MEETING

STATE OF CALIFORNIA

STATE LANDS COMMISSION

STATE CAPITOL

ROOM 2170

SACRAMENTO, CALIFORNIA

ORIGINAL

WEDNESDAY, OCTOBER 11, 1978

10:00 A.M.

Cathleen Slocum
C.S.R. License No. 2822

MEMBERS PRESENT

Mr. Kenneth Cory, State Controller, Chairperson

Mr. Sid McCaulsand, representing Roy M. Bell, Director of Finance, Commissioner

Ms. Betty Jo Smith, representing Mervyn M. Dymally, Lieutenant Governor, Commissioner

MEMBERS ABSENT

NONE

STAFF PRESENT

Mr. William Northrop, Executive Officer, State Lands Commission

Mr. Robert C. Hight, Staff Counsel, State Lands Commission

Mr. W. M. Thompson, Manager, Long Beach Operations, State Lands Commission

Ms. Diane Jones, Secretary, State Lands Commission

ALSO PRESENT

Mr. Jan Stevens, Assistant Attorney General

Mr. Alan Hager, Deputy Attorney General

I N D E X

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P R O C E E D I N G S

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CHAIRPERSON CORY: Okay. We'll call the meeting to order.

The Agenda item is the proposed Arco assignments.

Mr. Northrop, would you like --

EXECUTIVE OFFICER NORTHROP: Mr. Chairman, yes, I'd like to, if I may.

We have, since our last meeting, been in conference with Petro-Lewis and with Century Petroleum. As a matter of fact, the conferences were going on as a matter of just a few minutes ago.

We have evolved down to several problems at which we are at an impasse, and so we'll bring them to the Commission so they might give us the wisdom of their counsel. The first thing that we would probably like to discuss is the concept of the first sale. We think it's important that the State maintain its position of being the first seller. It's a concept that we've had since the inception of the program and we really feel to take a position otherwise would not only jeopardize --

CHAIRPERSON CORY: Current contracts are structured so that title to the oil passes at the Broadway-Mitchell --

EXECUTIVE OFFICER NORTHROP: Pump station.

CHAIRPERSON CORY: -- pump station, and after it's by the LACT units and it's out of the ground and all of that.

EXECUTIVE OFFICER NORTHROP: Right. And that's a problem --

CHAIRPERSON CORY: And DOE has accepted that concept?

EXECUTIVE OFFICER NORTHROP: Right. Petro-Lewis indicated they had some difficulty with that concept.

CHAIRPERSON CORY: That appears not to be a negotiable point?

EXECUTIVE OFFICER NORTHROP: I don't see how it can be.

CHAIRPERSON CORY: Okay. Go ahead. What's the next problem?

EXECUTIVE OFFICER NORTHROP: The next problem -- Yes.

MS. SMITH: It is a problem though, isn't it, if they're conditioning their bonus of 10 cents a barrel on whether or not they have the first sale, whether or not they can pass that cost off?

EXECUTIVE OFFICER NORTHROP: Could you repeat the question?

MS. SMITH: Whether or not the State makes the first sale in the transaction or whether or not the contractor actually does is the problem, as I understand it, because we're dealing with whether or not that 10-cent bonus can be passed on by them.

EXECUTIVE OFFICER NORTHROP: That's their contention. We feel that there is no problem under current regulations being able to do that. However, again, regulations are regulations.

MS. SMITH: Is their offer of a 10-cent bonus conditioned upon their having the first sale?

EXECUTIVE OFFICER NORTHROP: Alan -- I don't think it is.

MR. HAGER: As I understand it, Petro-Lewis' offer is that they will pay the 10 cents so long as the 10 cents can be charged on their sale to Century of the oil, not on whether it can be charged on the State or the city sale of the oil to its contractor.

MS. SMITH: How is the proposed contract structured now? Has that condition been included in the contract, or what are we talking about today? Are we talking about just a straight out offer from them and then letting them take the risk that they'll be able to pass on the cost?

MR. HAGER: Their offer in their proposal is that they do not take the risk. That the 10 cents will be paid only to the extent it can be charged under regulations applicable to their sale of the oil, not to ours.

Our proposal to them was that it be on the first sale which was our sale. They do not agree with that, and they say that is unacceptable.

MS. SMITH: So we no longer have an offer of a 10-cent bonus per barrel?

MR. HAGER: We have an offer, but under their terms. It isn't the offer that we thought it was.

CHAIRPERSON CORY: Why discuss anything else? I mean, is there anything to discuss if that's where we are?

MR. WATSON: My name is Bill Watson, and I'm an attorney for Petro-Lewis Corporation and P.P. Co.

I think Alan has correctly characterized the discussion we've had to date. That is that Petro-Lewis and P.P. Co. have not expressed any concern or argument about how the sales are characterized. At this point we are not concerned with whether the first sale is made by the State and city or whether the first sale is made by P.P. Co.

The offer we have made, however, is that to the extent we are able to collect 10 cents on disposing of the crude, we would be willing to pass this 10 cents on to the State outside of the net profits calculation. We are at risk in that we are offering the credit of Petro-Lewis

Corporation to back up this offer. That is to say, that if for some reason our sale with Century fell through -- and although it's an unhappy thing to think about, for instance, their bankruptcy -- would make it impossible for them to perform their purchase contract or might, the credit of Petro-Lewis Corporation under the guarantee would be available to continue paying this 10-cent premium whether or not Petro-Lewis Corporation or P.P. Co. as the actual seller was able to find a purchaser who would pay that premium price.

We are not conditioning it on our capacity to sell the crude at that incremental price, but we are conditioning it on it being legal for us to collect that additional amount. So we are taking a risk. We are not placing all the risk of that on the State. We are not willing to assume the risk, however, that either Washington or for a possibility, Sacramento, decides that we should not be allowed to collect that additional amount on our sale.

As to whether or not there's any reason for further discussion, obviously that is the Commission's decision. We think that we can at least make what we hope are reasonable arguments that there are policy reasons why the Commission should approve the proposal as we have put it forward.

MS. SMITH: As I understand it, when Century first approached the Commission, the offer was that they would pay us 10 cents a barrel on the crude that was produced from Tract 1 and 2 as a bonus without any conditions at all.

MR. WATSON: Well, I'm sorry, ma'am, if we were to ever phrase it that way, we would be misleading the Commission because there's always the possibility that regulations would prohibit it no matter how we described it. So unfortunately, as long as this is considered a transaction subject to governmental controls, we cannot guarantee that we can pay that premium.

MS. SMITH: I understood that it was a risk that you were willing to assume as an incentive for the State --

MR. WATSON: Yes, ma'am, it is.

MS. SMITH: -- to accept the proposed assignment.

MR. WATSON: We are willing to assume the risk if we cannot find a buyer who will pay that premium. We are not willing to assume the risk if some governmental agency will tell us we cannot collect it.

CHAIRPERSON CORY: Okay. That point is, I guess, clarified where we are. Why don't you go on with your other points, Bill.

EXECUTIVE OFFICER NORTHROP: All right. There are three other areas in which we have had some discussion.

The first one is on the performance bond in the amount of $750,000 for Tract 1 and $1,250,000 for Tract 2 as provided in the contractors agreement. P.P. Company has requested to waive the contract condition that would allow the charging of the annual premiums up to one percent of the bonds of the net profits account. The city and state previously waived the bonds for Arco as contractors; therefore, charging these premiums to net profits account would result in a loss of tidelands revenue.

In going over this program the staff felt that we were replacing a very substantial buyer with the ability to refine the crude oil with another buyer that was -- well, I think the substance is important; the relative size isn't. It's the fact that we do not have a buyer that has a refinery. For that reason, and there are some other things concerned in the bond. If, for example, during the life of the field there was a change in the equity formula or some act of God to demolish some equipment that had to be replaced at a substantial cost, we think that bond should be used at that time. For that reason, we feel the State should be held whole on this cost.

Secondly, the chart has been placed there as to the obligation that we would have in Tract 1 on that chart. Tract 2, while it's a lesser amount by about $200,000, tracks about the same way. We feel there should be some

Letter of Credit to cover our exposure. It is covered in red on that chart. We feel that, or some accommodation made so that we're not left holding the bag for the amounts involved in that chart.

Those, we ask that, because the price of crude oil changes, that we review that bond amount annually for the first five years and every other year after that. Those amounts would amount to about $800,000 for Tract 1, as displayed in the chart, and about 600,000 for Tract 2. Those two points we feel are important.

The third point we discussed was waiving the 20-day period for curing a default as provided in the contractor's agreement and replacing it with a 10-day period.

We had some other problems, and I understand they've been resolved. Arco has indicated that they now have approval for the use of the Four Corners line. So I think we've resolved the problem. In addition, they have agreed to change the take and take back from six months to 60 days. So we've resolved those problems.

So now the four basic problems that we're looking at is the first sale agreement, the 20-day for a 10-day period, and the bond and the Letter of Credit. So that' where we are.

Mr. Thompson, do you have anything you'd like to add as to where we are now?

MR. THOMPSON: I don't think so. We really don't have any document finalized here because we do have a difference of opinion on these. You've already heard one version on the first sale, and I think it's a question of talking about the others.

CHAIRPERSON CORY: As I understand the position on first seller is there is not an argument over who the first sale will be, it's a question of the contingency arrangement vis-a-vis the 10-cent bonus. That is the only dispute.

MR. THOMPSON: Well, I think it goes beyond that. I think it goes beyond the price that the State or city might receive. I think Alan can expand on this, but there's a possibility that if the State or city were exempt, for example, they could receive a price that you would then put 10 cents on top of that. We would like to receive that full amount and not be restricted to whatever price, then P.P. Co. would be selling that oil to someone else. It might be an entirely different dollar amount.

CHAIRPERSON CORY: If I understand Mr. Watson -- Is that the correct name?

EXECUTIVE OFFICER NORTHROP: Yes.

CHAIRPERSON CORY: -- your position, your client's position is that you have no problem with the State being the first seller, but as I understood what you were saying was that your client was unwilling to assume the risk of government interference with the ability to pay the 10 cents. That if it was okay with the government, the State or Federal, to pay the 10 cents, you would assume all other risk about the payment of the 10-cent bonus.

MR. THOMPSON: Or an amount over which you had paid the 10 cents above.

CHAIRPERSON CORY: That's not what he said.

MR. WATSON: Well, when I received Mr. Hager's proposal and called him back, at the time I thought we were just talking about some language that has little conceptual difference. I think there is a conceptual difference and it might be focused on the words that you used about the ability to pay. What we quite frankly are concerned about is that we will have regulatory capacity to pay, but will not have the regulatory capacity to collect. So the proposal we would ask the Commission to consider is that the regulatory ceiling on the bonus that we have proposed be triggered by our capacity to collect it rather than our capacity to pay it.

The fact that's been alluded to already is one of our concerns; and that is that for one reason or another a new regulatory scheme might be proposed before the termination of the contracts which exempts the State of

California and the City of Long Beach from all regulatory controls and yet places controls on P.P. Co. which would prohibit it from collecting the premium that we are proposing to pass on to the city and State.

MR. THOMPSON: For example, it might be possible to still produce upper and lower tier oil as far as the category is concerned by the regulatory agency of the government, but that portion that was owned by a city or a state might be able to be sold at pre-market price. So we would look to receive pre market price for the oil, but under a regulatory capacity, as far as refiners are concerned, it might still be upper or lower tier oil.

Do you agree with that possibility, Alan?

MR. HAGER: It's a possibility. It doesn't exist under current regulations.

MR. THOMPSON: It doesn't exist under current regulations.

MR. HAGER: Hopefully, it will never exist.

MR. WATSON: I think Alan and I are in agreement. He probably knows a great deal more about these regulations than I do, but our best opinion right now I believe is the difference in language we're talking about would have no impact under curren. regulations. We would be allowed to pass on any price that we were required to pay. However, I still think that there is the possibility that if pricing regulations for oil were removed and imposed hastily two years from now, that there could be a period of substantial or insubstantial duration where there might have been what I would assume would be a mistake because I think the pattern of regulation to date in this area has been to allow people to pass on all the costs that have been incurred. However, I think we can find instances where regulations, particularly those established in great haste, have some mistakes in them. Unfortunately, sometimes those mistakes are not corrected retroactively.

CHAIRPERSON CORY: Do you have any comments on the other items, the other three areas?

MR. WATSON: Yes, sir, I do.

If I might go completely off the subject, we found one typographical error in a document that's been submitted to the Commission. It is the Assignment from Century to P.P. Co. On page 4 of that Assignment, in the third line, there's a reference to PLC which we unfortunately missed changing when we were restructuring these documents, and it should be a reference to P.P. Co. The third line from the top.

From the direction we've taken so far, perhaps we can skip something I had outlined in my presentation; and that is, if there are questions about Petro-Lewis Corporation or P.P. Co. or the economic arrangements which

I think we've discussed to some extent last time, Mr. Blancett is here again and both he and I would be available to answer any of those questions. If those items are not of interest, we can skip that and I can go directly to discussing the staff proposal and our responses.

MS. SMITH: I have a question regarding the nature of the guarantees that Petro-Lewis is providing.

Is it Petro-Lewis' guarantee of P.P. Co.'s application based on Century's guarantee to the Petro-Lewis that they would back them up?

MR. WATSON: No, ma'am, I don't believe so. As I recall, there's no condition in it that mentions Century. Our idea in putting it forward is that P.P. Co. does not have substantial credit or it is what we call a mere nominee. It has no economic substance other than holding title as a convenience with dealing with the public records.

The reason we put forward the guarantee of Petro-Lewis Corporation is that is the economic entity we are proposing to the company as sufficient to give assurance to the State that they are dealing with a substantial company who will be able to meet the bills and make the payments.

MS. SMITH: So what you're saying is that Century has not in fact guaranteed any obligations that Petro-Lewis would incur in guaranteeing P.P. Co.'s obligations?

MR. WATSON: We have no document with Century, no agreement with them that they will guarantee us. I understand that there has been a position taken that, absent contrary statement, any person in the chain of title to the interest is responsible for all of the obligations. I believe that is a portion of the reason for some discussion about whether or not Arco would be released as a prior owner of the interest. But Century has not given us a document we would characterize as guarantee nor, so far as I know, have they made an agreement.

Their contract to purchase the crude from us has some of those elements in the sense that their agreement to purchase the crude is our protection that we will be able to market it. As I mentioned before, we are putting forward our credit independently of that contract. That if for any reason we cannot obtain their full and complete performance under that contract, we would still be liable under the basic operating contracts, under our specific conditions of consent and any other obligations that are owed by a party owning these interests to the State.

But as far as a guarantee agreement comparable to that that the PLC has delivered to the State and city, we have none.

MS. SMITH: Just one further question with regards to the guarantee. I understand that MacMillan Ring Free has agreed to step in P.P. Co.'s place and take the oil should they default; is that correct?

MR. WATSON: I don't believe they've agreed to step in P.P. Co.'s place. I have been told that MacMillan Ring Free has represented that they are willing to take over Century's place as a purchaser of the crude from P.P. Co. There is a representative of MacMillan present today. Perhaps he could elaborate on that.

MS. SMITH: Is this an enforceable guarantee, would you say, --

MR. WATSON: I believe so.

MS. SMITH: -- that would protect the State's interest?

MR. WATSON: I believe so. But I would hate to step on the toes of counsel for the State by giving an opinion.

MS. SMITH: Counsel for the State.

MR. HAGER: On the point of the guarantee, are you talking about MacMillan?

MS. SMITH: Yes.

MR. HAGER: I have not seen anything in writing from MacMillan. The last I saw was a letter that we had in the last meeting which said that they would be prepared to enter into an agreement to take the oil, and that is not an enforceable guarantee.

MR. HIGHT: Mr. Chairman.

CHAIRPERSON CORY: I think we're getting into minutiae, that if we don't deal with the fundamental concepts, there's no sense in dealing with the minutiae. I mean, either we're going to go with a Letter of Credit and a performance bond or we are not. Either you are going to put them up or you're not or we don't need to deal with the mechanical arrangements that go from there. I mean, they're outlined here four substantive areas of difference. As I understand the facts, Petro-Lewis is unwilling to proceed with what the staff wants and we ought to one by one resolve whether or not there is any accommodations that can be made in any of these four areas.

If there's some policy decision that we can make, then we can deal with the minutiae. But to argue any of the details of the documentation and all, I think is sort of irrelevant at this point unless we have a meeting of the minds as to the ultimate part of the business bargain. Does that make sense?

MS. SMITH: That makes sense.

CHAIRPERSON CORY: So we've got the first item which I think we understand. I'd like to hear your side of it in terms of the performance bond, the Letter of Credit, and the default clause. Those are the other three areas. Then I think we ought to sit here and vote up or down with the understanding that if any one of those is lacking and Petro-Lewis doesn't change their position, there's no deal and there's no sense in worrying about the minutiae of how to put it together. So give us your best shot.

MR. WATSON: All right, sir.

Perhaps there's no need to say it, but since we are disagreeing to some extent with the staff I thought we should eliminate any implication that we are challenging the Commission's authority to place these conditions on the consent. We are not. We would, however, put forward some arguments that the Commission should not.

The purpose for Petro-Lewis and P.P. Co. purchasing these properties is as a vehicle of public investment in developed oil and gas properties with the primary concern being a rate of return that is consistent with the goals of those investments. The thing that puts us at a considerable, almost impossibility of agreeing with some of the changes that have been proposed, are the very significant impact they would have on that cash flow and rate of return.

It has been alluded to the fact that Petro-Lewis Corporation and P.P. Co. are not vertically integrated major companies, and that is completely correct. We have no opportunity to make our profits at some other stage in the processing or distribution of these products and must look solely to this transaction and the cash flow from the sale of the crude oil and the net operated profits account for the justification for investment.

The two mechanical changes that were discussed, the first, and apparently the only one in dispute, being the reduction of the default provision from 20 days to 10 days. When this was first brought to our attention, we went and had some conferences with the people at Petro-Lewis who were responsible for this kind of compliance and their first response was to express surprise that it wasn't 30 days to start with.

I also would point out to the Commission the drastic results that occur if a default is in fact uncured for the period of time involved. We're not talking about a $15 per month penalty on a mortgage payment or some other minor thing. The thing that would happen to P.P. Co. if they should fail to meet a mechanical default requirement would be the absolute termination of their interest. This is an interest for which we are paying over a million dollars, and we would lose it. Ten days in our opinion is merely too short a time to protect that kind of investment.

We look at the possibility that with the best efforts, completely good-faith efforts on the part of P.P. Co. and Petro-Lewis, there is a possibility that they would be mechanically unable to correct the default after receiving notice.

CHAIRPERSON CORY: I don't understand that.

MR. WATSON: Well, if the notice, for instance, arrives at 5:30 on a Friday night, there is the possibility that all the people who can deal with it are gone for the weekend. We then look at possibilities of interruptions of communication, of transportation, and the fact that the curative requirement in fact requires two, three, four, or five days to occur even if you can start it immediately.

CHAIRPERSON CORY: I don't understand that. I mean, you either got the money or you don't. It's a cold turkey business world, and what we're talking about is you not paying. If you don't pay us for the oil you've delivered, we want the bread. You got ten days. We've blown two of them. So you've got eight days to come up with the bucks. That seems to be a relatively simple matter. You either have the money or you don't.

MR. WATSON: Well, we do have.

CHAIRPERSON CORY: Then why your hesitancy? I mean, the fact that you're hesitating, I've got to tell you, is weighing very heavily against you in how I'm going to look at the rest of this. It sounds to me like you're going to be taking us to the wire rather frequently or you consider that a distinct possibility that maximizes the possibility of you losing your million-dollar investment. I understand what you lose, but we're not in the credit business.

MR. WATSON: When this document was originally negotiated, apparently, to the extent they were consulted, companies that have been presented to us as paragons of credit and timely payment, insisted upon 20 days. There has been so far no evidence or assertion in specifics that a default is likely by Petro-Lewis or P.P. Co. or, for that matter, that it is even more likely than it was by Arco or Chevron. It is hard for us to argue against the need for the change when no one has yet presented any need for the change to start with. There is sort of an implication that our credit or our business practices are somehow lesser or more devious; and yet we have no specific thing to argue against. You're asking us to cut in half the amount of time we have to preserve a substantial investment. I cannot -- perhaps my understanding of the agreements is deficient in that extent -- but I cannot now assume that the only default that we might be speaking of is merely a failure to deliver funds in a timely manner. It seems to me that we're dealing with extremely complex agreements and that there may be other obligations you have that are not merely the delivery of funds. But it is difficult and troublesome for us to face, without any assertion, the implicit statement that Petro-Lewis is not a reliable person to do business with.

We asked at the last hearing, we've asked the staff, is there some problem. Do we need to submit more information? Is someone bad-mouthing us? So far, we've heard nothing.

You don't put a million dollars on the table to buy something and then play games about how fast you pay your bills. On the other hand, I don't think we can step forward and, merely because it seems to be a nice thing to do, reduce the default period. As I understand, the State drafted these documents to begin with or at least had a substantial say in how they were drafted, found 20 days to be adequate and is now for some reason suggesting that it no longer is.

CHAIRPERSON CORY: There were different people sitting on this Commission when that was approved. Let me tell you, if I were sitting here with what I knew today, I would not approve those prior documents. I mean, that's just where I come from. I don't know where the other Commissioners come from, but there are a lot of other provisions we're not dealing with.

MS. SMITH: For clarification, the staff's recommendation is that we reduce the period of default from 20 to 10 days. For what reasons?

MR. THOMPSON: I think basically responding on all these conditions to a concern we felt from the Commission themselves, trying to provide the most security, the most protection to the State.

MS. SMITH: So what additional security does that provide in addition to the performance bond and the Letter of Credit?

CHAIRPERSON CORY: Well, because you're dealing with a time frame that each day you're delivering more oil, and you have the period of time that that covers, as I understand it, is the amount that's due and payable as of today. But even if they don't pay on that day, they've got another 20 days before you can even start the mechanism in terms of the default. So that your at-risk factor goes up. Even though it's due on that date, they've got 20 days in which to skate.

MS. SMITH: Is that a risk that wouldn't be covered by the Letter of Credit or the performance bond?

CHAIRPERSON CORY: You can increase the amount to cover it, I guess, but they don't want to do that either. It's a combination of the two. It is sort of copping a slow plea in the trade. The two of them seem to work against you when you take both of them together.

MS. SMITH: Okay.

CHAIRPERSON CORY: We have your views on 20 and 10 days. Go ahead with the other ones.

MR. WATSON: As to the notice provision for the State initiating, terminating or changing the percentage of its oil which it has a right to take in kind under the Tract 2 agreement, as was mentioned, we have agreed to waive 120 days of that notice period with a resulting notice period of 60 days.

In the area of the performance guarantees that have been requested, I think it's already been identified that there's a total of $200 bonding provided under the existing contractor's agreement with the provision that the premium for those bonds up to one percent of the face amount will be allowed as an expense in that operating profits accounting. As has already been mentioned, apparently these have been waived previously for Arco and Chevron without formally amending the agreements. Our understanding of the staff recommendation is that they wish to reinstate those bonds and disallow the premium as an expense under the Net Operating Profits Agreement.

Petro-Lewis' position is that we are prepared to comply with the agreement which would have us putting up the bonds and the premium going through the net operating profits account.

CHAIRPERSON CORY: What is the cost of the premium in your opinion?

MR. WATSON: I don't know, sir.

CHAIRPERSON CORY: You'll put up the bond if it goes to the net operating account?

MR. WATSON: Yes, sir.

MR. THOMPSON: Up to one percent. The annual premium up to one percent.

CHAIRPERSON CORY: Can go in if it exceeds --

MR. THOMPSON: Under the present language in the contract. For example, if there's a $750,000 bond, if the annual premium were to be $5,000, it would all be charged to that profits account. If that annual premium were $10,000, only $7,500 would be charged.

CHAIRPERSON CORY: Okay. We're talking about 20 grand maximum, one percent of two million?

MR. THOMPSON: Yes.

MR. WATSON: Perhaps it would explain our reluctance to agree to this consent --

MR. McCAUSLAND: It's not one percent of the two million if the two million is the value of the bond. It's one percent of the net profit.

MR. THOMPSON: It's the annual premium. What from these properties on an annual basis of approximately 120,000 to $150,000. For us to absorb $20,000 in additional expense outside of the net operating profits account, obviously has a substantial impact on that cash flow as a percentage and, unfortunately for us, appears that it makes it no longer something that is suitable for investment by these public programs.

For the State to save this $20,000, however, it appears to us is to give up the additional income from the premium that has been proposed by us as a condition for the consent. Unfortunately, I cannot give you exact figures. I assume the staff has made some calculation, but I believe this is in the magnitude of $200,000 a year at current rates of production.

Again, although I understand the Commissioner's position about that if the deal were being done today, that it could be changed to improve the position of the State, which I think applies to any document or agreement the State has previously entered into. They still could all be approved. Again, it appears to us this is a position where an independent producer coming forward to try and enter into business with the State is being treated considerably differently than the existing major companies that are already doing business with the State.

The Letters of Credit, as we understand it, proposed by the staff, would total initially $1,400,000. Did I have --

EXECUTIVE OFFICER NORTHROP: Yes.

MR. WATSON: This Letter of Credit requirement is, to the extent I see it, would serve the same purpose, although in a different vehicle as the bonding requirement, and would give a total protection of over, well, initially of $3,400,000 with the possibility that it would grow. I believe this chart indicates, and I believe also Century has submitted to at least staff, their analysis of the cash flow which demonstrates that this bonding and Letter of Credit requirement is far in excess of at least the cash that is due to the State or the operator at any given time.

We've been advised by our bankers, and so far we have not received a detailed or specific quote, that the premium on this magnitude of a Letter of Credit would again approximate ten percent of the cash flow that is available to P.P. Co. as a result of owning this property. We're then looking at the possibility of these additional conditions being proposed by the staff and beyond the existing agreement, would eliminate perhaps as much as 20 percent of the entire net return to P.P. Co. as a prospective contract operator.

Additionally, although it is not susceptible to having an exact dollar figure placed upon it, by the nature of the standby Letter of Credit, this would also eliminate $1,400,000 of Petro-Lewis Corporation's total potential borrowing, their borrowings currently and projected.

CHAIRPERSON CORY: You've got a corresponding asset coming in.

MR. WATSON: Yes, sir, we do, but unfortunately it is not suitable for being offered as collateral for a production loan because it is terminable on bankruptcy.

I have already spoken to some extent about the language that is being proposed or discussed about the regulatory limit being placed on the 10-cent per barrel premium. I understand the Commission is well aware of the occasional impact of price controls on the sale of crude oil. I will not go back too much further into that except that we are willing to accept the risk that we cannot pass on that premium because we are prohibited from doing so by regulation.

As I said at the beginning, we think there are some policy reasons for the Commission approving the assignment with the conditions that Petro-Lewis had agreed to. There obviously are benefits to the State of dealing with a major integrated oil company. Petro-Lewis Corporation cannot duplicate all those benefits. The very fact of vertical integration sometimes makes it suspect, also perhaps gives it economic benefits. We would request that the Commission consider the competitive impact of insisting that it only do business with vertically integrated major oil companies. It seems to us, without any historical background, that looking at the structure of the original Tract 1 sale where it was offered in 80 percent, 10 percent, 5 percent, two and a half percent, one and a half percent, and one percent pieces, indicates that at least that time the city and State were attempting to make this investment opportunity, this opportunity to do business with the State, available to other than the most substantial oil companies.

After free competitive bidding, it appears that only the most substantial oil companies became involved. However, I think that it perhaps is relevant to the Commission to consider that intent when the thing was originally offered.

It seems that the State has an interest in the competitive oil and gas industry, specifically in the operation of the unit. In this case, allowing a non-integrated company to become involved in the operation of the unit and the disposition of the crude oil, offers an opportunity not only for that company itself to compete but also offers an opportunity to make crude oil available for small refiners to also compete in the business of refining that oil and making the products available to the public. Additionally, I believe the staff has given some consideration to, and I would request the Commission also to consider, that the entry of P.P. Co. into this situation and possibly the very agreement we've made concerning the premium, is a new factor in the marketing and pricing of the unit crude itself.

I do not see how the State can encourage and promote a competitive oil and gas industry by placing greater restrictions and costs upon the independents seeking to do business with the State than it places upon the major integrated companies competing for that business. Petro-Lewis Corporation, therefore, requests that the Commission approve the transfer and it be conditioned only upon a 10-cent per barrel premium if P.P. Co. can collect that premium in its sales and reduction of the State's notice period to the taking of oil from Tract 2 to a 60-day notice requirement.

Thank you.

CHAIRPERSON CORY: That's your request. Are any of the items under consideration negotiable or not?

MR. WATSON: Sir?

CHAIRPERSON CORY: I asked a question of you. I guess you were reading a statement or made a plea with a request. The question in my mind is, there are four items of concern that the staff had. I'm wanting to know if you wish to negotiate on those four items or be voted up or down if your position is take it or leave it, accept our request as it is or pass.

MR. WATSON: May I confer, sir?

CHAIRPERSON CORY: Yes. That's an understandable position for you to be in. I just want to know if that's where we are so you've got your best shot.

(Thereupon a brief recess was taken.)

CHAIRPERSON CORY: Go ahead.

MR. WATSON: I believe, sir, we'd like you to vote us up or down on the proposal we've presented.

CHAIRPERSON CORY: Pardon me?

MR. WATSON: We would like you to vote us up or down on the proposal we've presented.

Could I request that the other people present be allowed to present their positions?

CHAIRPERSON CORY: Yes. I was just going to ask to hear from any other people who want to be heard.

Yes.

MR. HODGES: My name is Everett L. Hodges. I'm President of Century Oil Corporation which is one of the parties that is to receive, if this transaction is completed, 2,000 barrels a day of the crude oil from the Wilmington tract.

I have closely followed the Arco interest in disposing of this property since the day it was proposed to Century Oil Corporation by Arco one year ago that we consider purchasing the interest from Arco. After conferring with the staff and the City of Long Beach, we determined that the $5 million net worth of Century Oil Corporation would not be adequate to satisfy the State's requirements from the standpoint of the purchase agreements. Thus, we turned the matter over to Century Resources Development which is headed by my brother, Morris Hodges, and he, over a period of time, developed the interest by Petro-Lewis Corporation of acquiring this interest.

I followed it closely because we're very much interested in access to a portion of this crude and have also conferred with the refiners that would be taking the remainder of the crude.

I have a letter that I'd like to read into the record from the California Independent Producers Association, an association of some 700 members which was submitted at the last staff meeting but not read there to show you their position they're taking. This letter is dated September 22, and it's addressed to Ken Cory, Chairman, State Lands Commission, Re Assignment by Atlantic-Richfield Company of Interest in Tract 1 and Tract 2, Long Beach Unit.

"Dear Mr. Cory:

"The California Independent Producers Association has been advised that the State Lands Commission will consider on September 27, 1978, the assignment by Atlantic-Richfield Company of its interest in Tract 1 and Tract 2, Long Beach Unit, to Century Resources Development, Inc., and the assignment by Century Resources Development, Inc., to Partnership Properties Co., an affiliate of Petro-Lewis Corporation. We have been further advised that Partnership Properties Co., has agreed to sell Century Resources Development, Inc., ..." crude from said tracts.

"Century Resources Development, Inc. will be selling" said "production to independent refiners in the Los Angeles Basin, including MacMillan Ring Free Company, Inc., and DeMenno Resources.

"Century Resources Development, Inc., has informed us that it intends to exchange some of the lower tier crude oil attributable to these interests with independent oil producers in the San Joaquin Valley" area "for use in steam generators in the field. This procedure enables those producers to lower substantially their cost for fuel consumed in secondary recovery operations."

There's approximately 15 different independent producers receiving the benefits of this exchange of lower tier entitlements.

"The California Independent Producers Association supports the proposed assignment of the interest of Atlantic-Richfield Company in Tract 1 and Tract 2. It promises to be of substantial benefit both to independent refiners and producers in California. We therefore urge your support and approval of the proposed assignments and request the State Lands Commission...give its consent.

"Very truly yours,

"Dr. Morris F. Frankel, President, California Independent Producers Association."

The last four days I have seen the problems as they have evolved between recommendations of the staff and Petro-Lewis' position. From what I heard, Petro-Lewis is making an investment of public funds for some kind of return on the investment, and by the time they pay a million plus to Arco, they're also putting $500,000 up in inventory which nobody's ever bothered to mention which is in the unit, I understand, which is locked up in advance cash in the unit. They're also advancing approximately $500,000 per month against deliveries of crude. They're approaching a two million dollar investment in this matter, and by the time you look at the return of 120,000, you can readily see if that kind of money is involved in it, you're talking about a five, six percent return. Compounded with a cost of a bond of two million dollars which I understand they're proposing to indemnify the State against any loss, regardless of what kind of loss.

It might take a period of time to collect it, but the two million indemnifies against noncollection of money for any purpose. They're willing to put that up.

They're asking that the premiums of $20,000, maximum of $20,000, would be paid out of the unit cost. But when you take a look at 15 cents per barrel or $120,000 per year, I don't see where there should be a big problem. The major problem --

CHAIRPERSON CORY: What's 15 cents a barrel?

MR. HODGES: Pardon me. Fifteen thousand dollars per month or approximately $120,000 a year in revenues to the State against a premium of 20,000.

3 The major problem, as I understand it in talking to both Bill and Moose Thompson, are the Letter of Credit of $1,400,000. As they point out, it's an horrendous undertaking, a lot of money must be guaranteeing it and that cash flow costs them money and pretty soon the economics of the deal just fail by its own weight.

I submitted a proposal to Petro-Lewis this morning and I've talked to the two refiners involved, and I want to submit the following for consideration of the staff which I think would eliminate the 20-day notice problem because it would be solved by virtue of the following proposal. As you're aware, CRD is selling, and we've got the contracts to both DeMenno Resources, MacMillan Ring Free and Century Resources Development and Century Oil Management.

I would propose the following, and I've conferred with Petro-Lewis and they would be agreeable to this so they could eliminate the bond and show you that you've got in essence better than the Letter of Credit aspects of the deal by having cash that you could call on in escrow.

The four buyers of all of this crude -- you're not looking at one guy that can take you down the tubes if

Petro-Lewis can't carry out their obligations. There will be four purchasers of this crude that will sign an agreement that all the monies paid prior to it going to Petro-Lewis will go into a trust or an escrow account. That trust agent will have authority to forward the money to Petro-Lewis providing no default has been filed by the State of California. If the State of California files a default, then the monies are in the escrow account for the account of the State of California. So that you have the monies coming in several times per month into that account, with a control and agreement between all the parties that the cash received by Petro-Lewis Corporation goes to an escrow and, as long as there's no default, the State doesn't file any complaint, and the escrow agent simply forwards it to Petro-Lewis. If the State elects to file a Notice of Default and does so, the escrow agent holds the money for the account of the State of California.

CHAIRPERSON CORY: Are those four companies paying in advance?

MR. HODGES: They're paying anywhere from 10 days of delivery, but we must have a certification of the delivery of the crude from the State of California before we can pay it. If we don't get the bill from you, we can't pay you. But we pay within 10 days of billing, 15 days of billing.

CHAIRPERSON CORY: But if it's paid after the fact, the account could still end up short.

MR. HODGES: You're receiving $500,000 from Petro-Lewis Corporation on crude oil and, in addition to the amount of money that we're paying, there is at the essence at the end of each month a $500,000 slush over is what it amounts to. We're paying for 100 percent of this crude, paying the full amount in value to Petro-Lewis, but they're also advancing $500,000 in advance calls. You call the 1st and the 15th and collect $500,000. So you have that besides the money that's in the escrow account which is paid monthly.

Now, in addition to that, I don't think there's any problems with the producers themselves assigning Letters of Credit to guarantee their payment to Petro-Lewis to this account. That amounts to right now approximately $750,000.

So between assignment of letter, Letters of Credit of seven fifty, all the money to the cash flow into the escrow account and the $500,000 that Petro-Lewis Corporation is advancing, I don't see where the State has any exposure at all. In addition to that, the State has a two million dollar bond guaranteeing them against any loss and, in addition to that Petro-Lewis has another $500,000 in inventory out in those leases.

The standard procedure for payment in the industry is, you pay the 25th following the month of delivery of the crude. It takes that long to get the certification and get the bill to you. This is majors as well as independents. There's 55 days from the day one before it's paid. Thus, I think your exposure would be down to nil. In addition to that, you'd have two million dollars worth of bond backup.

MR. THOMPSON: Let's see if I follow what he's saying here.

CHAIRPERSON CORY: Well, Moose, I'm not so sure that it's relative because the principal has said they either want their deal or nothing. If that's their position, I hear what Red's saying, but they've taken a position --

MR. McCAUSLAND: I would like to say that I was willing to discuss some accommodations on the proposal that was put forth this morning. I could not vote for it in the form that it was presented, but I was willing to discuss modifications that would allow us to allow the more independent segment of the industry to participate in this tract. But on a yes-or-no vote, it becomes a pretty simple decision.

MR. HODGES: Well, I discussed with Petro-Lewis, Mr. Blancett, this morning his consent in the event -- the major thing seems to be a $4,100,000, a Letter of Credit, called on by Petro-Lewis Corporation. Because, as pointed out, there is a period of time where the State has its tail hanging out. If the buyers of the crude put bonds and cash into that account which is on call to the State immediately, you're talking about cash every month on a minute's notice.

CHAIRPERSON CORY: But it's not up in advance. It's up after the fact which is a distinct difference.

MR. HODGES: The Letters of Credit are up in advance. There's $750,000 of Letters of Credit now. There's a $500,000 call by Petro-Lewis which is a $1,250,000. I'm talking about Letters of Credit by the refiners and producers that agree to guarantee CRD and Petro-Lewis that they're going to get their money. These Letters of Credit go to this escrow. They're seven fifty now, and we haven't called on Letters of Credit from another thousand barrels of this crude. So if Petro-Lewis has 500,000 cash calls, and they're paying --

CHAIRPERSON CORY: Petro-Lewis is saying: We either want the deal the way we want it -- they're not willing to accept any amendments.

MR. HODGES: Well, that's not --

CHAIRPERSON CORY: That's what they said. They were here, Red. That's what they said. They're still sitting here. They haven't jumped up and made any changes. So I don't think we've got anything to talk about unless they want to talk.

MS. KNIGHT: Mr. Cory, my name is Nancy Knight. I represent Century.

Petro-Lewis has said that they are not willing --

CHAIRPERSON CORY: Wait. We're dealing with Petro-Lewis.

MS. KNIGHT: Yes, sir.

CHAIRPERSON CORY: And we have to enter into a contract with the principal. They're here in the room.

MS. KNIGHT: Yes, sir.

CHAIRPERSON CORY: If they aren't willing to come forward, I don't think we have much to talk about. I understand their problem --

MS. KNIGHT: May I ask you, sir, if Petro-Lewis is unwilling to put up the Letter of Credit but that the succeeding buyers are willing to assign their Letter of Credit, would that satisfy the staff, Letters of Credit that are going to be required of the refiners who are purchasing and other parties who are purchasing would assign for the benefit of the State?

CHAIRPERSON CORY: You see, once we enter into that, it seems to me that it creates a hiatus that if you withdraw as a purchaser, then your Letter of Credit would be withdrawn and we'd be on the hook with Petro-Lewis in the deal without our protection. That's why Petro-Lewis has to be a party to what's going on. If they don't wish to be, they don't wish to be. I understand where you're coming from, but I think we probably ought to hear from the other people and you guys conclude with your basic argument. I hear what you're saying, but the ball seems to be in Petro-Lewis' court. But we're willing to listen to other folks.

I believe Arco --

MR. PENDERGRAFT: Members of the Commission, my name is Jeff Pendergraft. I'm an attorney representing Atlantic-Richfield. While we're waiting for Petro-Lewis here, I think I'll just take a few minutes to explain our views, our position, what we're asking for and why we think the State ought to approve it. I'll try to be brief.

Atlantic-Richfield is seeking the State's approval for two transactions today. Although those transactions are related, they are not necessarily interdependent and it would be beneficial to us if only the first transaction were approved, although our preference, obviously, would be to have both transactions approved.

The first thing we're asking for approval for is for a cross assignment of interest between Chevron and Atlantic-Richfield. This cross assignment affects Tract 1 only. Atlantic-Richfield and Chevron jointly acquired an interest in Tract 1. Well, actually, acquired four interests in Tract 1 totaling ten percent of the contractor's interest. As I said, those were acquired jointly and what we're seeking to do is partition them so that Chevron will become the sole owner of the five percent interest and Atlantic-Richfield Company will become the sole owner of the three interests of two and a half percent, one and a half percent, and one percent, which total five percent.

CHAIRPERSON CORY: Why should we do that?

MR. PENDERGRAFT: There's basically two reasons why we're asking for this.

CHAIRPERSON CORY: I understand, and I don't care why you're asking. Why should we do it? I don't see what's in it for the State. Right now we have two great oligopolistic powers here and we can go after either one of you for your money. Why should we let either one of you off the hook and let you partition?

MR. PENDERGRAFT: You're not letting either one of us off the hook at all, Mr. Cory.

CHAIRPERSON CORY: If it's separated and Arco goes belly because they discover there's really not any oil in the North Slope or something, we eat the five percent.

MR. PENDERGRAFT: I don't believe so. Under the existing arrangement, Atlantic-Richfield and Chevron are jointly and severally responsible for a total of ten percent. Once these assignments are made and they're being sought without requesting a release from the State, Atlantic-Richfield and Chevron will be primarily responsible for individual five percents, but still --

CHAIRPERSON CORY: You're remaining on the hook.

MR. PENDERGRAFT: -- remaining on the hook for those shares. Okay?

CHAIRPERSON CORY: That is the documentation? I might ask the staff because I was led to believe that we just have one on five percent and one on the other five percent.

MR. PENDERGRAFT: That's not how I understand the law of assignments, but you're entitled to advice from your counsel.

I think the assignor absent or released remains responsible. That's why we're specifically requesting a release from the Century transaction.

CHAIRPERSON CORY: Okay. We get your point. Go ahead with --

MR. PENDERGRAFT: All I was going to say --

CHAIRPERSON CORY: That becomes a much easier problem for you.

MR. PENDERGRAFT: There's two reasons we're --

CHAIRPERSON CORY: Because we love you both.

MR. PENDERGRAFT: I'm glad to hear that. Is that on the record?

(Laughter.)

MR. PENDERGRAFT: There are two reasons we're asking --

CHAIRPERSON CORY: Pardon me. He said it smilingly.

(Laughter.)

MR. PENDERGRAFT: The reasons for that, just quickly, one reason and the primary reason, that will facilitate a transfer to the third parties. The other reason that we prefer to have this thing approved anyway is it simplifies considerably the accounting. The accounting doesn't have to be double accounted, once to the joint interest and then to the individual parties.

As I have indicated, I don't think there's any impact to the State from approving that transaction. Although there's no great benefit, there's no detriment and we would request that it be approved. Without a detriment, we think that the State cannot unreasonably withhold approval.

Let me go on now to the second transaction that we're requesting the State's approval for; and that is the transaction between Atlantic-Richfield and Century whereby we would take this interest that's just been partitioned with Chevron and transfer it to Century. We are asking in that case that we obtain a release because once that transaction is made, we will not have any remaining interest in the production from the unit as to Tract 1 and 2. Without the benefits that go along with being a contracting party, we don't think we ought to be responsible for the obligations.

I think there are some reasons why the State ought to approve that transaction.

CHAIRPERSON CORY: Betty.

MS. SMITH: Will Standard remain liable?

MR. PENDERGRAFT: Excuse me?

MS. SMITH: Will Standard remain liable even though you're requesting a release? Will they continue to guarantee the obligations of the assignee?

MR. PENDERGRAFT: I have an opinion on that. I suppose I'd prefer that you ask your counsel, but my view is that absent Chevron being released, they continue to be responsible.

CHAIRPERSON CORY: You may have just solved their problem.

EXECUTIVE OFFICER NORTHROP: I must say for the record, Mr. Taafe from Chevron asked if he should be here today, and I told him I didn't think it would be necessary.

(Laughter.)

CHAIRPERSON CORY: That's why he should ask his own lawyers, and a real lawyer.

MR. McCAUSLAND: He may know something you didn't know.

CHAIRPERSON CORY: Alan, do you want to comment on that? That's a relatively --

MR. HAGER: I hate to rely on it. I can see the argument, but after we specifically released Arco, and that we accept performance from Arco's assignee, that we have not at least impliedly released Chevron.

CHAIRPERSON CORY: What if we write them a letter and put them on notice? Say, it's on the condition of that understanding and that's their understanding of the law, and that's all we've done. I don't see being sneaky about it. We're here at a public meeting. If we put them on notice that it's approved and if at that point then there's some question about what the legal nuances of that is, then I would suggest that Petro-Lewis, Arco, Standard, the State, can all go up before a judge and find out what it meant. If the judge came to the conclusion that Standard is off the hook, then we by our very act didn't do it. Put everybody on notice right up front.

MR. HAGER: Standard --

MS. SMITH: They need to be here.

MR. HAGER: We really need to get their response.

I just think the fact that you can impliedly release someone --

CHAIRPERSON CORY: Explicitly state that we're not.

MR. HAGER: If you explicitly state it --

CHAIRPERSON CORY: And put them on notice that we're not releasing them. Then they seem to be a real party in interest to the transaction at that point. I don't know.

MR. HAGER: I still have a problem that in a sense by this transaction Arco is committing Chevron to something that they don't know about and they're not aware of it.

CHAIRPERSON CORY: Except we are not releasing Arco unless that is a final outcome --

MR. PENDERGRAFT: I don't want to be in a position of committing Chevron to anything.

CHAIRPERSON CORY: I understand that. But I'm just saying that if we gave conditional approval and we did it in the proper sequence, anything that we did for you would not have been done if, in fact, it turned out we didn't have a responsible financial party on the hook. That's an intriguing position. I don't know where it settles out. It might get us 70 percent of the loaf. Go ahead with your position and we'll let our lawyers contemplate what that means.

MR. PENDERGRAFT: I've given you my opinion and really I think you need to decide that for yourself.

Just briefly, I think there are two compelling reasons why the State ought to approve this transaction separate and apart from whatever conditions the staff may have suggested. I realize there are benefits from those conditions, but it seems to me that even without those benefits it ought to be approved. The first reason is economic. Because Century is in a different position in the marketplace than Atlantic-Richfield, they're in a position to Petro-Lewis to offer an additional 10 cents a barrel and the State will derive benefit from that not only directly but through the contract provision.

The only contingency when that would not occur is if there's a change in federal regulation which prohibits Petro-Lewis from collecting what they've agreed to pay the State. I frankly don't see that change as a likely possibility. I think there are benefits here now under the existing regulations that the State would be denying themselves if they don't approve this transaction.

The second reason is basically a policy reason. The Long Beach Unit, as I'm sure you know, was a creation of the State Legislature. It was structured to maximize participation. There were several interests created in

Tract 1, six. There are sell-off provisions in the various agreements which are intended to maximize participation from various individuals and an assignment to Century is totally consistent with that basic policy concept.

CHAIRPERSON CORY: What are the percentage units in that tract? What is it?

MR. PENDERGRAFT: In Tract 1?

MR. THOMPSON: Tract 1, 80 per nt, 10 percent, 5 percent, two and a half percent, one and a half and one. The 80 percent was the field contractor's portion.

CHAIRPERSON CORY: And Standard and Arco entered into a joint venture on bidding in that?

MR. PENDERGRAFT: Yes.

CHAIRPERSON CORY: And did you bid on all increments of that?

MR. PENDERGRAFT: Yes, Mr. Cory. We lost the first 80 percent interest by something less than a tenth of a percent if my history is correct.

CHAIRPERSON CORY: And you had the financial capacity to handle the 80 percent had you been the successful bidder?

MR. PENDERGRAFT: Presumably at that time, right.

CHAIRPERSON CORY: Why did you remain joint venturees in the lesser percentages since you had the financial capacity to handle 40 percent -- I assume it's an equal share -- you had the financial capacity to handle a 40 percent interest since you bid on 80. Why did you have a partner on a ten percent and a 've percent bid and a two and a half and a one and a half and one?

MR. PENDERGRAFT: I think that's really the nature of the bidding process. The contract with Standard to jointly bid, -- it was Richfield and Standard at that time -- was entered into obviously before the bidding took place. Not knowing whether we'd be successful or not, it was what's commonly called a joint bidding arrangement and the obligation was to bid jointly on all opportunities.

CHAIRPERSON CORY: Are those written agreements or not?

MR. PENDERGRAFT: Yes, sir.

CHAIRPERSON CORY: And are they entered into -- I'm just curious how we find ourselves in this position is what I'm getting at.

4 You enter into a contract before you decided what you were going to bid or would you start negotiating and then enter into the contract after you arrived at the bid arrangement?

MR. PENDERGRAFT: I'm really not sure. My guess is that the contract is entered into first because you're obviously not going to want to discuss potential bids with somebody who may turn out not to be your partner in a business proceeding.

CHAIRPERSON CORY: Okay. Any questions?

MS. SMITH: I have one question for Alan.

It's been rumored that we don't really have Arco on the hook, that if they fail to make profits for a 12-month period, that they can terminate the contract; is that correct?

MR. HAGER: No, that doesn't occur until after the final area assignment, the equity from it is finalized. That won't be until 1990.

EXECUTIVE OFFICER NORTHROP: That's the maximum time.

MR. HAGER: Then after that time, if there are no net profits for a period of, I think, one year, then the contractor can terminate. But the contractor has no right to terminate under those circumstances until the final area assignments have been established. That won't happen until 1990.

MR. HODGES: Ken, I've been over here wheeling and dealing over the last few minutes to try to salvage this deal. Let me tell you what we've come up with and then ask some comment from Bill Northrop.

As discussed at the last meeting here in September, we're supposed to have this deal cinched up, closed or in escrow October the 15th. We've got a short fuse in that period of time. The Chevron-Arco matter must be resolved by the 15th. That's if this Commission consents to the assignment of Chevron over to the Arco interest, that can get involved. As far as the costs involved in this thing, it's not a matter of a great deal of money. But if that is done, I am proposing the following: That we set this meeting over until the 26th at which time we will have a million dollars in Letters of Credit deposited to the escrow and an escrow procedure by which the State of California, with all parties agreeing to it, will have call on funds that are flowing through to Petro-Lewis from the buyers of the crude.

In addition to that, concurrent with this, it's understood that if the sales take place to Petro-Lewis, in addition to that you have their $500,000 of advances which I think at that point in time --

CHAIRPERSON CORY: What is the $500,000?

MR. PENDERGRAFT: Well, the State of California and the city call on $250,000 the first and 250,000 on the 15th, and it can be that they never receive one barrel of crude. According to John Parkin, this crude can be shipped in fifty or twenty thousand barrel slugs, but it doesn't go on a continuous flow. You could get it the 20th, the whole thing. By then you've already collected 500,000 out in front. So if you've got a half a million dollars in advance --

CHAIRPERSON CORY: Who can determine when the shipment is made?

EXECUTIVE OFFICER NORTHROP: The contractor --

MR. THOMPSON: It can be arranged within a certain amount of flexibility.

CHAIRPERSON CORY: But I mean, what we're really struggling for is a mechanism to keep the State whole if the worst happens. If Petro-Lewis gets the assignment, do they schedule the shipment or does the State schedule the shipment or does the operating contractor schedule the shipment?

MR. THOMPSON: It's kind of a mutual deal to work out. In other words, everybody can't take their oil exactly when they want it because we've got oil coming out 75,000 barrels a day and it's got to go. In other words, everybody can't stand back and say I want mine on the 22nd day of the month. You're involved here with about 5500 barrels a day. It would be possible to arrange this in certain ways. Again, depending on the pipeline connections and everything like that. This has to be scheduled.

CHAIRPERSON CORY: But if we had it so all deliveries were after the 15th, then the 500,000 is real money?

MR. HODGES: That's right. Then we agree to that, along with the terms of the escrow, the million dollar bond and the payment, I think we can handle your exposure problem and it would be done by a Letter of Credit, but it's going to be from the refiners and producers instead of Petro-Lewis.

MR. THOMPSON: Am I to understand that you would put a million dollars in for the seed money initially?

MR. HODGES: There's a million dollar Letter of Credit plus all the cash flow which probably amounts to a million and a half dollars going through that account each month. In addition to that, if Petro-Lewis advances is agreed, their half a million dollars a month, you have more than your million four hundred thousand dollars to protect you.

CHAIRPERSON CORY: Okay. I would think what we need to do at this point is to take a recess to allow the staff to go through the steps of that to make sure everybody understands what we're doing.

MS. SMITH: Who's here representing the producers?

MR. HODGES: I'm representing the producers and MacMillan is representing the refiners.

MS. SMITH: And the refiners are also putting up the money for the Letter of Credit?

MR. HODGES: What is MacMillan's Letter of Credit? How much is it?

MR. M. HODGES: I think it's about 600 of the total purchase. The balance of that is put up by our company.

MR. HODGES: So the producers and DeMenno will place the other $400,000 Letter of Credit.

MR. THOMPSON: What you're doing is in effect you're getting a Letter of Credit to cover part of it and you're moving the obligation then for a balance of a Letter of Credit to the crude buyer. That has got the iffyness of the crude buyer because they're really not parties to this agreement. But what you're doing is you're setting this escrow account up --

CHAIRPERSON CORY: I think you need to sit down and go over the details of that as to what it is. Shall we come back at 1:00? Would that be enough time?

MR. HODGES: Fine.

CHAIRPERSON CORY: Can you people make it?

MR. McCAUSLAND: I've got further meetings at 1:30, but I'll stick around.

CHAIRPERSON CORY: Does that make sense? It would seem to me rather than hash it out with paying reporters and all of that, go through the mechanics of where we're at. Somebody might also call Chevron.

(Laughter.)

CHAIRPERSON CORY: We will come back in at 1:00

o'clock.

(Thereupon the morning session of the State Lands Commission Meeting was recessed for lunch at 11:30 a.m.)

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AFTERNOON SESSION

--o0o--

EXECUTIVE OFFICER NORTHROP: Your Honor, the jury is back and we have arrived at a verdict.

CHAIRPERSON CORY: You are what?

EXECUTIVE OFFICER NORTHROP: We have arrived --

CHAIRPERSON CORY: Oh, arrived. I thought you had said that we had bribed a verdict.

(Laughter.)

EXECUTIVE OFFICER NORTHROP: I think --

MR. THOMPSON: To a degree.

CHAIRPERSON CORY: Tell me, Mr. Hoffa.

EXECUTIVE OFFICER NORTHROP: Mr. Hager has been the official keeper of notes and transcriber of what's happened. So we'll move on them one at a time.

In the first sale agreement which is a problem we suffered with, how did that come out?

MR. HAGER: We've agreed to some language. There was the risk that was talked about and that risk, however small, that there would be some sort of regulation that would permit the first sale to come in one price and yet forbid every seller to pass that thing through completely. The language we have would make the State assume that risk. It would assure us that if, indeed, the price were obtainable on the first sale and could be passed through, we would get it.

CHAIRPERSON CORY: But per regulation, not per lack of a buyer or --

MR. HAGER: Yes.

MS. SMITH: Is that correct?

MR. WATSON: Yes, ma'am.

MR. HAGER: May I read the agreed-upon language? This is the entire paragraph, but we go into a consent and assumption agreement. I'm reading it as it would be for the Tract 1. The language we modified for Tract 2 where necessary.

"As a further consideration for the granting of consent by the State to the assignment, P.P. Co. agrees that upon Exhibit A becoming effective P.P. Co. will pay to the City of Long Beach, in an amount equal to 10 cents per barrel for every barrel of crude oil allocated to P.P. Co.'s interest in the contractor's agreement in addition to the City's net profit share of the value of crude oil as determined under Article IX of the contractor's agreement. The additional 10 cents per barrel shall be paid directly to the City and shall not be credited to P.P. Co.'s non-operating contractor's net profits account.

The payment of this additional compensation shall be made only to the extent that its addition to the value of the crude oil as determined under Article IX shall result in a price that does not exceed any applicable ceiling price for the first sale of domestic crude oil imposed by any governmental entity having jurisdiction and that any such governmental regulations permit the receipt in full by P.P. Co. on any sale by it of the crude oil of the Article IX value and the added compensation."

CHAIRPERSON CORY: Question. Should not that provide that it's 10 cents, if it would allow 9 cents of it, that you go ahead and pass the 9 cents through?

MR. WATSON: I think the language says to the extent.

CHAIRPERSON CORY: The last thing seemed to double back on it and maybe obviate that. If you draftsmen are happy, I just thought I picked up from the last -- what was the last clause that you read?

MR. HAGER: "...and that any such governmental regulations permit the receipt in full by P.P. Co. on any sale by it of the crude oil of the Article IX value and the added compensation."

CHAIRPERSON CORY: When it says "receipt in full," if you don't receive it in full, but you only receive a partial --

MR. HAGER: They receive in full whatever they are permitted to --

CHAIRPERSON CORY: As long as there's a clear meeting of the minds of what we mean by that.

MR. WATSON: Yes, sir. We obviously are willing to change the language. Our intent and understanding is that if this results in only a portion of the 10 cents being payable, that that portion will in fact be paid.

CHAIRPERSON CORY: I guess a side letter would probably cover that as an addendum rather than mess with the actual language if everyone is happy with it. Do you agree?

MR. McCAUSLAND: Okay.

MS. SMITH: Okay.

MR. WATSON: Is the record a sufficient stipulation?

CHAIRPERSON CORY: That's up to the lawyers. You're beyond my --

MR. HAGER: I think the record is sufficient.

EXECUTIVE OFFICER NORTHROP: The next item, Mr. Chairman, was the one percent of the bonds for the 750,000 for Tract 1 and the 1,250,000 for Tract 2. We have compromised on splitting it down the middle a half a percent rather than a percent, figuring that the cost of that would be about $10,000 a year to the State and that would make a compromise rather than the 20 we discussed earlier.

CHAIRPERSON CORY: Okay.

EXECUTIVE OFFICER NORTHROP: The second is the revolving Letters of Credit. The lawyers worked the longest on this one to get the language right. So I would like to have Alan and the law firm that we have involved here of the State and Petro-Lewis and Century address that.

MR. HAGER: Okay. This is the language that we have roughly concluded. I think it says our intent. If there's any slight modification, I think it probably could be done.

Before I start reading, this would be put into both the Arco-CRD assignment and the CRD-P.P. Co. assignment as specific conditions to those assignments. I'm reading now.

"This consent is conditioned upon Century providing to the City of Long Beach or State of California" -- that would be Tract 1 or Tract 2 -- "one, an irrevocable Letter of Credit covering payment due from P.P. Co. and its successors and assigns under the contractor's agreement or

Tract 2 agreement in the amount of 625,000 for Tract 1" --

(Thereupon a discussion was held off the record.)

MR. HAGER: -- "625,000 for Tract 1, 375,000, Tract 2, which shall be issued by a national or state-chartered bank qualified to conduct banking business in the State of California. The obligations under which shall be continuing obligations during the term of the contractor's agreement or Tract 2 agreement or; two, the sum of $625,000, Tract 1, $375,000, Tract 2, cash or bonds secured by the full faith and credit of the State of California or the United States placed in an interest-bearing blocked account in a national or state-chartered bank qualified to conduct banking business in the State of California, with irrevocable instructions to said bank that other than by demand of the City or State as hereafter provided no portion of the principal amount of said funds may be withdrawn during the term of the contractor's agreement or Tract 2 agreement and that upon notice by the City, State, of a failure of P.P. Co. and its successors and assigns to pay any amount due under the contractor's agreement or Tract 2 agreement. Such sums shall be paid to the City or State upon demand."

CHAIRPERSON CORY: Bill.

EXECUTIVE OFFICER NORTHROP: This million, plus we have had discussions with the City of Long Beach, and they have indicated that because the oil is shipped in batches and not on a pro rata "X" number of barrels a day, they would be willing to instruct the contractor to make their best attempt to ship all of this in the latter part of the month which would mean our exposure would be minimized by that amount also. There's no way they could guarantee it, but John Parkin who is in the audience has indicated that that would be a possibility that probably could happen.

CHAIRPERSON CORY: And that's acceptable to the parties of the contract, Century and Petro-Lewis?

MS. KNIGHT: Yes.

MR. WATSON: Yes, sir.

EXECUTIVE OFFICER NORTHROP: The record indicates Mr. Hodges is nodding in the affirmative.

MS. SMITH: Alan, did you read two possibilities or was that all one proposal?

MR. HAGER: There would be an alternative. Either they would establish two Letters of Credit, one for Tract 1 and one for Tract 2, or establish two bank accounts.

CHAIRPERSON CORY: They have the option.

MR. HAGER: They have the option, either they get a Letter of Credit or they put up the cash.

EXECUTIVE OFFICER NORTHROP: Just one other item, Mr. Chairman, and I find no other place to cover it, so I put it in this place.

As you know, Mr. Hodges or some others are trying to put a new refinery in Bakersfield. That refinery requires the approval of another state agency. I discussed with them that the disapproval by another state agency shouldn't act as a defense against this contract. They have agreed to that as well.

CHAIRPERSON CORY: We're stipulating we're not our brother's keeper; right?

EXECUTIVE OFFICER NORTHROP: Right.

CHAIRPERSON CORY: Okay.

MR. WATSON: Excuse me, sir.

Although it was not in dispute, I'd like to read the language we have agreed to for the condition regarding the waiver of a portion of the existing notice provision before the state takes its oil in kind.

CHAIRPERSON CORY: Okay.

MR. WATSON: This would go only in the consent affecting Tract 2. It would read:

"As a further consideration for the granting of consent by the State to the assignment, P.P. Co. agrees that, upon Exhibit A becoming effective, P.P. Co. waives the right to written notice under Article IX of the Tract Number 2 agreement in excess of 60 days and agrees that 60 days previous written notice shall be sufficient notice for any election under said Article IX of the Tract Number 2 agreement."

EXECUTIVE OFFICER NORTHROP: That leaves us with the one last point of the default cure period. With the bonding and the late delivery, that would considerably reduce our exposure. I don't know. Mr. Thompson had a look at that. Would you care to get his comment on that?

MR. THOMPSON: Well, again, by taking the oil later in the picture, we're keeping our exposure down. So it is reducing the Letter of Credit amount. Taking and paying a half-percent of the bond premium is offset again by your added amount of the 10-cent bonus.

CHAIRPERSON CORY: Okay. What is the specific recommendation from the staff people who have participated?

EXECUTIVE OFFICER NORTHROP: Do you want to poll us?

CHAIRPERSON CORY: We're all sitting here publicly.

EXECUTIVE OFFICER NORTHROP: Mr. Chairman, as the Executive Officer, I think it's been a --

CHAIRPERSON CORY: Why don't you wait. Given the hierarchy, I'd rather hear from the guys down below so you don't poison the well.

(Laughter.)

CHAIRPERSON CORY: Moose.

MR. THOMPSON: I think so. I think it's acceptable. I think you have the protection here and maybe you're getting the best of the deal as far as the bonus side is concerned. I think that this will help you, your security on the back side.

CHAIRPERSON CORY: Alan.

MR. HAGER: Yes. I think it gives the State the security that it's been looking for.

MR. McCAUSLAND: While you have Mr. Hager on the floor, you might ask him if he's discussed the matter with Chevron first.

EXECUTIVE OFFICER NORTHROP: Oh, we both discussed the matter with Chevron.

With all due respects to the representative from Arco, Chevron doesn't see through the same glasses at all. They feel when this is severed, it's severed and they are no longer responsible. Since we didn't have a speaker phone, I handed it to Mr. Hager. Do you want to get his reaction?

MR. HAGER: Yes. He said that Chevron, their intent on that is that once the severance is made, they are no longer responsible for anything but their individually-held five percent interest. Whether that's what the agreement clearly says or not, we are on notice that that is indeed the intent.

CHAIRPERSON CORY: We did not specifically agree to that one way or the other. We heard their views.

MR. HAGER: But the thing is, we cannot very well act on --

EXECUTIVE OFFICER NORTHROP: We can act on Arco's behalf.

MR. HAGER: But if we accept that thinking that we rely on that, that's not good reliance.

CHAIRPERSON CORY: Okay.

EXECUTIVE OFFICER NORTHROP: Mr. Chairman.

CHAIRPERSON CORY: Jan, do you have anything to add?

MR. STEVENS: No. I didn't really participate in this.

CHAIRPERSON CORY: Mr. Hight.

MR. HIGHT: I think the State is legally

protected in this transaction.

CHAIRPERSON CORY: Dave.

MR. HAYWARD: Yes, I agree that our concern I think has been taken care of by what's happened today here. So I would go along with it.

CHAIRPERSON CORY: Mr. Northrop.

EXECUTIVE OFFICER NORTHROP: With all my staff going for it, I can't go against them. I have to look to them for information.

CHAIRPERSON CORY: Arco.

MR. PENDERGRAFT: I really have nothing to add. I just thought I'd clarify for the record, for whatever it's worth, that Alan and I have discussed the concept of Century remaining responsible. I think we're in agreement that it's the intent of the parties that control, that my opinion was based on absent any expression of intent, for whatever that's worth.

MR. McCAUSLAND: Speaking on behalf of Chevron, U.S.A. --

(Laughter.)

MR. HAGER: May I interrupt? I just have a notice that what I read as far as numbers for the amounts to the Letter of Credit or cash are backwards. Not that the total wouldn't be a million dollars, but the $625,000 would apply to Tract 2 and the 375,000 would apply to Tract

1. Am I correct in this restatement or not?

MR. WATSON: I don't believe so. I believe the bonding runs the other way. The ratio of the bonding is five to three with the five --

EXECUTIVE OFFICER NORTHROP: To Tract 2.

MR. WATSON: That's Tract 2?

MS. KNIGHT: There's a greater amount of oil on Tract 1.

MR. THOMPSON: The bonding goes one way, but I'm not too sure that the Letter of Credit might not go the other way because your net profits percent might be higher.

MR. HAYWARD: Well, the point was made this morning though that they would be in the same ratio as the bonding and that's the point I picked up.

EXECUTIVE OFFICER NORTHROP: Page 2 on your list shows 800 for Tract 1 and 600 for Tract 2.

MR. WATSON: My mistake. The lower bonding requirement is on Tract 1. So if you based it on the bonding ratio, Alan, it would be right.

MS. KNIGHT: It depends on whether you want it on the bonding ratio or your proposed Letter of Credit ratio.

MR. HAGER: I was thinking it was going to be on the proposed Letter of Credit ratio.

MS. KNIGHT: In which case Tract 1 was higher.

MR. THOMPSON: And that was a ratio of 8 to 6, was it?

MR. HAYWARD: Eight to six.

MR. THOMPSON: With the highest percentage being Tract 1.

CHAIRPERSON CORY: The LC's are covering the exposure of the oil that's in the pipe and gone. So it seems to me, shouldn't it follow that?

MR. HAGER: I would agree.

MR. THOMPSON: Well, it's also a slight difference though in the net profits percent. The net profits percent is higher in Tract 1.

MR. HAYWARD: Yes.

MR. HAGER: So our exposure is greater on Tract 1.

MR. HAYWARD: No problem. It's the way he had it originally.

MR. HAGER: Okay. For the record, the figures are the way as I originally read, 625.000 for Tract 1, 375,000 for Tract 2.

EXECUTIVE OFFICER NORTHROP: Mr. Chairman, that completes our conference report.

CHAIRPERSON CORY: What is the wish of the Commissioners?

MR. McCAUSLAND: I'm pleased that the staff worked so hard on this little monster. If I'd have known how hard it was to get the independent oil industry involved in this business, I'm not sure I would have joined you in this adventure.

(Laughter.)

MS. SMITH: I move adoption of the staff's recommendation.

CHAIRPERSON CORY: Moved.

MR. McCAUSLAND: Second.

CHAIRPERSON CORY: Seconded. All in favor signify by saying aye.

(Ayes.)

CHAIRPERSON CORY: Opposed.

Carried.

EXECUTIVE OFFICER NORTHROP: Mr. Chairman, I think we wanted an Executive Session.

MR. McCAUSLAND: Does this staff recommendation by assumption include the Arco-Chevron partitioning?

EXECUTIVE OFFICER NORTHROP: Yes.

CHAIRPERSON CORY: Yes. It's done simultaneously and Arco skates.

If we could clear the room, we have an executive matter.

(Thereupon the State Lands Commission Meeting was adjourned at 1:30 p.m.)

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CERTIFICATE OF SHORTHAND REPORTER

I, CATHLEEN SLOCUM, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing State Lands Commission Meeting was reported in shorthand by me, Cathleen Slocum, and thereafter transcribed into typewriting.

I further certify that I am not of counsel or attorney for any of the parties to said meeting, nor in any way interested in the outcome of said meeting.

IN WITNESS WHEREOF, I have hereunto set my hand this 12th day of October, 1978.

Cathleen Slocum

CATHLEEN SLOCUM
Certified Shorthand Reporter
License No. 2822