

**CALENDAR ITEM
C39**

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**CONSIDER APPROVAL OF AMENDMENTS TO THE
CRUDE OIL VALUATION PROVISIONS OF THE
CONTRACTORS' AGREEMENT AND TRACT NO. 2 AGREEMENT,
LONG BEACH UNIT, WILMINGTON OIL FIELD,
LOS ANGELES COUNTY**

APPLICANT:

California State Lands Commission
100 Howe Avenue, Suite 100 South
Sacramento, CA 95825-8202

AREA, TYPE LAND AND LOCATION:

The Long Beach Unit consists of two offshore tracts and over 90 onshore townlot tracts in downtown Long Beach. The two offshore tracts are Tract 1 and Tract 2. Tract 1 is the largest tract in the Unit and consists of tide and submerged lands granted by the Legislature to the City of Long Beach (City) subject to the public trust. Tract 2 is a smaller tract, consisting of tide and submerged lands subsequently granted in trust to the City with the minerals reserved to the State.

BACKGROUND:

Oil and gas production from the Long Beach Unit began in the 1960s and has resulted in the production of over 900 million barrels of oil and has provided the State with over \$4 billion in oil revenues. The environmental record of this production operation has been excellent. Tract 1, which is by far the largest tract in the Unit, consists of tide and submerged lands granted by the Legislature to the City of Long Beach (City) subject to the public trust. The Legislature did not reserve the mineral interest in the trust grant, but the State receives the largest segment of oil revenues from this tract as a result of court decisions and legislation. Tract 2, a far smaller tract, consists of tide and submerged lands subsequently granted in trust to the City with the minerals reserved to the State.

Tract 1 is operated pursuant to the Contractors' Agreement that was authorized by Chapter 138 of the Statutes of 1964, First Extraordinary Session. The

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agreement provides for the operation of the Long Beach Unit by an oil company contractor under the direction of the City of Long Beach. The Tract No. 2 Agreement, also authorized by Chapter 138, governs production from Tract 2. This agreement is between the State and a contractor that does not have operating responsibilities. Occidental Long Beach, Inc. (OLBI), a subsidiary of Occidental Petroleum Corporation, is the contractor under both agreements. Both agreements provide for sharing the net profits from the production operations between the government entities and the oil company. The agreements have been made subject to the Optimized Waterflood Program Agreement in 1991, pursuant to which additional development has been undertaken with the contractor being required to take investment risks and, in turn, obtaining a greater share of the net profits from that investment. Under the Optimized Waterflood Program, the City and State receive approximately 96 percent (96%) of the net profits from base production and the contractor receives approximately 4 percent (4%). With respect to incremental production from the Optimized Waterflood Program, the combined City and State's share of the net profits is approximately equal with that of OLBI, the contractor.

Under these net profits contracts, specifically allowed costs are deducted from the value of the oil produced to determine the net profits. The provisions of the Contractors' Agreement and the Tract No. 2 Agreement govern the calculation of the value of the oil. The oil valuation provisions in these two contracts are essentially identical and are critical in determining the amount of the net profits. These provisions provide for an initial valuation to be used by the contractor in making monthly payments to the City and the State. These initial valuations are based on posted prices and are currently structured as the higher of the average of posted prices in the Wilmington oil field or the average of posted prices in the Wilmington, Huntington Beach, Long Beach (Signal Hill) and Inglewood oil fields. After the City obtains data on prices paid by purchasers of oil for specific contractually defined purchases of oil in the Wilmington, Huntington Beach, Long Beach (Signal Hill) and Inglewood oil fields, the City calculates the average of the prices paid for these purchases in just the Wilmington Field and in all four fields. The City and the State then adjust upward the initial oil valuation to the higher of the average of prices for purchases of oil in the Wilmington field or in the four fields.

Since the mid-1960s when the Contractors' Agreement and the Tract No. 2 Agreement became effective, the amount of production in the four fields from which valuation data are to be used has decreased, the number of companies posting prices in these fields has decreased and the identity of the buyers and

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sellers in these fields has changed. For example, four major refiners used to post prices in most of the four fields. Presently, only one or two refiners have been posting in these fields, and in Wilmington, the last remaining poster, ConocoPhillips, has indicated that it no longer will be posting in this field. The principal sellers in these fields used to be the major refiners whose production affiliates sold the oil to their refining affiliates. There were few arms length sales and those consisted primarily of sales by the City and State of oil made available to them for sell off by their contracts. Companies that do not have refineries now make most of the sales, and the largest number of sales by far is made in the Wilmington field due, in large part, to the decline in production from the other fields.

The changes in the oil market in the Wilmington field and the other nearby fields need to be addressed by making two changes to the oil valuation provisions of the Contractors' Agreement and the Tract No. 2 Agreement to make the valuation data more reflective of the fair market value of the oil as was intended. These changes also will eliminate costly calculations that are paid for by the City and the State that do not yield higher values for the crude oil.

The first change will involve, in the valuation based on posted prices, the inclusion of the posted prices for the Midway-Sunset oil field in Kern County. Because the Midway-Sunset field is a large field where all major refiners purchasing crude oil in California post prices, its postings provide a better reflection of the California market than the limited number of postings remaining in the four fields. The initial oil valuations based on posted price, therefore, will be the higher of the average of the posted prices in the Wilmington oil field or of the average of the posted prices in the Wilmington, Huntington Beach, Long Beach (Signal Hill), Inglewood and Midway-Sunset oil fields. Additionally, the Midway-Sunset posted prices in recent years have been higher than the posted prices in the Wilmington field and its neighboring fields. The inclusion of the Midway-Sunset posted prices, therefore, will provide higher initial valuations for the oil.

The second modification will change the method where oil value is adjusted yearly based on oil sales revenues. This change will remove from the adjusted valuation the Huntington Beach, Long Beach (Signal Hill) and Inglewood oil fields' oil sales information because that information has historically been unavailable. The subsequently adjusted valuations will use only the prices paid for the purchases of oil in the Wilmington field where most all of the sales occur, including the higher priced sales. These sales, unlike those in the other fields,

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are those for which the City and the State have contractual rights to obtain the sales data from the sellers.

The proposed amendments are to become effective March 1, 2007. The use of the Midway-Sunset postings will apply to the initial monthly valuations of crude oil beginning in March 2007. The change to the valuation standards based on prices paid for specified purchases of crude oil will apply to adjusted crude oil valuations beginning with those for calendar year 2006.

The Agreement Amending Crude Oil Valuation Provisions, Contractors' Agreement, Long Beach Unit, Wilmington Oil Field, California is attached as Exhibit A, and the Agreement Amending Crude Oil Valuation Provisions, Tract No. 2 Agreement, Long Beach Unit, Wilmington Oil Field, California is attached as Exhibit B. The amendments have been approved as to form by OLBI and the City's staff. The City is expected to consider approval of the amendments at its next meeting, which is scheduled for February 6th, 2007.

STATUTORY AND OTHER REFERENCES:

With respect to the amendments to the Contractors' Agreement, section 10(b) of Chapter 29 of the Statutes of 1956, First Extraordinary Session, requires the California State Lands Commission's consent to any amendment to a contract for the drilling for, developing, extracting, processing, taking or removing, or disposing of oil from the Long Beach tidelands for the amendment to be valid. Pursuant to section 3(j) of Chapter 138 of the Statutes of 1964, First Extraordinary Session, the Commission was given the authority to enter into the Tract No. 2 Agreement, which like its oil and gas leases, it may modify by amendment with the consent of the lessee.

OTHER PERTINENT INFORMATION:

1. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines [Title 14, California Code of Regulations, section 15060(c)(3)], the staff has determined that this activity is not subject to the provisions of the CEQA because it is not a "project" as defined by the CEQA and the State CEQA Guidelines.

Authority: Public Resources Code section 21065 and Title 14, California Code of Regulations, sections 15060(c)(3) and 15378.

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EXHIBITS:

- A. Agreement Amending Crude Oil Valuation Provisions, Contractors' Agreement, Long Beach Unit, Wilmington Oil Field, California
- B. Agreement Amending Crude Oil Valuation Provisions, Tract No. 2 Agreement, Long Beach Unit, Wilmington Oil Field, California

PERMIT STREAMLINING ACT DEADLINE:

N/A (not a "development project" subject to the Act)

RECOMMENDED ACTION:

IT IS RECOMMENDED THAT THE COMMISSION:

CEQA FINDING:

- 1. FIND THAT THE ACTIVITY IS NOT SUBJECT TO THE REQUIREMENTS OF THE CEQA PURSUANT TO TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15060(c)(3), BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY PUBLIC RESOURCES CODE SECTION 21065 AND TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15378.

AUTHORIZATION:

- 1. CONSENT TO THE CITY'S APPROVAL OF THE AMENDMENTS TO THE CRUDE OIL VALUATION PROVISIONS OF THE CONTRACTORS' AGREEMENT AND AUTHORIZE THE EXECUTIVE OFFICER TO EXECUTE THE CONSENT PROVISION IN AN AGREEMENT AMENDING THE CRUDE OIL VALUATION PROVISIONS OF THE CONTRACTORS' AGREEMENT IN THE FORM OF THAT ATTACHED AS EXHIBIT A.
- 2. APPROVE THE AMENDMENTS TO THE CRUDE OIL VALUATION PROVISIONS OF THE TRACT NO. 2 AGREEMENT AND AUTHORIZE THE EXECUTIVE OFFICER TO EXECUTE ON THE COMMISSION'S BEHALF AN AGREEMENT AMENDING THE CRUDE OIL VALUATION PROVISIONS OF THE TRACT NO. 2 AGREEMENT IN THE FORM OF THAT ATTACHED AS EXHIBIT B.