CALENDAR ITEM
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S	27	M. Voskanian

CONSIDERATION OF AN AGREEMENT BETWEEN TIDELANDS OIL PRODUCTION COMPANY, OXY TIDELANDS, INC., OXY WILMINGTON, LLC, CITY OF LONG BEACH, AND THE CALIFORNIA STATE LANDS COMMISSION FOR IMPLEMENTATION OF AN OPTIMIZED WATERFLOOD PROGRAM FOR THE WEST WILMINGTON OIL FIELD, CITY OF LONG BEACH, LOS ANGELES COUNTY

PARTIES:

State, acting by and through the State Lands Commission

City of Long Beach

Oxy Wilmington LLC

Oxy Tidelands, Inc.

Tidelands Oil Production Company

BACKGROUND:

In 2006, OXY Tidelands, Inc. and OXY Wilmington, LLC, wholly owned subsidiaries of OXY Long Beach, Inc., collectively referred to as “Oxy”, acquired 100 percent (100%) of the general partnership interest in Tidelands Oil Production Company (referred to as “TOPCO” or “Contractor”) and thereby became the owner of the Contractor under the Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract, as amended (“Contract”). OXY Long Beach, Inc. is a wholly owned subsidiary of Occidental Petroleum Corporation. Occidental Oil and Gas Holding Corporation, which holds substantially all of Occidental Petroleum Corporation worldwide oil and gas assets, has guaranteed the performance of the contractual obligations of Oxy Tidelands, Inc. and Oxy Wilmington, LLC.

Oil and gas have been produced from the West Wilmington field since its discovery in 1932. The field is divided into five fault blocks plus Parcel A (see

Exhibit A). Fault Blocks II through V are each further divided into two segments. Segment One is the "tidelands" area located southerly and seaward of the boundary line established by Section 7 of Chapter 138, Statutes of 1964, First Extraordinary Session, and Segment Two is the "uplands" area northerly of that line. Much of the tidelands area includes filled lands within the Port of Long Beach. The Contract lands include Segment One in Fault Blocks II through V and Parcel A. The City of Long Beach ("City") is the owner/trustee of the mineral rights in the tidelands and "Operator" of the area subject to the Contract and the Operator of the uplands area, unitized for oil and gas production purposes with the tidelands area, under a separate contract. The City holds the lands and the mineral resources, which are the subject of the Contract, in trust for the State pursuant to various legislative grants.

Under the current Contract, executed by the City and the Contractor in 1989, the State receives 95% of net profits from all oil and gas produced and sold from the lands subject to the Contract. The Contractor receives 5% of the net profits, while the City receives no percentage of the net profits. Net profits are those revenues remaining after production costs and other expenses have been paid. The Contractor informed the City and Commission that the current net profits sharing arrangement does not provide sufficient incentive to them for further development. Staff from the Commission, City and the Contractor began discussion in 2006 on ways to provide a financial incentive to undertake further development. In 2008, Chapter 446 ("Chapter 446") was enacted. It authorizes the Commission, the City and the Contractor to enter into a new contract that incentivizes the Contractor to develop additional oil reserves, while providing a fair and equitable return to the State and the City from the revenue obtained from the production of these additional oil reserves. All parties have been steadily working since then on such a contract and the result of that work is the item offered for consideration – the proposed Agreement for the Implementation of an Optimized Waterflood Program for the West Wilmington Field ("Agreement").

PROPOSED AGREEMENT:

Chapter 446 requires that the Agreement: (1) preserve the current method for sharing among the State, City and Contractor for current oil reserves; (2) provide a means responsive to the market price of crude oil for determining additional oil reserves; (3) provide a method for sharing the revenues from the additional oil reserves among the State, City and the Contractor that incentivizes the Contractor to develop those reserves and provides a fair and equitable return to the State and City from production of those reserves; (4) require the Contractor to spend a negotiated amount on new development; and (5) require the Contractor to prepare on a regular and continuing basis, plans and budgets for the exploration and development of the additional oil reserves, which may be reviewed by Commission staff.

The oil that makes up the current oil reserves is referred to as the “base” and is calculated based on a complex model that looked at past performance to forecast the rate of production decline of the base reserves without additional development. The market price of crude oil and the cost of production affects the determination of how much additional oil reserves, in excess of the “base”, can be developed economically. Net profits from base production will continue to be shared 95% to the State and 5% to the Contractor.

The current oil production is called "base production" and has associated with it “base costs.” Production obtained above the base is referred to as "incremental production.” Costs above base costs are "incremental costs" and the net profits above base net profits are “incremental net profits.” The incremental net profits derived from incremental production, after deducting incremental costs, will be split 51%/49% between the State and the Contractor, respectfully. After the incremental development starts turning a net profit, anticipated to occur in the next three to five years, the State will share 2% of its incremental net profits with the City, resulting in a 49% share of the incremental net profit to the State. This incremental revenue split provides an incentive to the Contractor to undertake further development, while providing a fair and equitable return to the State, and the City as Operator.

Projected State net profits from base production over the next twenty years has been estimated to be $650 million (at $100 per barrel) without the implementation of an optimized waterflood program. If the optimized waterflood program is successful, an additional $204 million of incremental net profit is estimated to be possible (at $100 per barrel) to be shared by the State, the Contractor, and the City. At a 49% share the State would obtain $100 million of the $204 million. It should be understood that the amount of recoverable oil changes with improvements in technology, that the costs to produce the oil in such a mature field are high, and the price received for that oil are highly variable. As such, the above amounts are best estimates.

The proposed program Agreement is responsive to the market price of oil. The wide fluctuations in oil prices in the Wilmington Field in recent years (a high in July 2008 of $128.50/barrel to a low six months later in January 2009 of $25.80/barrel) creates a situation where new development investments of private capital by Oxy requires an increased incentive and under the current Contract would be a speculative risk, especially in a field that has been subject to depletion since 1932. In the proposed Agreement Oxy commits to expend a minimum of $50 million in the first two years for new development, if the price of oil exceeds an average of $65 a barrel for a six month period.

The proposed agreement requires the Contractor to design and implement a program to increase production. Of the $50 million expenditure in the optimized waterflood program $40 million must be spent on well drilling. The repayment of this investment cost, all subsequent incremental investment and other costs of development of incremental oil, will be paid solely out of incremental revenue. It will not come out of the base revenues. The Contractor will prepare plans and budgets annually for the incremental development, with Commission staff having the right to review. As part of this process, it is anticipated that quarterly meetings between the staffs of the Commission, City and the Contractor will occur. The Contractor has agreed to reimburse the Commission's staff costs incurred in the review of the incremental production development.

Under the terms of the proposed Agreement, the terms of which apply only to incremental development, all existing agreements affecting tidelands oil operations in the West Wilmington oil field, including the Long Beach Harbor Tidelands Parcel and Parcel "A" Contract and the Unit Agreements and Unit Operating Agreements for the Fault Block Units will remain unchanged, except that the term of the Long Beach Harbor Tidelands Parcel and Parcel "A" Contract will be extended from the current termination date of March 2024, to the end of the field operations.

STATUTORY AND OTHER REFERENCES:

Chapter 446, Statutes of 2008; Chapter 29, Statutes of 1956, 1st E.S.; Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract, as amended.

OTHER PERTINENT INFORMATION:

1. The Long Beach City Council is scheduled to consider the subject Agreement on May 22, 2012.

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

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

3. This activity involves lands statutorily exempted from Public Resources Code sections 6370 et seq., pursuant to Public Resources Code section 6377.

EXHIBIT:

A: Site and Location Map

AUTHORIZATION:

1. Find that the subject Agreement is not subject to the requirements of CEQA pursuant to California Code of Regulations, Title 14, section 15060, subdivision (c)(3), because the subject activity is not a project as defined by Public Resources Code section 21065 and California Code of Regulations, Title 14, section 15378.

2. Find that this activity is statutorily exempt from Public Resources Code sections 6370 et seq., pursuant to Public Resources Code section 6377.

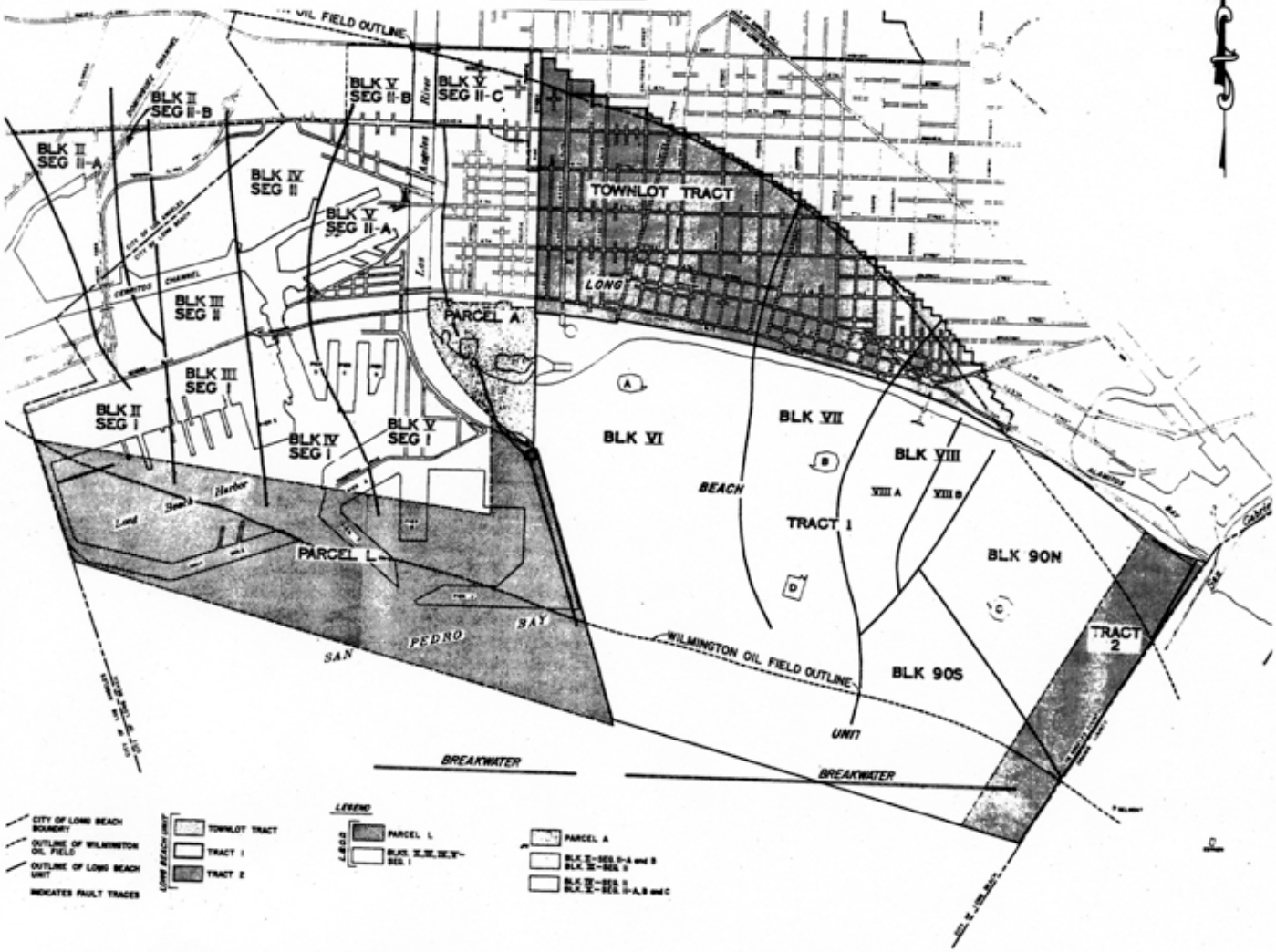
3. Find that the proposed Agreement for the Implementation of an Optimized Waterflood Program for the West Wilmington Field complies with Chapter 446, Statutes of 2008.

4. Approve on behalf of the State of California, the proposed Agreement for the Implementation of an Optimized Waterflood Program for the West Wilmington Oil Field, City of Long Beach, Los Angeles County, in substantially the form of the copy of such agreement on file with the Commission.

5. Direct the execution of any document(s) necessary to effectuate the Commission's action, including the Eleventh Amendment to the Long Beach Tidelands Parcel and Parcel "A' Contract in substantially the form of the copy of such agreement on file with the Commission, extending the term of as provided for in the Optimized Waterflood Program Agreement.

NO SCALE

SITE



PORT OF LONG BEACH, LOS ANGELES COUNTY

NO SCALE

LOCATION

MAP SOURCE: USGS QUAD

This Exhibit is solely for purposes of generally defining the lease premises, is based on unverified information provided by the Lessee or other parties and is not intended to be, nor shall it be construed as, a waiver or limitation of any State interest in the subject or any other property.

Exhibit A

W 12001
WEST WILMINGTON
OIL FIELD
OIL & GAS LEASE
LOS ANGELES COUNTY

MJJ 05/16/12