Oil Companies Face Double Dip

Will Beverly Hills and L.A. voters dig extraction levies?

Howard Fine, Los Angeles Business Journal, 1-31-11

Three oil companies that drill for oil under Beverly Hills could be hit with a double whammy of a tax hike if voters in Beverly Hills and the city of Los Angeles approve extraction tax measures on the March ballot.

Beverly Hills voters will decide March 8 whether to quintuple the tax on oil taken out of the ground beneath the city. L.A. voters also will decide that day whether to impose an extraction tax for the first time. Officials in both cities placed the measures on the ballot to raise revenue to help close budget deficits.

Caught in the middle are three oil companies with well heads in Los Angeles but whose wells extend under Beverly Hills. Therefore, they'd have to pay taxes to both cities – Beverly Hills because they extracted the oil from its ground and Los Angeles because that's were the oil came to the surface.

Downtown L.A.-based Breitburn Energy Partners LP, Foothill Ranch-based Hillcrest Beverly Oil and Houston-based Plains Exploration and Production Co. would face a cumulative tax of $3.60 per barrel for oil they extract from under Beverly Hills, about 10 times what they currently pay in extraction tax.

"It's going to be tough," said Morris Hodges, president of Hillcrest Beverly Oil, a South Orange County company that owns and operates wells in the Rancho Park area south of Century City. His company also pays landowners higher-than-normal royalty fees, which further cuts into any profit. "It's going to be much harder on us than some of the other producers because our royalties go up to 30 percent of the price per barrel in some cases."

Denver-based Venoco Inc., which operates an oil field next to Beverly Hills High School near Century City, is the only company whose drilling is entirely within Beverly Hills city limits and would thus not be subject to the L.A. tax but would have to pay the new Beverly Hills tax.

The oil companies are also arguing that thousands of local property and mineral rights owners could share in some of the pain from the new or increased taxes as their royalty checks could shrink by as much as 5 percent.

"A lot of people – be they single-family homeowners or apartment building owners or commercial property owners – pay all or most of their property taxes with these royalty revenues," said Hal Washburn, chief executive of Breitburn, which operates 50 wells on a site in Los Angeles just south of Beverly Hills. Many of those L.A. wells slant drill under Beverly Hills, so they stand to be double-taxed.

Breitburn Executive Vice President Greg Brown said that royalty payments range from as little as $200 per year paid to condominium owners to tens of thousands of dollars paid annually to the current or former owners of larger parcels.

New gas tax

Beverly Hills officials say the oil companies are exaggerating the reduction in royalty tax income. City Treasurer Eliot Finkel said last week that his office conducted a review of some of the royalty agreements and found that the Beverly Hills tax would reduce royalty payments by an average of 40 cents for every $100.

Currently, Beverly Hills charges $3,880 for the first 10,000 barrels of oil produced each year at wells within city limits (or close to 39 cents a barrel) and 36 cents for each additional barrel extracted. For wells slanting under the city from outside, the tax rate is $1,933 for the first 10,000 barrels (or 19 cents a barrel) produced each year and 14 cents for each additional barrel.

Measure O would set a rate of $2,000 for each well completely within the city and raise the per-barrel tax to 2.5 percent of the gross receipts from the sale of oil extracted from beneath the city, whether direct or slant drilled. That would amount to about $2 a barrel at current prices. It would also tax natural gas for the first time – also at 2.5 percent of gross receipts.

Los Angeles does not currently levy an extraction tax on oil. That city's ballot measure – also known as Measure O – would charge a flat $1.44 per barrel of oil "produced in the city of Los Angeles." The tax applies to every operating well head in the city, regardless of whether the well slant drills beneath another city, such as is the case in Beverly Hills.

Oil company executives say if both taxes passed, they would likely have to shut down production of more marginal wells sooner than if only one of the taxes passed.

But Finkel said that if Beverly Hills' tax levy forces the shutdown of marginal wells, "one has to wonder how much longer those wells would have operated anyway and how much revenue they really would have brought into the city."

Of course, Hillcrest Beverly Oil faces even more pressure, because many of its royalty payments are higher than the industry norm of 15 percent to 20 percent.

Hillcrest's Hodges said the tax increases, if approved, will be bitter.

"I'm 77 years old and I've never really made a lot of money on this operation," he said."

Mineral rights

The oil companies make royalty payments to the thousands of individuals who hold title to mineral rights beneath residential and commercial properties in both Beverly Hills and Los Angeles. The royalty rates vary but typically range between 15 percent and 20 percent of revenue from the sale of oil.

In many cases, the mineral rights are held by the current property owners. But since mineral rights can be bought and sold separately from surface property, many royalty recipients don't own property in Beverly Hills.

One such example is the Huntington Library and Art Galleries in San Marino, which receives more than $10,000 a year in royalty payments from Hillcrest Beverly Oil. Those royalties date from decades ago, when the estate of Henry Huntington owned oil-producing land in the area.

It has long been standard practice for oil companies to deduct government-imposed taxes from royalty payments, thus passing along some of the tax hit to royalty recipients.

Rock Zierman, president of the California Independent Producers Association, which represents independent oil companies, said that when the companies get less money, the rights holders get less money, too.

"That's the secondary hit," Zierman said.