorb the excess royalty to the City. They further refused our 160 acre proposed unit. I told Mr. Connolly that in either event, giving us a drill site to drill a well to protect the City from drainage (which we preferred), or giving us a drill site to use as leverage to force Union to form a secondary unit with us, we had to have the drill site. Mr. Connolly was non-committal.

On May 15, 1980, I wrote the City Council, in care of Mr. Lee Savage, formally requesting a drill site, which at the request of the City would only be used after exhausting all possible avenues in attempting to pool with Union. See letter attached as Exhibit "C".

In early August, 1980, I called Mr. Day and informed him that Union had commenced production. Continued requests for drill site.

By December, 1980, we decided that the City was not going to act any time soon and to gamble that a location on our 12 acres would enter the gas reservoir. Drilled well on our 12 acres. Dry hole. Gas pool now proven conclusively to be of limited size and that the substantial portion of Union's 640 acres does not contain gas. Only gas is from lands in the very immediate vicinity of the City's parcel.

On January 2, 1981, I wrote a letter to Mr. Savage (see attached Exhibit "D") imploring him to act on our request for a drill site as a great deal of royalty to the City was being lost. It is now the only way to prevent further drainage from the City's property and attempt to recover the expense incurred by us to date.

January '81 to July '81. Periodic calls to Mr. Day and Mr. Savage awaiting response.

On July 7, 1981, we received a proposed amendment for a drill site from Mr. Savage. Agreeable with us.

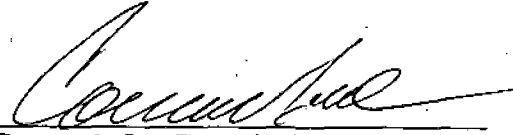
July to September '81. At least two scheduled council meeting appearances postponed.

On September 29, 1981, City Council meeting Mr. Connolly presents chronology of events totally and absolutely at odds with the facts as enumerated above.

FIELD REVENUE TO DATE

Attached is a record of the production of the Union well to date. There is no reason to assume that the production from a well by Quadren on the City property would not be equally productive and possibly more so. The royalties to date that the City would have received had it (1) leased to Union on a 16 2/3% royalty in a 640 acre unit, (2) gone along with our original proposal of a 160 acre unit, or (3) royalties from just a straight well with Quadren are as follows:

- (1) Union 1/6 lease - 640 acre unit \$ 4,166
- (2) Quadren's proposed 160 acre unit (18% of unit) 44,370
- (3) Quadren's proposed single well on City parcel 420,000


 Conrad O. Grenfell
 Vice President

PRODUCTION RECORD
FLORIN #1

	<u>PRODUCTION (MCF)</u>	<u>RECEIPTS</u>
<u>1980</u>		
7/80	22,955	\$ 51,960.94
8/80	9,364	21,601.38
9/80	26,173	60,569.56
10/80	27,576	64,563.60
11/80	24,175	57,127.94
12/80	22,687	54,144.79
<u>1981</u>		
1/81	30,041	74,428.85
2/81	29,466	71,867.57
3/81	35,533	87,659.91
4/81	35,039	88,333.32
5/81	34,837	88,642.75
6/81	37,226	95,607.54
7/81	38,975	101,058.28
8/81	20,024	52,340.73
	<u>394,071</u>	<u>\$969,907.16</u>

REMAINING RESERVES OF FIELD

Assumption #1

Assuming that there is twice as much gas as has been produced and that the City is entertaining the idea of waiting until our lease expires and then entering into a lease with Union with the stipulation of retroactive royalties, we present the following projections of revenues from such action versus granting us a drill site:

Union 640 acre unit only:

Future gross revenue	\$2,000,000
Landowners royalty	333,333
Landowners within city limits royalty	80,000
City's royalty	8,350
Retroactive royalty to City	4,166
Union's share of remaining reserves	1,666,666

Union's 640 acre unit - Quadren-City #1 share remaining reserves:

Future gross revenue	\$2,000,000
Union's Landowner Royalty	166,666
Union's Landowners within city limits royalty	40,000
Union's share of remaining reserves	833,333
Quadren's share	\$575,000
Less City #1 well cost	-225,000
Dry hole cost to date	-105,000
Quadren Potential Net Profit	245,000
City Royalty from Quadren-City #1	425,000

Therefore, those that would sacrifice the City's right to have a well on it's own property in order to protect a few city resident's royalty on remaining reserves, would do so at great expense to the City. A nominal difference to a few residents, that would have only their approximate \$6-\$10 per month checks last somewhat longer. The big winner by far is Union, gaining \$833,333. The city loses over \$400,000 at the expense of city residents gaining approximately \$40,000 for gas that probably isn't even under their property.

Assumption #2

Assuming there is seven times as much gas yet to be produced:

Union 640 acre unit only:

Future gross revenue (without obvious price increases)	\$7,000,000
Landowner's Royalty	1,166,666
Landowner's within city limits royalty	290,000
City's Royalty	29,166
Retroactive royalty to City	4,166
Union's share of remaining reserves	5,833,333

Union's 640 acre unit - Quadren-City #1 share remaining reserves:

Future gross revenue		\$7,000,000
Union's Landowner royalty		583,333
Union's Landowner's within city limits royalty		145,000
Union's share of remaining reserves		2,916,666
Quadren's share	\$2,012,500	
Less City #1 well cost	-225,000	
Less dry hole cost to date	-105,000	
Quadren Potential Net Profit		1,682,500
City Royalty from Quadren City #1		1,487,500

Once again, continued failure to give Quadren a drill site and by far the biggest loser is the City (and Quadren) and the biggest gainer is Union. The city lot owners (that probably don't have any gas under their property anyway) will have their small checks continue for another approximate seven years instead of only 3½. The City will lose close to \$1,500,000 or more and Union gains close to an additional \$3,000,000. Union has already recovered far in excess of it's costs and a large profit. The City already has lost several hundred thousand dollars it could have received to date from a Quadren well.

(All figures are approximate and are presented for purposes of demonstration of widely differing results under the circumstances presented)

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EXHIBIT "A"

8N-5E

Sacramento County

34

35

1760'

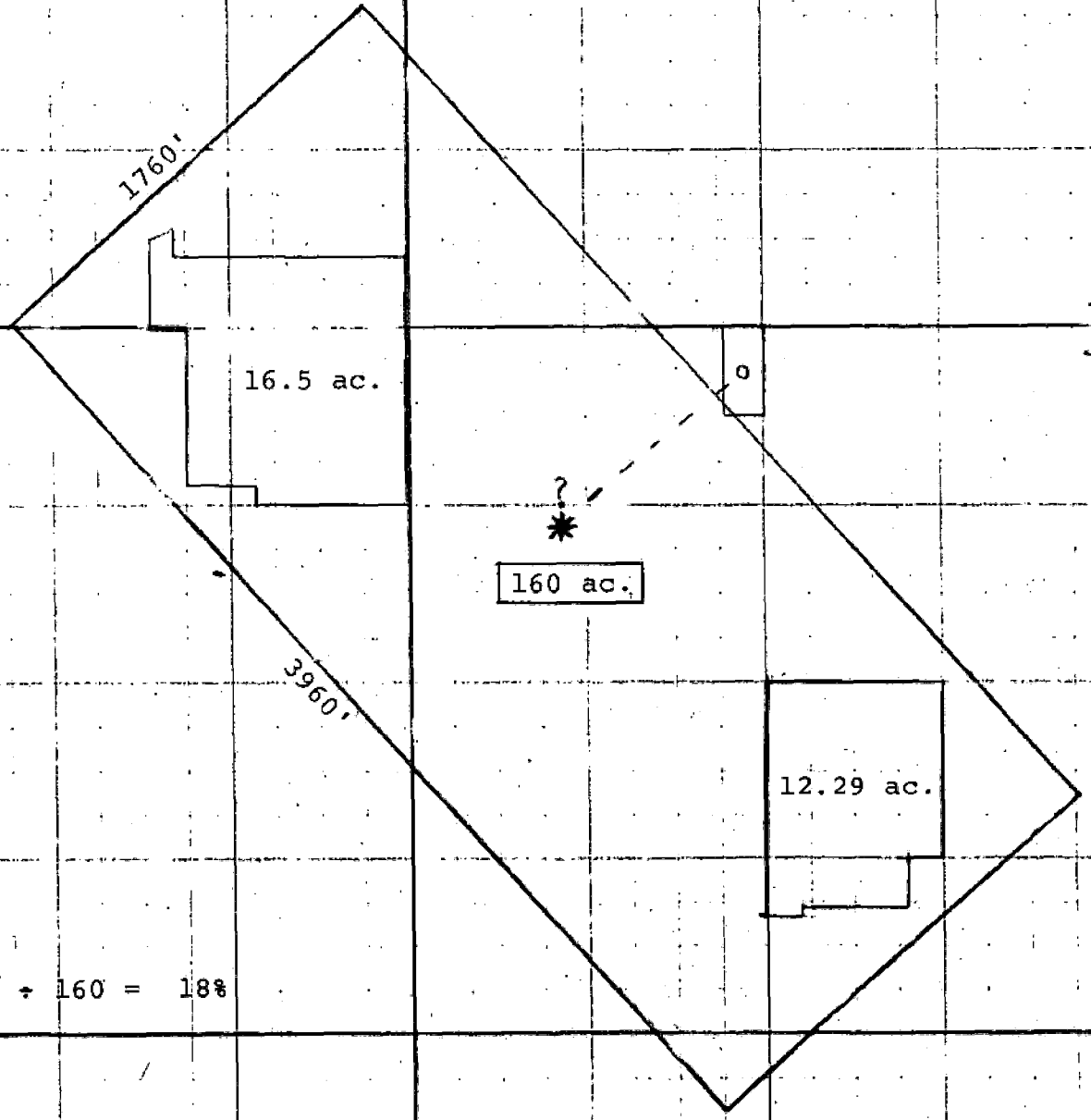
16.5 ac.

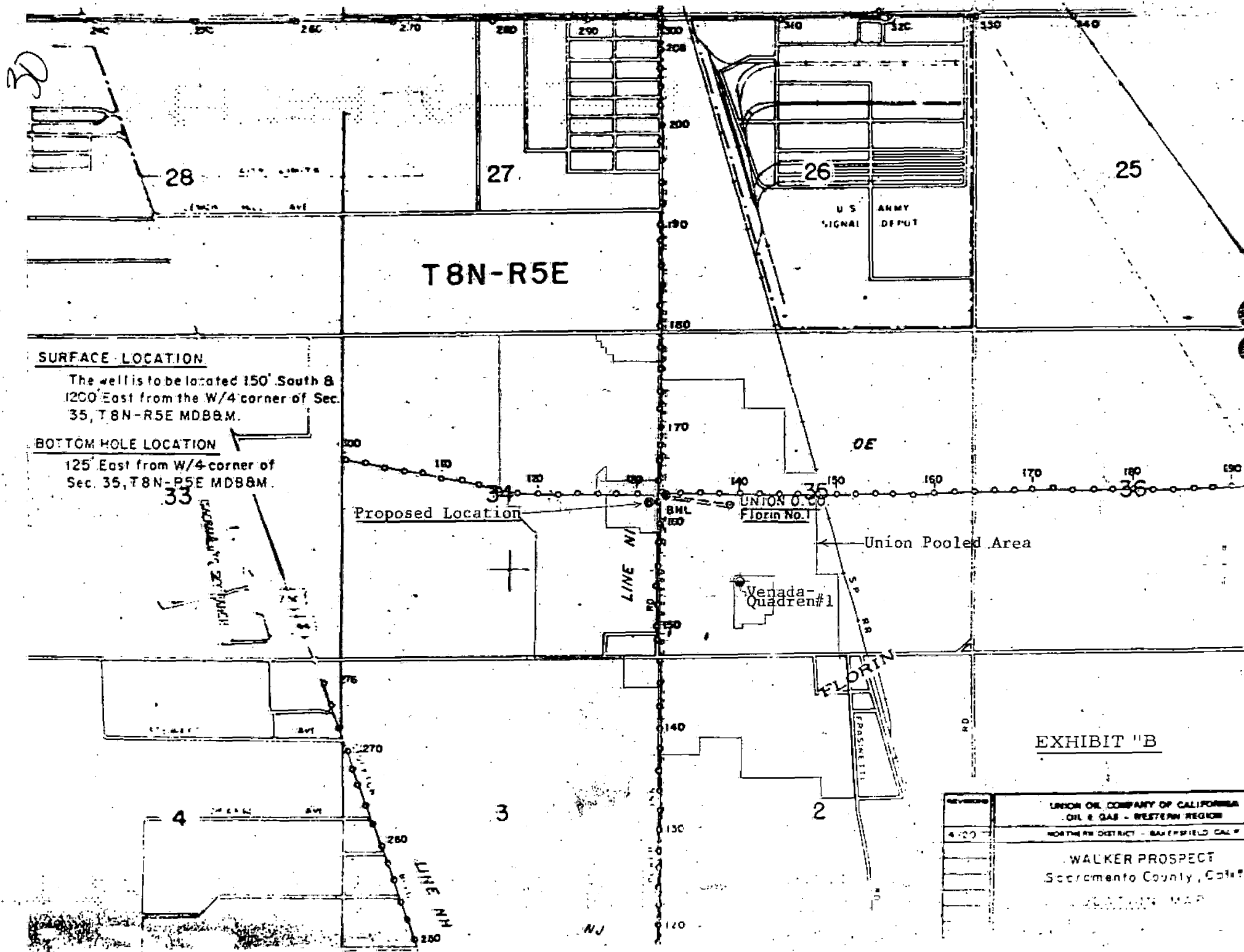
160 ac.

12.29 ac.

3960'

$$\begin{array}{r}
 16.50 \\
 12.29 \\
 \hline
 28.79 \div 160 = 18\%
 \end{array}$$





T8N-R5E

U.S. ARMY
SIGNAL DEPT

SURFACE LOCATION

The well is to be located 150' South & 1200' East from the W/4 corner of Sec. 35, T8N-R5E MDB&M.

BOTTOM HOLE LOCATION

125' East from W/4 corner of Sec. 35, T8N-R5E MDB&M.

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CORRECTION SET NORTH

Proposed Location

LINE N/1

UNION OIL
Florin No. 1

Union Pooled Area

Venada-Quadren #1

FLORIN

FRASNETT

EXHIBIT "B"

REVISIONS	UNION OIL COMPANY OF CALIFORNIA OIL & GAS - WESTERN REGION
4-20	NORTHERN DISTRICT - SACRAMENTO CALIF.
	WALKER PROSPECT Sacramento County, Calif.
	LOCATION MAP



Quadren Limited Services

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RECEIVED J.M.D.

MAY 13 1980

May 15, 1980

EXHIBIT C

City Council
City of Sacramento
City Hall
Sacramento, Ca.

Gentlemen:

Reference is made to our oil and gas lease with the City of Sacramento covering 16.5 acres known as the Florin Reservoir located on Power Inn Road.

Since receiving your executed lease we have attempted to form an operating unit with Union Oil for the most logical production of the Florin gas pool. We offered to unitize additional land we own in fee at no royalty to us to attempt to equalize the high royalty bid for the city property, and also to reimburse Union for our proportionate share (i.e. our percentage of the unit) of their costs to date. They have declined our proposal and closed any further discussion of the matter by telling us to "drill your own well".

Therefore, in order to protect the city's property from probable drainage, we request a minimal-sized drill site of one acre to be located approximately 100' west and 100' south of the intersection of Power Inn Road and 53rd Avenue, together with a permit for pipeline to be laid adjoining Power Inn Road and Berry Avenue to the right of way of the Southern Pacific Railroad.

Very truly yours,

QUADREN CORPORATION

Conrad Q. Grenfell
Vice President

CQG:my

RECEIVED J.M.D.

JAN 05 1980

H. J. Smith
Dir

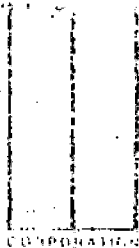


EXHIBIT D

January 2, 1981

Mr. Lee Savage
City Attorney
City of Sacramento
City Hall
Sacramento, Ca.

Re: Oil & Gas Lease
Florin Reservoir

Dear Mr. Savage:

The confidentiality status of the Union Oil Company's Florin No. 1 well with the State of California, expired just recently. We have obtained copies of the information contained in the file and it confirms the actual bottom hole location of the well to be very close to the intersection of Power Inn and Junipero.

Union's well is producing at a reported rate in excess of 25,000,000 cubic feet per month. Due to the extremely close proximity of the bottom hole location of Union's well to the City's property, a substantial amount of this gas has to be coming from under the City's property.

In order to protect the City's property from further drainage, we urge you to take action on our long standing request for a drill site. A similar productive well by Quadren on the City's property would yield a royalty to the City in the area of \$25,000 per month. This amount is presently being lost to Union and they have been producing for six months.

Very truly yours,

Conrad Q. Grenfell
Vice President

COG:my
cc-J. Day

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CITY OF SACRAMENTO

DEPARTMENT OF ENGINEERING
915 I STREET SACRAMENTO, CALIFORNIA 95814
CITY HALL ROOM 207 TELEPHONE (916) 449-5281

CITY MANAGER'S OFFICE
RECEIVED
AUG 4 1981

R. H. PARKER
CITY ENGINEER
J. F. VAROZZA
ASSISTANT CITY ENGINEER

August 3, 1981

City Council
Sacramento, California

Honorable Members in Session:

Subject: Resolution Authorizing Amendment to the Subsurface Oil and Gas Lease with Quadren Corporation to Provide for a Drill Site - City Owned Property at 53rd Avenue and Power Inn Road

SUMMARY:

This report recommends an amendment to the subsurface oil and gas lease between the City of Sacramento and Quadren Corporation at City owned property at 53rd Avenue and Power Inn Road by providing a gas well drill site.

BACKGROUND:

In the summer of 1977 the Union Oil Company obtained a use permit from the County of Sacramento to drill a gas well at a site just south of the City limits and easterly of Power Inn Road. At that same time Union Oil approached the City of Sacramento with the request for a subsurface lease on approximately 16-1/2 acres of City property located at 53rd Avenue and Power Inn Road, the location of the Florin Water Reservoir. The lease offered by Union Oil contained a 1/6th or 16.67% royalty clause which they informed the City was standard in the industry. The City staff was unfamiliar with the legal aspects of oil and gas leases and therefore hired the firm of Downey, Brand, Seymour, Rohwer. After studying the issue, the law firm recommended that the lease be put out to public bidding as required by law. The City Council subsequently held a hearing on this matter and a resolution was adopted directing the City Clerk to advertise for bids in October of 1979. Three bids were received with royalties as outlined below.

Quadren Corporation	42.5%
Petroleum Properties	22.5%
Union Oil Company	16.67%

Staff analyzed these bids and in consultation with Downey, Brand, Seymour, Rohwer recommended award of the subsurface lease to the high bidder, Quadren Corporation for a royalty of 42.5%. Because it had no drill site on the City property, Quadren Corporation approached Union Oil Company to form an operating unit for

producing the Florin gas pool. They offered additional land that they owned and the land they had leased from the City but Union Oil declined the proposal and told Quadren to drill their own well. Quadren proceeded to eventually drill their own well on property owned by them approximately 1600 feet south of the Union Oil well site. This well was unsuccessful in providing a producing gas well even though it was in the middle of the 640 acre Florin gas pool established by Union Oil Company. Quadren has informed the City that the Union Oil well is slant drilled from its site easterly of Power Inn Road so that it bottoms out just easterly of Power Inn Road in the County and right adjacent to our Florin Reservoir site. Quadren is confident because of the location of the Union Oil Company well that a producing gas well could be developed on the unused portion of the Florin Reservoir site if the lease is amended and they are given the right to drill a well.

The proposed amended lease attached to this report would provide for a drill site at the Florin Reservoir property at a location mutually agreeable to the City and the Quadren Corporation. It would also provide that Quadren be responsible for the procurement of all necessary permits. This would include a special permit from City Planning. Quadren would also be responsible for all cost incidental to obtaining all environmental clearances. The proposed amendment to the lease provides that Quadren shall have one year to complete a producing well and market the natural gas or to include the leased land in a producing pool with the consent of the City.

FINANCIAL:

Quadren Corporation, as owner of some house lot leases in the 640 acre Union Oil pool, received information from Union Oil regarding the gross revenues from sales in the Florin gas well. This information indicated that during the month of June Union Oil received gross revenues of \$95,607.54. If the City had signed the lease with Union Oil for 1/6th royalty for 16.5 acres in a 640 acre pool, the revenue to the City for the month of June would have been \$410.81. If Quadren Corporation is able to develop a producing well on the Florin Reservoir site, the revenue to the City would be much higher than the \$410.81 which would be due to the City under the Union Oil pooling arrangement.

RECOMMENDATION:

It is recommended that the City Council approve the amendment to the lease for the Florin Reservoir site for Quadren Corporation to include a drill site and making

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City Council

-3-

August 3, 1981

Quadren Corporation responsible for the procurement of all necessary permits and environmental documents by passage of the attached resolution.

Respectfully submitted,



R. H. PARKER
City Engineer

Recommendation Approved:



Walter J. Slipe, City Manager

August ²⁵ N, 1981
District No.6

RESOLUTION NO.

ADOPTED BY THE SACRAMENTO CITY COUNCIL ON DATE OF

August 11, 1981

RESOLUTION AUTHORIZING EXECUTION OF AN
AMENDMENT TO THE SUBSURFACE OIL AND GAS
LEASE BETWEEN THE CITY OF SACRAMENTO AND
QUADREN CORPORATION TO PROVIDE FOR A DRILL
SITE ON CITY OWNED PROPERTY AT 53RD AVENUE
AND POWER INN ROAD

BE IT RESOLVED BY THE COUNCIL OF THE CITY OF SACRAMENTO:

That the City Manager is hereby authorized and directed to execute an amendment to the subsurface oil and gas lease between the City of Sacramento and Quadren Corporation to provide for a drill site on City owned property at 53rd Avenue and Power Inn Road.

MAYOR

ATTEST:

CITY CLERK