



City of La Habra Heights AGENDA REPORT

Meeting Date: October 23, 2019

Agenda Item # _____

TO: Honorable Mayor and City Council

FROM: Fabiola Huerta, City Manager

BY: Michael Maurer, City Attorney ____

SUBJECT: INTRODUCTION OF ORDINANCE APPROVING SETTLEMENT AGREEMENT WITH MATRIX OIL RELATING TO REDRILLING OF EXISTING WELLS

SUMMARY

Approval of the proposed ordinance would adopt a binding agreement between the City and Matrix Oil Corporation and RMX Resources LLC (collectively referred to as “Matrix” in this report) that will run with the land to any successors-in-interest for a period of 20 years and govern the redrilling of oil wells within the City. If approved, Matrix will have the right to perform redrilling of Wells in the City, subject to the terms of the agreement. The Settlement Agreement contains the following key benefits to the City:

- *No fracking.* Matrix commits not to use the well stimulation technique known as hydraulic fracturing, commonly known as “fracking.”
- *No trucking.* Matrix commits not to truck oil through the City except in very limited circumstances.
- *Fee payment.* For all redrilled wells, Matrix will pay a premium of 1% of the market value of all oil produced. This amount will be paid in addition to the City’s current per barrel tax and is approximately twice the amount of the tax.
- *Standard protocols.* All redrilling will follow certain protocols to ensure that the redrilling is performed consistent with community standards in a rural residential environment.

BACKGROUND

The City of La Habra Heights lies above the Sansinena Oil Field. The history of oil production in the Heights dates back to the 1940’s, and the roots of the Heights community in maintaining the community character and values in light of the oil production runs just as deep. As highlighted in the General Plan:

“Prior to the 1940’s, the local oil companies had limited success in finding oil in “the Heights.” However, in 1948 Union Oil “struck oil” at the Sansinena #15 well. The oil companies quickly began to expand extraction efforts and the potential for unrestricted drilling threatened the quality of life in the area. In response to this potential threat, the Heights Association formed an “oil well drilling committee” that reviewed all zoning exceptions and helped to establish requirements governing the installation of new wells.”

At the time oil was initially discovered, the Heights was an unincorporated community and the County of Los Angeles controlled land use in the area. County Zoning generally did not allow for oil production, but the County would grant “zoning exceptions” subject to certain terms and conditions. Throughout the 1940’s and 1950’s, the County granted a series of zoning exceptions to allow for the drilling of wells on sites in the Heights. There are presently 100 active and 39 inactive (not abandoned) wells in the City, distributed amongst 10 different sites. These wells were originally approved through the County zoning exception process, and production continues as a result of those entitlements.

Since the wells were originally drilled in the 1940’s and 1950’s, the oil production sites have changed hands through numerous owners. Today, each of the production sites are owned jointly by Matrix and RMX.

The Dispute

In 2017, Matrix approached the City about possibly “redrilling” some of the wells, and a dispute arose as to the procedural requirements to perform a redrill. The State’s Department of Conservation, Division of Oil, Gas and Geothermal Resources, or “DOGGR” regulates oil production within the State and has authority to review and approve plans for the drilling, redrilling, and other work on wells. Matrix notified the City that it had submitted notices of intent to DOGGR to perform redrills within the City. While DOGGR has authority to regulate the resource production, such as the engineering within the wellbore, cities still have general land use authority related to above-ground activities. Section 3.6.60.M of the City’s Municipal Code indicates that a conditional use permit is required in order to re-drill. City staff informed Matrix that it would have to apply for a conditional use permit.

Matrix disagreed with the City’s position. Matrix argued that because it obtained zoning exceptions prior to the City’s incorporation, the zoning exceptions gave Matrix a right to redrill without further City approvals.

At the same time Matrix was discussing potential re-drilling with the City, Matrix began redrilling wells located at Site 9, which is in unincorporated territory within the Heights but outside the City limits. (It is located at 2348 Vista Road.) County code enforcement took a position that, based on prior zoning exceptions, Matrix did not need to acquire any further permits from the County. Matrix has since performed redrills on Site 9.

Rather than litigate the dispute, the City and Matrix decided to engage in settlement discussions, at Matrix’s expense. The City and Matrix have engaged in significant settlement

discussions since this time. The settlement negotiations have led to the agreement that is being proposed for adoption.

Scope of the Agreement

The basic exchange in the Agreement gives Matrix the right to redrill wells without further discretionary approvals from the City, provided that Matrix otherwise complies with all terms of the Agreement. The City's Municipal Code references redrills but does not provide a definition of the term. DOGGR regulations include redrill under the broader definition of "rework," but do not specifically define redrill. Thus, the parties have set forth that the agreement will apply to situations in which a drill rig is utilized and/or 24-hour drilling work is undertaken. It does not apply to smaller jobs using workover rigs that already regularly occur within the City.

The Agreement also does not extend beyond the existing scope of oil production in the City. It only allows for redrilling of existing wells – that is, wells that are recognized by DOGGR and have not been abandoned. It does not contemplate any new drilling or increase in the number of wells in the City. It also limits the average daily production to maximum historical levels. Finally, except for the restriction on fracking, the Agreement does not regulate the engineering or location of drilling within the wellbore or any other matter that would be subject to DOGGR's preemptive authority. The Agreement does require that Matrix comply with all federal and state regulations.

Benefits to City

The Agreement confers private benefits on Matrix, and in exchange Matrix must provide public benefits to the City. For each well that is redrilled, Matrix will make payments to the City that are equal to 1% of the market value of all oil that is produced from a redrilled well each month. The value of oil is based on the California Crude Oil First Purchase Price (the "Oil Index") as published by the U.S. Energy Information Administration, which is an index showing the value of a barrel of crude oil in the California market. The amount of oil produced can be verified from public records; Matrix, like all other oil producers, is required to report its production numbers to DOGGR. The payment will be made quarterly in arrears after the Oil Index values are published. Revenues from the Agreement Fee will be unrestricted and deposited in the general fund.

The payment under the Agreement is in addition to the City's per barrel tax. The calculation is similar to the per barrel tax in that both are tied to the Oil Index, but the per barrel tax uses average index numbers from the prior calendar year, and taxes production at a rate of \$0.60 per barrel, adjusted through a formula set forth in the Municipal Code. The Agreement Fee, on the other hand, uses the price during the month the oil was produced and maintains a flat 1% rate. The effect is that the Agreement Fee is roughly nearly double the amount of the tax (though the exact ratio between the two numbers will fluctuate).

The anticipated revenue from the Agreement will depend on the wells that are redrilled and the impact that redrilling has on productivity of the wells. The 1% fee will increase to 2% if the well is sold or leased.

In addition to financial consideration, the Agreement also contains two binding commitments from Matrix. First, the Agreement prohibits Matrix, or any successors-in-interest to the sites, from engaging in “fracking,” a controversial well stimulation technique that critics argue can lead to groundwater contamination, earthquakes, and other public harms. In general, DOGGR, not the City, has authority to regulate the techniques used in resource production, and thus the City does not regulate fracking. However, the Agreement grants the City a binding contractual right to enforce a “no fracking” rule.

Second, the Agreement prohibits Matrix from trucking produced oil within the City, except in limited circumstances. Existing infrastructure enables Matrix to convey oil that is produced through pipelines rather than trucks, and this is how oil from La Habra Heights makes its way to market. Despite the fact that oil is not generally trucked in the City, the agreement establishes a binding contractual commitment from Matrix not to truck oil, even if trucking were to hypothetically become more economically viable for Matrix. The only exceptions would be for emergencies and for the “slop oil” that is produced for a limited time immediately following a redrill. “Slop oil” is oil that contains byproducts from the redrilling process and thus cannot be placed into a pipeline.

Redrilling Procedure

A redrill is a temporary action that involves four steps: site preparation/mobilization, drilling, demobilization, and completion. During mobilization, which lasts approximately 5-7 days, the drilling rig and related equipment is delivered to the site for assembly and the site is prepared for the drilling. Site preparation involves the installation of temporary soundwalls or other installations related to the drilling, and the installation time depends on the size of the site and the installation. Drilling will last approximately 10-12 days and will occur 24 hours. Drilling will occur in a manner that complies with both the City’s noise ordinance requirements, including night time noise, and the dark skies requirements. In most instances the drilling rig will be electrically driven and powered by generators, which will also have to comply with the City’s noise ordinance. For the demobilization phase, Matrix will disassemble the drilling rig and transport it offsite, and the byproducts from redrilling (i.e. drilling muds, produced water, drill cuttings, etc.) will be transported offsite for proper treatment and disposal. It is expected that approximately 20 to 30 total trucks will be accessing the well location. All trucking will only occur during approved hours and along approved routes. Finally, a small workover rig will come on site to perform completion work (e.g., well perforation).

Redrilling Protocols

The agreement contains protocols for redrilling, which are attached to the agreement as Exhibit 5. These protocols establish a standard procedure for the City to monitor redrilling operations and ensure that the operations comply with City Code requirements. Prior to commencing a redrilling operation, Matrix will be required to submit a packet of documents to the City to indicate how the operation will proceed. Among the documents will be a site map, a sound management protocol, and a truck routing and safety protocol. The primary purpose of the site map will be to identify safety requirements at the site, particularly as it relates to fire safety and fire code compliance. The City’s fire inspector will review the site

map and perform an inspection of the site prior to commencement of operations in order to confirm that fire safety measures (including fuel management) measures are in place.

The sound management protocol will set forth the operator's plan for ensuring that noise during redrilling does not exceed decibel levels allowed under the Municipal Code. The nature of the plan will depend on the activity and the specific site, but it may involve temporary installation of a sound wall or other barriers. The plan will also require constant monitoring of the operation to documents that sound levels stay within those allowed by the Municipal Code.

The truck routing and safety protocol will establish routes and timing of mobilization and demobilization activities, and include safety requirements, such as flag men and pilot cars, as needed. The purpose of the protocol will be to limit redrilling traffic to non-rush hour times, identify specific routes where traffic will be expected, avoid use of unconventional routes, and maintain safety during periods of closures or impediments.

Prior to commencing any redrilling activities, Matrix will be required to make community outreach efforts to inform the community of the planned activities. Matrix will be required to hold at least one informational public meeting and to mail notice prior to the redrill to all properties within 800 feet of the site where the well is located.

Matrix will bear all costs of the City's monitoring of the redrilling operation. Once operations commence, the operator has agreed to \$1,000 payment as liquidated damages to the City for any breach of the redrilling protocols.

City Protections

Matrix will be required to prove its good faith compliance with the agreement each year while the agreement is in effect. If Matrix does not prove that it has complied in good faith with the agreement, there will be a procedure for the City Council to terminate the agreement. Matrix will also be required to maintain insurance and deliver a bond to the City, as additional protections.

The agreement will be recorded against the property and will run with the land. Thus, any successors-in-interest to Matrix will continue to be subject to the terms of the agreement and will be required to continue paying the (increased) fee to the City.

General Plan Compliance

Staff recommends that the City Council find that the Agreement is consistent with the General Plan. The General Plan designates each of the oil production sites as Open Space-Resource Production. The General Plan anticipates that resource production uses will remain only for the next ten to fifteen years [from 2004], at which time it will become uneconomical to continue production. It seeks to require a change in use upon depletion and remediation of the sites. The General Plan sets forth the following land use policies related to resource production sites:

Land Use Element Policy 28. In light of the economic life remaining with respect to resource operations in La Habra Heights, the City should work with appropriate state agencies to require the operators to prepare for and to fulfill their obligations to remediate and abandon oil wells and other facilities as required by law.

Land Use Element Policy 29. At such time as the State of California or other appropriate authorities pronounce the land designated as “Open Space-Resource Production” as being remediated so that it is suitable for alternative uses, the City shall consider requests for a General Plan Amendment and rezoning from the owners of such properties.

To date, the resources have not been depleted and it has not become uneconomical to continue production, even though fifteen years have passed. The Agreement is consistent with the General Plan because the Agreement is in furtherance of continued production until depletion. Moreover, to the extent redrilling results in more efficient production, the resource will be depleted more quickly, and the City will be able to encourage re-use of the sites. Additionally, as individual wells become more efficient, other wells may become unnecessary, leading to abandonments of some wells pursuant to the DOGGR process.

Municipal Code Compliance

The Agreement complies with the provisions of the Municipal Code. First, the sites are all zoned for Open Space-Resource Production, and resource production has been occurring on the sites for decades. Second, the Agreement specifically incorporates the Municipal Code and requires the Owner of the sites to fully comply with the Municipal Code. The Agreement does not create exceptions to any Municipal Code provisions or grant rights that are not available to other property owners.

Third, the Agreement is consistent with Chapter 7.20 of the Municipal Code, relating to development agreements. The Agreement is not a development agreement in the traditional sense because it does not allow for any new development and only allows for redrilling of existing wells. Nonetheless, the Agreement incorporates the protections to the City contained in Chapter 7.20, and the Agreement is being processed following the approval process for development agreements.

Though the Agreement proceeded as a settlement agreement, it is substantially consistent with section 7.20.20, and the information related to the sites is contained in the Agreement, particularly within the exhibits. Each of the mandatory contents set forth in section 7.20.40 is incorporated into the agreement:

1. *Duration of the Agreement.* The duration of the agreement is 20 years.
2. *Permitted Uses.* The permitted uses of the subject properties are not changed. The Agreement only allows for redrilling of existing active wells.
3. *Density and intensity of the permitted uses.* The Agreement does not allow for any increase in the number of wells or any other change in the density or intensity of the use.
4. *Approved site plans, elevations, floor plans and sections, including the maximum height and size of proposed buildings.* The Agreement only applies to the current

location of the Wells, without any change in the site plan. The Agreement does not call for any proposed buildings or other structures; to the extent temporary buildings or other structures are added to the sites, the Agreement requires that the installation of the buildings follow City Code processes.

5. *Provisions, if any, for reservation or dedication of land for public purposes or other contribution to public improvements and amenities of benefit to the City.* Because there is no change or increase in use and no development of land, there is no reservation or dedication for public purposes. The Agreement prohibits fracking and trucking of oil, and provides a payment to the general fund based on the value of oil produced from redrilled wells.
6. *Protection from either a future growth control ordinance or a future increase in development impact fees.* The Agreement allows a vested right to redrill and therefore provides protections against future ordinances prohibiting redrilling.
7. *Provisions that address the applicable environmental review for the project.* The ordinance adopting the Agreement contains the City Council's environmental determination.
8. *Provisions requiring periodic review of the development agreement under Section 7.20.60.* The Agreement provides for periodic review.
9. *Provisions which would necessitate a reconsideration or amendment of the development agreement if any health and safety issues of compelling public necessity are discovered (i.e., a new environmental health hazard is discovered).* The periodic review allows for reconsideration or amendment resulting from health and safety issues of compelling public necessity.

Environmental

Staff recommends that the City Council find that approval of the Agreement is exempt from environmental review for the following reasons, each of which is independently sufficient to exempt the entire Project under the California Environmental Quality Act (Pub. Resources Code, § 21000 et seq.: "CEQA"):

Existing Facilities Exemption (Class 1)

Title 14 of the California Code of Regulations, section 15000 et seq. ("State CEQA Guidelines"), section 15301 provides a categorical exemption for existing facilities. Specifically, it states that "Class 1 consists of the operation, repair, maintenance, permitting, or minor alteration of existing public or private structures, facilities, mechanical equipment, or topographical features, involving negligible or no expansion of existing or former use." According to the regulation, the "key consideration is whether the project involves negligible or no expansion of use." Example activities include, but are not limited to, interior or exterior alterations involving such things as interior partitions, plumbing, and electrical conveyances.

The Agreement establishes specific protocols that Matrix must follow for the purpose of redrilling existing, active wells on property that Matrix owns within the Sansinena oil field in the City of La Habra Heights. The redrilling is necessary to repair and maintain existing oil wells owned by Matrix. The redrilling protocols ensure that the redrills are undertaken consistent with Matrix's current operating procedures. The redrilling would involve negligible or no expansion of the existing oil wells. The existing use would remain effectively unchanged by the redrilling except that the redrilled wells would be cleaner, safer, and more

technologically sound compared to the existing wells. Redrilling work will be within existing well bores, and there will no increase in well numbers or historical production of oil. The amount of oil available in the Sansinena field is limited and the redrills would not expand or otherwise increase the amount of oil available for production. Therefore, for the foregoing reasons, approval of the Ordinance is categorically exempt pursuant to State CEQA Guidelines, section 15301.

Replacement or Reconstruction Exemption (Class 2)

State CEQA Guidelines, section 15302 (Class 2) provides a categorical exemption for replacement or reconstruction of existing structures and facilities. The key for this exemption to apply is that the new structure would be located on the same site as the structure replaced and would have substantially the same purpose and capacity as the structure replaced.

As described above, the Agreement would allow Matrix to replace or reconstruct existing oil wells and associated facilities at existing well sites within the Sansinena oil field in the City of La Habra Heights. The purpose of the redrilling, i.e., replacement or reconstruction, of existing, active wells is to remove corrosion and to replace old deteriorated pipes and valves with new pipes and valves. The redrilling would involve negligible or no expansion of the existing wells, and would occur on the same site as the existing wells, with substantially the same purpose and capacity as the existing well. Specifically, the redrill activity would not increase the well facility footprint and would not increase the oil supply. The well count will not change because the number of wells stays the same with redrilling activity. The redrilled wells will have the same API number with DOGGR but may have a subsequent notation (such as a letter marking) to indicate that the well has been redrilled. Because the redrilled wells have the same purpose (extraction of oil from the Sansinena oil field) with the same capacity (supply of oil in the field is unchanged), approval of the Agreement is categorically exempt pursuant to State CEQA Guidelines, section 15302.

Common Sense Exemption

Approval of the Agreement is also exempt from environmental review under State CEQA Guidelines section 15061, subdivision (b)(3) (Common Sense Exemption) because it can be seen with certainty that there is no possibility that approval of the Agreement would have a significant effect on the environment.

The Agreement establishes specific protocols that Matrix must follow for the purpose of redrilling existing, active wells on property that Matrix owns within the Sansinena oil field in the City of La Habra Heights. The redrilling protocols ensure that the redrills are undertaken consistent with Matrix's current operating procedures. The redrilling work is industry standard maintenance activity that Matrix must undertake to keep its facilities functioning safely and efficiently. The Agreement does not expand Matrix's current operations but instead memorializes the protocols that Matrix has been using to guide redrill activity within the City. The City wishes to ensure that the protocols are clearly memorialized by way of the Agreement so as to avoid future uncertainty about how these activities must be undertaken. Therefore, because the Agreement does not permit new activity or allow for an expansion of Matrix's existing operation, there is no possibility that the Agreement could have an environmental impact.

Exceptions to the Exemptions

Staff considered the exceptions to categorical exemptions identified in State CEQA Guidelines section 15300.2 and recommends that the City Council find that none of the exemptions to the categorical exemptions apply for numerous reasons, including the following:

First, redrilling will not occur in a particularly sensitive environment or impact an environmental resource of hazardous or critical concern, because the redrilling involves reconstruction and rehabilitation of existing, active well sites, such that the existing conditions of each site are already highly disturbed.

Second, redrilling will not result in a cumulatively significant impacts from successive projects of the same type in the same place, over time, as the Agreement memorializes existing protocols that are used when Matrix engages in redrilling to ensure that no potentially significant environmental effects will occur, such as requirements to comply with all City Code requirements, safety requirements, fire code, sound management, and traffic safety management.

Third, there are no unusual circumstances surrounding the redrilling that result in a reasonably possibility of a significant effect on the environment, as the each site is already developed and has existing, active wells, so the sites are heavily disturbed. Redrilling involves standard reconstruction and rehabilitation of existing wells.

Fourth, redrilling will not damage scenic resources, including trees, historic buildings, rock outcroppings, or similar resources, within a highway officially designated as a state scenic highway because redrilling will only occur on existing, active well sites that are heavily disturbed and there are no redrilling well sites within a highway officially designated as a state scenic highway.

Fifth, redrilling does not involve activities on any hazardous waste sites included on any list compiled pursuant to Section 65962.5 of the Government Code.

Sixth, redrilling will not cause a substantial adverse change in the significance of a historical resource because there are no historic resources on the redrilling sites, and redrilling involves standard rehabilitation and reconstruction of existing well sites that are already heavily disturbed and redrilling would not involve new disturbances that might cause a substantial adverse change in the significance of a historical resource.

FISCAL IMPACT

Upon completion of each redrilled well, the City will receive 1% (which may increase to 2% upon sale) of the market value of all oil produced from each redrilled well. The Agreement is otherwise intended to be cost-neutral to the City.

RECOMMENDATION

It is recommended that the City Council:

- A. Waive reading in full and read by title only;
- B. Introduce and hold a first reading of Ordinance No. 2019-05, an Ordinance approving a Settlement Agreement with Matrix Oil Corporation, a California corporation and RMX Resources, LLC, documenting protocols for redrilling oil wells in the City; **AND**
- C. Direct staff to notice a public hearing before the Planning Commission and the City Council

ATTACHMENTS

1. Draft Ordinance No. 2019-05
2. Settlement Agreement

AGENDA REPORT APPROVAL

Fabiola Huerta
City Manager

Rafferty Wooldridge
Assistant City Manager