

MINUTE ITEM

This Calendar Item No. 24
was approved as Minute Item
No. 24 by the State Lands
Commission by a vote of 3
to 0 at its 5/7/84
meeting.

CALENDAR ITEM

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05/07/84

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APPROVAL OF SETTLEMENT OF
LONG BEACH UNIT MINING RIGHTS
ASSESSMENT APPEALS FOR 1979 THROUGH 1983

With the State Lands Commission in the forefront, the Long Beach Unit Participants appealed the mining rights assessments made by the Los Angeles County Assessor of the Long Beach Unit for the years 1979 through 1983. These appeals were based upon disagreements with the Assessor's opinion of value of Long Beach Unit hydrocarbon reserves and the methods by which the Assessor added new reserves to previously determined reserve estimates. With the advent of Proposition 13, the method of assessing the value of oil and gas interests changed radically. The assessment appeals were, to some extent, responsive to the unsettled state of mining rights assessments in the wake of Proposition 13. The settlement constitutes acceptance for these years of the assessment methodology set forth in Board of Equalization Rule 468.

The States' interest in Long Beach Unit ad valorem property taxes is substantial. Pursuant to a 1972 agreement between the County of Los Angeles, the City of Long Beach, the Long Beach tidelands oil company contractors and the State, the issue of the taxability of the various possessory interests held by the oil companies under the Long Beach tidelands net profits contracts was settled. The operating interest of the Field Contractor (80 percent of Tract 1) was determined to be taxable, and the non-operating Contractors' interests (the remaining 20 percent of Tract 1 and Tract 2) were determined to be exempt. As a consequence of this settlement and as provided by the tax-sharing provisions of the Unit Agreements, the taxable private interests in the Townlot area of the Unit account for about 15 percent of Unit taxes and the Field Contractor's share of Tract 1 accounts for the remaining 85 percent. When the Field Contractor charges property taxes to the net profits account, as permitted by their net profits contract, the State becomes the indirect payor, by virtue of a loss in oil revenue, of about 95 percent of the offshore share

of property taxes, or about 83 percent of all Unit property taxes. Consequently the dispute over Long Beach mining rights assessments and property taxes is primarily an intra-governmental affair concerning the allocation of revenue between the State on one side and the County of Los Angeles, the City of Long Beach and the Long Beach Unified School District on the other.

Instead of proceeding to a hearing before the Assessment Appeals Board on all assessment appeals for 1979 through 1983, the parties agreed to attempt to settle their differences through negotiations. These negotiations took place over the past year and involved the Assessor's staff and the Assessor's legal counsel, the Commission's staff, the Attorney General's Office and the legal counsel for the Unit Participants. These negotiations culminated in an agreement on March 28, 1984.

The agreement was structured to minimize tax refunds while setting a basis for tax savings in the future. This minimized any cash dislocations for the local governments that would result from settling the assessments for five years on the single most valuable property in Los Angeles County. The Participants obtained a restructuring of the 1983 Proposition 13 value, the base upon which future assessments will be built, that should provide for substantial tax savings between now and the year 2000 when the term of the present Contractors' possessory interest expires.

The major elements of the agreements are as follows:

1. There will be a refund to the Participants of \$1.8 million in overpaid 1981 taxes plus interest. The overpayment resulted from an acknowledged error in the 1981 assessment in which the County counted all new wells as producers when in fact some were injectors.
2. The 1979 and 1980 assessments will be revised by adding 10,723,000 barrels of new recoverable reserves to the 1979 assessment and subtracting the same number of reserves from the 1980 assessment. Since the value of added reserves was substantially less in 1979 than in 1980, the result of this adjustment will be a significant reduction in value of the Proposition 13 protected reserves that are used as the base for future assessments. This adjustment will be applied prospectively only so that no tax refund will be generated as a result of its adoption.

3. In addition to bringing forward the revision provided for in paragraph 2, the 1983 assessment will be revised by discounting the 1983 added reserves with a capitalization rate of 10-1/2 percent plus taxes instead of 10 percent plus taxes as in the original assessment. This revision will be applied prospectively.

4. Beginning with the 1984 assessment and continuing through the assessment for the March 1, 2000 lien date, the Assessor will assess mining rights taxes on Tract 1 by excluding from recoverable reserves and applicable value those Tract 1 reserves and applicable value which are recoverable after the expiration of the term of the possessory interest, which is the year 2000. This involves application of the concept, which is discussed in American Airlines, Inc. v. County of Los Angeles (1976) 65 Cal. App. 3d 325, that no value should be placed on a possessory interest in tax exempt property for periods after its termination date unless there is a reasonable basis for concluding that the possessory interest will be renewed.

Because of the substantial addition of new reserves by the Assessor in the 1983 assessment, the likelihood of the addition of large amounts of new reserves in the future, or change in the time-rate projection of the current reserves, which under Proposition 13 are the bases for triggering higher taxes, is reduced in the absence of unforeseeable economic and/or technological changes. This is not to say that there will be no additions to reserves in the near future. In the event there are such additions, they will be made on the basis of sound and reasonable engineering estimates and will be fairly apportioned between the periods before and after the termination of the current possessory interest in the year 2000.

The 1983 assessment provides a substantial quantity of protected reserves, and the settlement factors, taken together, provide a reduction in value of these protected reserves that would have translated into a \$1.5 million savings in mining rights taxes to the Unit if 1983 mining rights taxes had been recalculated. Assuming that Proposition 13 remains as the law, this tax savings will inure to the benefit of the Unit through the year 2000. The State's share of this savings will be 83 percent or more. After 2000, the Assessor may revalue the offshore reserves on the basis of a change in ownership if new taxable

possessory interests are created when the current possessory interests end.

The staff and the Attorney General's Office believe that this settlement is in the best interests of the State and of the Unit Participants and recommend its approval by the Commission.

IT IS RECOMMENDED THAT THE COMMISSION APPROVE THE SETTLEMENT OF THE APPEALS OF THE LONG BEACH UNIT MINING RIGHTS ASSESSMENTS FOR THE YEARS 1979 THROUGH 1983, AS OUTLINED ABOVE, AND AUTHORIZE THE EXECUTIVE OFFICER TO EXECUTE ANY AND ALL DOCUMENTS NECESSARY TO PUT THE SETTLEMENT INTO EFFECT.