

**CALENDAR ITEM
C48**

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04/06/10

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**CONSIDER APPROVAL OF PROPOSED 2010 LONG BEACH
TIDELANDS DRY GAS PRICE AGREEMENT AND PROPOSED TERMINATION
OF THE POWER PLANT GAS USAGE AGREEMENT,
WILMINGTON OIL FIELD,
LOS ANGELES COUNTY**

APPLICANT:

City of Long Beach
Long Beach Gas and Oil Department
Attn: Mr. Christopher J. Garner, Director
211 East Ocean Boulevard, Suite 500
Long Beach, CA 90802

BACKGROUND:

The City of Long Beach (City) and the California State Lands Commission (Commission) entered into the 2003 Long Beach Tidelands Dry Gas Price Agreement (2003 Agreement) which sets the reasonable wholesale market value for Long Beach tidelands dry gas that the City pays to the State for tidelands dry gas that it receives and can economically utilize in its municipal gas system. Section 6 of Chapter 29 of the Statutes of 1956, First Extraordinary Session requires the Commission and the City to determine jointly from time to time the reasonable wholesale market value of dry gas for the purpose of pricing tidelands dry gas received by the City and not sold to third parties.

Since the 2003 Agreement was made, several events have occurred that have required changes in the disposition of tidelands dry gas that the City's municipal gas department, Long Beach Gas and Oil (LBGO), receives into its system which, in turn, make fitting an update of the pricing determinant in the 2003 Agreement.

Shortly after the 2003 Agreement became effective, the carbon dioxide content of dry gas produced from the Long Beach tidelands increased to a point where it no longer could be used in LBGO's gas system. As a result, the tidelands dry gas

CALENDAR ITEM NO. **C48** (CONT'D)

was diverted for use in the Long Beach Unit power plant until the Unit built an amine plant to reduce the carbon dioxide content of the gas so that the gas could be used in LBGO's system. In January 2009, the amine plant became operational and the tidelands dry gas can now be received into LBGO's system.

In 2007, the Long Beach Bond Finance Authority (LBBFA) entered into a long-term agreement with Merrill Lynch Commodities, Inc. (MLCI) where LBBFA prepays for a supply of natural gas. LBBFA receives the prepaid natural gas pursuant to the agreement with MLCI and delivers the gas to the City at a discounted price pursuant to a separate natural gas supply agreement.

The City recently entered into a short-term contract (delivery period no longer than three years under any transaction confirmation) with MLCI for the sale of tidelands dry gas received into LBGO's system that cannot be utilized economically by the City. The short-term contract is known as the MLCI Confirmation. The City's 2007 contract for prepaid gas makes the tidelands dry gas uneconomic for the City at its reasonable wholesale market value. Whenever any Long Beach tidelands dry gas cannot be utilized economically in the City's municipal system and is not required for oil field operations in the Long Beach tidelands, the City may sell the gas under short-term contracts like the MLCI Confirmation. The MLCI Confirmation also enables the City to free space in its system to provide gas to the Long Beach Unit power plant. The City pays to the State the MLCI Confirmation price for tidelands dry gas received into LBGO's system and sold to MLCI. The State is not a party to the MLCI Confirmation, and the MLCI Confirmation is not subject to Commission approval under the statutes governing Long Beach tidelands oil operations.

The City and the State, nonetheless, need to maintain a dry gas price agreement pursuant to which they have determined jointly the reasonable wholesale market value of tidelands dry gas. This price determination is needed to implement the agreement for valuing Long Beach tidelands shallow gas production and tidelands dry gas taken into LBGO's system when the City does not market it to third parties under short-term contracts.

The City, as it has a right to do under the 2003 Agreement, requested a renegotiation of the price determinant in the 2003 Agreement. Staff entered into negotiations with the City on a 2010 Long Beach Tidelands Dry Gas Price Agreement (2010 Agreement) and has concluded that the use of the First of the Month price minus five cents, the price used in the MLCI Confirmation, is a fair determination of the reasonable wholesale market value of dry gas. This First of the Month price is the price in effect on the first of each month for gas at the active trading point in the Los Angeles Basin in which gas enters the Southern California Gas Company (SoCalGas) system known as city-gate. The city-gate

CALENDAR ITEM NO. C48 (CONT'D)

price is used widely in spot market purchases and sales and is a competitive price due to the number of players in this pooled dry gas trading market. The five-cent deduction from the First of the Month price represents the wholesale market value of the gas; the retail value would be the city-gate price itself. The First of the Month price minus five cents is comparable to the California-Arizona border price for interstate gas deliveries to SoCalGas. The proposed 2010 Agreement is attached as Exhibit A.

The City and THUMS Long Beach Company (THUMSCO), the agent for the Field Contractor for Tract 1 of the Long Beach Unit, recently entered into the Natural Gas Sale Agreement for Power Plant, a new contract for the sale to the Long Beach Unit power plant of dry gas from LBGO's system. This new contract, to which the State is not and need not be a party, supplants the Power Plant Gas Usage Agreement (Gas Usage Agreement) that was entered into in 2001 among Oxy Long Beach, Inc., THUMSCO, the City and the State when construction of the power plant had not yet begun. The Gas Usage Agreement provided the terms by which gas produced from the Long Beach Unit could be used as fuel in the power plant. The Gas Usage Agreement now needs to be terminated. Section 8.3 of the Gas Usage Agreement provides for its termination by a written instrument signed by all parties. The proposed written instrument for terminating the Gas Usage Agreement is attached as Exhibit B.

OTHER PERTINENT INFORMATION

1. The 2010 Tidelands Dry Gas Price Agreement only makes a determination of the reasonable wholesale market value of dry gas to be used to price tidelands dry gas received into the system of LBGO as required by Section 6 of Chapter 29. The Instrument Terminating the Power Plant Gas Usage Agreement only terminates that agreement. Neither causes a direct or indirect physical change in the environment.
2. 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 neither of these activities is a "project" as defined by 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

EXHIBITS:

- A. 2010 Long Beach Tidelands Dry Gas Price Agreement
- B. Instrument Terminating Power Plant Gas Usage Agreement

CALENDAR ITEM NO. C48 (CONT'D)

PERMIT STREAMLINING ACT DEADLINE:

N/A

RECOMMENDED ACTION:

It is recommended that the Commission:

CEQA FINDING:

1. Find that the activity is not subject to the requirements of 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. Approve the 2010 Long Beach Dry Gas Price substantially in the form of the agreement in Exhibit A, attached hereto.
2. Approve the termination of the Power Plant Gas Usage Agreement in the form of the instrument in Exhibit B, attached hereto.
3. Authorize the Executive Officer or his designee to execute any documents necessary to implement the Commission's action.

EXHIBIT A

W 13001

2010 LONG BEACH TIDELANDS DRY GAS PRICE AGREEMENT

Pursuant to section 6 of Chapter 29 of the Statutes of 1956, First Extraordinary Session, the City of Long Beach (City) shall receive into the system of its municipal gas department all Long Beach tidelands dry gas that it can economically utilize. The City shall pay to the California State Lands Commission (State) for the gas it can economically utilize the reasonable wholesale market value as determined from time to time jointly by the City and the State. The last agreement where the City and the State jointly determined the reasonable wholesale market value of tidelands dry gas was made in 2003 and is known as the 2003 Long Beach Tidelands Dry Gas Price Agreement (2003 Agreement).

In 2007, the Long Beach Bond Finance Authority (LBBFA) entered into a long-term agreement with Merrill Lynch Commodities, Inc. (MLCI) pursuant to which LBBFA prepaid for a supply of natural gas. LBBFA receives the prepaid natural gas pursuant to the agreement with MLCI and delivers the gas to the City at a discounted price pursuant to a separate natural gas supply agreement.

Shortly after the 2003 Agreement became effective, the carbon dioxide content of the tidelands dry gas increased to a point where it no longer could be received into the system of the City's municipal gas department. The City then sold the tidelands dry gas to the Long Beach Unit power plant and paid to the State the net proceeds from that sale, as provided in the Interim Agreement for Sale of Tidelands Dry Gas to the Long Beach Unit Power Plant. The amine plant

became operational in January 2009, so that the carbon dioxide in the tidelands dry gas could be reduced to a level where it could be received into the City's system.

The City recently entered into an arrangement with MLCI for the sale of tidelands dry gas received into its municipal system under a short-term contract (i.e., a delivery period no longer than three years under any transaction confirmation). Whenever any Long Beach tidelands dry gas cannot be utilized economically in the City's municipal system and is not required for oil field operations in the Long Beach tidelands or cannot be sold to the Long Beach tidelands oil operations for other purposes, the City may sell the gas under short-term contracts, including that certain purchase and sale agreement between the City and MLCI referred to as the Physical Natural Gas Transaction Confirmation (Trade ID: _____) dated _____, 2010, and entered into pursuant to the International Swap Dealers Association, Inc. Master Agreement dated as of September 3, 2008 (MLCI Confirmation).

The City gave notice under the terms of the 2003 Agreement for a renegotiation of the determinant of the reasonable wholesale market value of tidelands dry gas. The MLCI Confirmation provides the price the City pays to the State for tidelands dry gas received into the City's system and purchased by MLCI. The City and the State, however, still need to maintain an agreement pursuant to which they have determined jointly the reasonable wholesale market value of tidelands dry gas. This price determination will be used to implement the agreement for valuing Long Beach tidelands shallow gas production and for valuing Long Beach tidelands dry gas received into the City's system when the City does not market it under short-term contracts.

The 2003 Agreement uses as the market value determinant 100% of Southern California Gas Company's cost of purchases of interstate gas for sales to its core customers (SoCal

WACOG) in effect at the time the tidelands dry gas is taken by the City, plus one-half of the total intrastate transportation rate per MMBtu paid by the City to Southern California Gas Company (SoCalGas) on the gas the City transports through SoCalGas's pipeline system. This market value determinant needs to be updated to reflect current market practices and conditions. The City and the State have agreed to use as their current determinant of the reasonable wholesale market value of tidelands dry gas the First of the Month price (more specifically defined below) minus five cents.

Therefore, the City and the State agree as follows:

1. Whenever Long Beach tidelands dry gas cannot be utilized economically in the City's municipal system and is not required for oil field operations in the Long Beach tidelands and cannot be sold to the Long Beach tidelands oil operations for other purposes, the City may sell the gas under short-term contracts, including that certain purchase and sale agreement between the City and MLCI referred to as the Physical Natural Gas Transaction Confirmation (Trade ID: _____) dated _____, 2010, including but not limited to the pricing mechanism set forth therein, and entered into pursuant to the International Swap Dealers Association, Inc. Master Agreement dated as of September 3, 2008 (MLCI Confirmation). Long Beach tidelands dry gas sold to MLCI in connection with the MLCI Confirmation could not and cannot be utilized economically in the City's municipal system and was not and is not required for oil field operations in the Long Beach tidelands and could not and cannot be sold to the Long Beach tidelands oil operations for other purposes.

2. The reasonable wholesale market value of Long Beach tidelands dry gas to be used as the price determinant for tidelands dry gas received by the City into the system of its municipal

gas department and not sold under the MLCI Confirmation or other short-term contracts shall be the First of the Month Price minus five cents. First of the Month Price is the price published under the heading “Market Center Spot Gas Prices” for “California - SoCal Gas city-gate” as reported by Inside FERC’s Gas Market Report (\$/MMBtu). If Inside FERC’s Gas Market Report no longer is published, then the First of the Month Price shall be the SoCal Gas city-gate price as determined by some other generally accepted industry publication reasonably selected by the City.

3. Notwithstanding paragraph 4 of the 2003 Agreement providing for retroactive application of a newly agreed upon price, the price determinant in paragraph 2 above shall not become effective until the effective date of the Natural Gas Delivery and Purchase Agreement for Unit Gas among the City of Long Beach, a municipal corporation, the City of Long Beach, as Unit Operator of the Long Beach Unit, THUMS Long Beach Company and Oxy Long Beach, Inc.

4. If either the City or the State believes that the price determinant in paragraph 2 above no longer reflects the reasonable wholesale market value of tidelands dry gas, either the City or the State may demand a renegotiation of this 2010 Long Beach Tidelands Dry Gas Price Agreement (2010 Agreement). The demand for renegotiation shall be made in writing and shall provide a factual basis for the belief on which the demand is based. Upon the making of a valid demand for renegotiation, the City and the State shall commence within thirty days of the notice, negotiations in good faith on a new pricing mechanism for tidelands dry gas. If a new price is agreed upon, the price shall be adjusted retroactively to reflect the newly established price from thirty days after the date of the notice demanding a price renegotiation.

5. This 2010 Agreement shall remain in effect until a new agreement takes its place or until the City and the State mutually determine that the agreement no longer is needed for purposes of valuing tidelands dry gas.

6. This 2010 Agreement has been approved on behalf of the City by the Long Beach City Council and on behalf of the State by the California State Lands Commission.

Dated: _____

CITY OF LONG BEACH

City Manager

Dated: _____

CALIFORNIA STATE LANDS COMMISSION

Paul D. Thayer, Executive Officer

EXHIBIT B

W 13001

WRITTEN INSTRUMENT TERMINATING POWER PLANT GAS USAGE AGREEMENT

In 2001, Oxy Long Beach, Inc. (OLBI), the Field Contractor for the Long Beach Unit; THUMS Long Beach Company (THUMSCO), the agent for the Field Contractor; the City of Long Beach, a municipal corporation acting as Unit Operator of the Long Beach Unit; and the State of California, acting through the California State Lands Commission (State) entered into the Power Plant Gas Usage Agreement (Gas Usage Agreement). The Gas Usage Agreement, which was entered into before the Long Beach Unit power plant had been constructed, provided the terms by which the gas produced from the Long Beach Unit could be used as fuel in the power plant. The City and THUMSCO recently entered into the Natural Gas Sale Agreement for Power Plant, a new contract for the sale to the Long Beach Unit power plant of dry gas from the system of Long Beach Gas and Oil. Because this new contract supplants the Gas Usage Agreement, the Gas Usage Agreement needs to be terminated. Section 8.3 of the Gas Usage Agreement provides for its termination by a written instrument signed by all parties.

By this written instrument, OLBI, THUMSCO, the City and the State, as the parties to the Gas Usage Agreement, terminate the Gas Usage Agreement effective as of the date this

written instrument is signed by all parties. By signing this written instrument, the signatory for each party represents that he/she has full authority to sign on behalf of the party he/she represents.

Dated: _____

Oxy Long Beach, Inc.

by _____

Dated: _____

THUMS Long Beach Company

by _____

Dated: _____

City of Long Beach, a municipal corporation

by _____

Dated: _____

State of California, State Lands Commission

by _____
Paul D. Thayer, Executive Officer