MINUTE ITEM

This Calendar Item No. 35 was approved as Minute Item 35 by the State Lands Commission by a vote of 3 to 0 at its 9/30/76 meeting.

CALENDAR ITEM

35.

9/76
W 10313
WMT

STATE - CITY OF LONG BEACH SETTLEMENT OF OIL REVENUE ACCOUNTING

A. INTRODUCTION:

At its meeting of February 26, 1976, the State Lands Commission authorized the Executive Officer to execute an agreement with the City of Long Beach regarding conditions under which formal negotiations would be undertaken to resolve eleven items of dispute regarding accounting for oil revenue distribution between the City and State. Informal negotiations on several of the items had been conducted since the 1972, without resolution. Essentially, the agreement, dated March 4, 1976, provided for a specific term, (through July 31, 1976), within which negotiations were required to be concluded, and stipulated that any statute of limitations would be tolled for the period of the negotiations without admitting the applicability of any statute of limitations to the parties' claims.

On July 22, 1976, because it appeared that negotiations could be successfully concluded, the Commission authorized the Executive Officer to execute an amendment to the March 4 agreement, extending the negotiation period through August 31, 1976. Within the extension period, a settlement was achieved with the City of Long Beach on all but one (Interest on Oil Revenue) of the original eleven items, and is presented to the Commission today, September 30, 1976, for its consideration. The settlement agreement is Exhibit III, on file with the office of the State Lands Commission and by reference made a part hereof.

The eleven items which were originally the subjects of negotiation are commonly referred to as:

1. Subsidence Costs
2. Harbor Department Land Rental
3. Amortizations
4. 6% Administrative Overhead
5. Interest on Oil Revenue
6. Property Tax (Ad Valorem) Impound Account
7. Lease Fuel Processing Charges
8. Retroactive Adjustments in Remaining Oil Revenue following LBU Equity Changes
9. Fuel Gas Transport Charge
10. Fault Block V Advanced Costs
11. Produced Gas for Lease Use.

A brief description of the concerns of each of these items is attached as Exhibit "I".

A 52, 57, 58

S 27, 31

During the course of the negotiations, two of the items, i.e. Interest on Oil Revenue and Produced Gas for Lease Use were removed from the negotiations by mutual agreement of the State-City negotiating teams. As to "Produced Gas for Lease Use", the City agreed to withdraw its claim. Regarding Interest on Oil Revenue, the City maintained that this was not a negotiable item, and a resolution would have to be effected in some other manner. A course of action for Commission consideration as to the latter is recommended later in this presentation.

B. THE PROPOSED SETTLEMENT:

With respect to the remaining nine items, the staff, in conjunction with the Office of the Attorney General, reached the following proposal for settlement with the City of Long Beach, which if approved by the Commission would have an effective date of September 1, 1976.

1. Subsidence Costs

Forty-five Authorized Fund Expenditures (AFE's) and Work Orders representing thirty-six capital expenditure projects completed by the Long Beach Harbor Department and containing subsidence remedial work receive final settlement of the subsidence costs. Of the forty-five AFE's and Work Orders, the City withdraws and waives any claim to that AFE representing the Army Outport Terminal Project, i.e. AFE 811. Additionally, within the remaining forty-four AFE's and Work Orders, the City acknowledges overdeductions made in error on AFE's 831 and 832, Piers G and J extensions. A final closing will be made by the State Lands Commission on forty-five AFE's and Work Orders representing thirty-six completed projects, in the amount of the subsidence costs claimed by the City.

2. Harbor Department Land Rental Charges to the Prior Tideland Oil Development

Instituted unilaterally in January 1970, by the Harbor Department, a land rental imposed on the prior tideland oil development operations, i.e., the land areas occupied by the Long Beach Oil Development Company (LBOD) and Powerine Oil Company operations, is discontinued. In place of a land rental, the Harbor Department is allowed to charge the prior tideland oil development operations those additional costs incurred by the Harbor by reason of the oil operations. An example of such an additional cost is the employment of harbor guards for oil area security. These "Special Facilities and Service" charges were, in fact, being made by the Harbor, with State concurrence, prior to 1970.

To more easily administer the Special Facilities and Service charges in the future, actual costs for fiscal year 1975-76

have been converted to a square foot charge, to be applied to the total square footage occupied by the LBOD and Powerine operations. From the effective date of the Agreement, the square foot charge will be 10.5 cents/sq. ft. and subject to future inflationary increases determined by pay and benefit increases received by representative personnel classes supplying the subject services as specified in Exhibit III. The charge also will be subject to an annual review of the total square footage occupied by the LBOD and Powerine operations. The effect of the settlement is to reaffirm the principle that a trustee may not impose a land-use charge against the trustor. Additionally, the charge to oil operations is reduced, thus resulting in added future income to the State.

3. Amortization of General Facilities and Water Plants "A", "E", "G", "J", AND "Z" - Prior Development

The proposed settlement constitutes complete satisfaction of the City's past and future claim to 50% of General Facility and Water Plant amortizations unrecovered as of January 1, 1969, at which time, due to the State-City sharing relationship given in Chapter 138, amortizations were no longer shared 50-50 with the City, but received, in effect, 100% by the State.

4. 6% Administrative Overhead - Prior Development

With respect to the LBOD Unit Operations, i.e., Fault Blocks II, III and IV and the Fault Block V Ranger Zone, the proposed settlement affirms the City's present procedure, which is permitted under the terms of an Agreement entered into between the State and the City in 1966. That Agreement allows the City to impose a flat 6% administrative overhead charge, in lieu of actual administrative overhead charges, on those items of expense chargeable to Unit Expense, as provided in the Unit Agreements and Unit Operating Agreements for each Fault Block Unit. Such 6% charge the City may place into its General Purpose or other proprietary fund, i.e., a non-trust fund.

As to the 6% administrative overhead charge imposed by the City on non-unit costs, the City will first deduct its actual administrative overhead expenses and then divide the remaining amount of the 6% with the State in accordance with the revenue distribution provisions of Chapter 138.

The effect of the latter procedure is to treat that portion of the remaining 6% divided with the State as though it were oil revenue, and the City will discontinue its present practice of retaining 6% amounts in excess of its maximum oil revenue limitations imposed by Chapter 138, currently $9 million annually, such excess will be income to the State.

5. Property Tax Impound Account - LBCD

The proposed settlement provides that the LBOD Property Tax Impound Account (maintained by the City Treasurer in the General Deposit Trust Fund) will be eliminated, and the accumulated deposits will be credited to the LBOD net profits account. The latter means that 91% of the accumulation will become income to the State, and the 9% balance will revert to LBOD. The elimination of the account means that taxes will be paid on a cash basis as they come due. It also means that the issue of whether the interest that was being earned on the impound account is or is not oil revenue to be shared in accordance with Chapter 138, will become moot. For the future, the City agrees not to establish any such impound accounts within the oil operations; such operations shall be on a cash basis.

6. Lease Fuel Processing Charge - Prior Development

The City, under the proposed settlement, will, if and when feasible, attempt to obtain an amendment to the LBOD contract to provide that the Contractor is to assume a percentage share of gas processing charges equal to his profit percentage. Failing such an amendment, the City shall include such a provision at the time a new contract is negotiated.

At the present time, under the terms of its contract, Powerin does assume a 9% share of gas processing costs.

7. Equity Adjustments - Long Beach Unit

The essence of the proposed settlement is that retroactive adjustments in State-City revenue sharing due to changes in Area Assignment of Tract 1, will not be made, except under one or more of the following conditions:

A. The City's share of oil revenue in any future year is an amount less than the maximum amount for that year as provided in Chapter 138; i.e., a "percentage" year, rather than a fixed dollar amount year.

B. If a change in Area Assignment would result in a shift in any given year of the sharing ratio for the City from a fixed dollar amount to a percentage for that year.

C. If a change in Area Assignment would result in a shift in the year in which the City will have retained a total of $238 million in remaining oil revenue. As provided in Chapter 138, the City, in the year subsequent to that in which it has received a total of $238 million, will receive a maximum of $1 million a year.

D. At the time Final Tract Assignments are Established for the Long Beach Unit.

8. Fuel Gas Transport Charge - All Oil Field Operations

The present $.05/MCF charge imposed by the Long Beach Gas Department is deemed, under the proposed settlement, to be an equitable transport charge. Any future increases in the charge shall be substantiated by the City prior to initiation of the increased charge.

9. Fault Block V Advanced Costs - LBOD

On the basis that the subject advances were made by the City to encourage unitization of the Fault Block V Ranger Zone, the proposed settlement affirms the 50-50 sharing ratio of recoveries of the advanced costs made since January 1969. It is also agreed, however, that such affirmation establishes no precedent on the issue of whether the recoveries are or are not oil revenue.

The above items complete the matters resolved by the proposed settlement. As noted earlier, the City has withdrawn its claim regarding the matter of transferring residue dry gas. (See Exhibit "I"). The remaining item of dispute, then, is Interest on Oil Revenue. On this issue, the State and City have agreed that resolution will be a matter for litigation and/or other means.

C. LIMITS OF THE PROPOSED SETTLEMENT

1. A major issue involved in several items of dispute, e.g., Amortization was the question of the meaning of "oil revenue", defined in Chapter 138 as "...the net proceeds received by the City of Long Beach from the sale or disposition of oil, gas, and other hydro-carbon substances..." and "...also includes the net receipts from the sale of property used in such extraction or sale or disposition..." The State contends that oil revenue should be broadly interpreted to include any revenues earned from the oil operations regardless of their source. On this basis, such revenues would be shared between the State and City in accordance with Chapter 138 as "remaining oil revenue". The City, however, interprets the language in a restrictive manner contending that revenues in the form of amortizations, for example, would not constitute "oil revenue" and thus are not subject to sharing with the State because they are not proceeds received directly from the sale or disposition of oil, gas and other hydrocarbons.

This issue is not resolved by the proposed settlement. The latter, however, does provide that where the issue is involved, the settlement does not establish any precedent for the future

and the State and the City are free to pursue the definition of "oil revenue" that either might give to it.

2. A second major issue not resolved by the proposed settlement is the interpretation to be given to certain subsidence remedial projects of the City as to whether the costs qualify as "subsidence costs" to be deducted from oil revenue. Chapter 138 states that, " 'Subsidence costs' means costs expended by the City of Long Beach with the prior approval of the State Lands Commission to remedy or protect against (1) the effects of subsidence of the land surface...". The City's interpretation of this would allow within the entire Harbor District, for properties already owned by the Harbor or to be acquired, filling to the pre-subsidence level, whether or not there is justification to fill to such level, for whatever purposes might be desired by the Long Beach Harbor Department. The cost of such fill could be a 100% subsidence claim upon the State depending upon the magnitude and split of the remaining oil revenue. There is an opposite contention that the State Lands Commission has discretion in these matters, and the subsidence claim against the State is qualified by the need for subsidence costs expenditure relative to intended uses, and/or whether subsided properties were in the ownership of the City at the time subsidence occurred.

The completed subsidence projects receiving final closing in the proposed settlement contain among them (although not all) this and other differences of interpretation. The final closing, however, establishes no precedent for the future on these issues, and the State and City are free to pursue their respective interpretations as new subsidence projects are submitted by the City for the prior approval of the Commission.

In its essence, the proposed package settlement clears up a number of issues of past dispute, but leaves the two issues described above to be resolved in the future by negotiation, litigation, or other means.

In consideration of settling the outstanding, retroactive monetary claims of both the State and the City, the settlement provides for a one-time cash payment from the State to the City in the amount of $800,000, to be deducted in one lump sum from oil revenue. The payment will not be considered oil revenue to the City, but will be tideland trust revenue.

Staff, the Office of the Attorney General and representatives of the City of Long Beach, have met to draft the appropriate documents to effect the settlement. The Long Beach City Council and the Long Beach Board of Harbor Commissioners have approved the settlement and authorized execution of the Agreement.

The Office of the Attorney General has reviewed the proposed settlement and advises it is legally proper for the Commission to enter into the settlement.

EXHIBITS: I. Summary of Long Beach Oil Operations Accounting Dispute Areas.

II. Resolution.

III. State-City of Long Beach Agreement Resolving Outstanding Oil Accounting Disputes.

Attachments: Exhibits "I" and "II"

EXHIBIT "I"

SUMMARY OF
LONG BEACH OIL OPERATIONS
ACCOUNTING DISPUTE AREAS

Subsidence

Both Chapters 29 and 138 provide for the State to share in the costs of remedying previous subsidence damage and protecting against future subsidence. The City of Long Beach is authorized to retain oil revenue for such costs, in addition to the $250 million the City is allowed to retain as remaining oil revenue, pursuant to Chapter 138.

There are legal, technical and policy problems on past subsidence projects, such as whether the City may retain 100% of the cost for fill as subsidence costs, regardless of the amount of fill material used.

Harbor Department Land Rental

In January 1970, the City (Harbor Department) began charging a land rental for certain Harbor Lands used by the oil operation in the prior development area. The State's position is that it cannot be charged for the mere use of trust lands. A charge for special services due to the oil operations is permissible. The City (Harbor Department) has disagreed.

Amortizations

Prior to January 1, 1969 (at which time the State started receiving 100% of remaining oil revenues in excess of $9 million), the City and State shared in building certain "general facilities" and water injection plants to be used in the oil operations. Up to 1969, the amortizations of these investments were shared 50-50 in accord with the revenue split. Beginning on January 1, 1969, because the State received 100% of remaining oil revenue (in excess of $9 million), it also received 100% of the amortizations. The City objected, saying that amortization recoupment should be shared on the same basis as the original expenditure. The State's position has been that these expenses should be accounted for no differently than any other oil expenses, such as an oil well expenditure.

6% Administrative Overhead

Under Chapter 138, the City is entitled to recover its municipal administrative costs attributable to oil operations. Such money can be placed in the City's general fund and not a trust

fund. The dispute is that the City is retaining for its trust fund a portion of the 6% administrative overhead amount on its non-unitized operations, that is in excess of actual administrative costs, and in excess of its maximum dollar limitation. Such excess amounts are not shared with the State as provided for in Chapter 138. The State's position is that such excess should be treated as oil revenue and thus shared with the State in accordance with the provisions of Chapter 138.

Interest on Oil Revenue

Procedurally, the City properly holds for a given number of days the money it is required to pay the State as the latter's share of remaining oil revenue. The City, however, retains for its Tideland Operating Fund the interest earned on the money during this holding period. The State contends that this interest is oil revenue and should be shared with the State in accordance with the provisions of Chapter 138. The City disagrees.

Property Tax (Ad Valorem) Impound Account

A property tax (ad valorem) impound account has been established in the City Treasurer's Office, into which the contractor for the Long Beach Harbor Department Tidelands Parcel (LBOD) makes monthly deposits. The impound account earns interest which is shared by the State and City. The issue is whether the interest is oil revenue or not. If it is, then the State would receive the share presently retained by the City that is in excess of its maximum annual sharing limitation.

Lease Fuel Processing Charge

Natural gas that is produced in the prior tideland development, from Long Beach Harbor Department Tidelands Parcel and Parcel A, is returned for use as fuel in oil operations. Before the natural gas can be so used, however, the entrained natural gas liquids and hydrogen sulfide must be removed by processing of the gas. At present, the processing cost is being treated as a cost of oil operations which, because the City is receiving each year its maximum limit of remaining oil revenue, is in effect being deducted from State revenue, except for a 9% share being paid by Powerine in accordance with its contractual obligation. No such contractual obligation exists for LBOD.

When and if feasible, the State requests that the LBOD contract be amended so that LBOD would pay 9% of the gas processing charge allocated to LBOD operations.

Equity Adjustments

Any time a change is made in the Area Assignment for Tract I of the Long Beach Unit, a retroactive adjustment in State-City

revenues back to April 1, 1965, the commencement date of the Unit, theoretically would be appropriate. Clarification, however, was needed as to the circumstances under which an actual retroactive adjustment would be made.

Fuel Gas Transport Charge

Originally this charge had been primarily a penalty imposed by the City Gas Department for returning to oil field operations a better quality of gas than it received from the operations. Presently at $.05/Mcf, the penalty feature has been eliminated and the State's concern now is whether the $.05/Mcf is a reasonable transport charge.

Fault Block V Advanced Costs

Prior to the unitization of Fault Block V Ranger Zone (in the prior development), the City had drilled water injection wells on the tidelands. With formation of the Fault Block V Ranger Zone Unit in 1964, these wells became Unit property and the upland participants agreed to reimburse the City for the investments made. A portion of the investment was paid by the Unit at the time the Unit was formed. The remaining amount was to be recovered by the City based upon secondary recovery allocation percentages applicable to the upland participants. The issue is whether the amount unrecovered at January 1, 1969 is to be accounted for as oil revenue subject to the sharing formula of Chapter 138.

Produced Gas for Lease Use

At the present time, the prior development area is not producing a sufficient quantity of gas to meet fuel requirements of the properties from which gas is produced. The deficit is being made up by transfer of gas produced, and processed from the Long Beach Unit allocation. The City contends that the deficit amounts now being transferred from the Long Beach Unit allocation should be purchased directly from the City Gas Department. The State is concerned that the purchasing of gas from the Long Beach Gas Department would impose an additional cost on prior development operations which would, in effect, be borne principally by the State.

EXHIBIT II

RESOLUTION

A. SETTLEMENT:

THE STATE LANDS COMMISSION:

1. FINDS THAT IT IS IN THE BEST INTEREST OF THE STATE TO SETTLE ITS DISPUTE WITH THE CITY OF LONG BEACH REGARDING THE NINE ITEMS WHICH ARE THE SUBJECT OF THE PROPOSED SETTLEMENT AGREEMENT.

2. RECOGNIZES THAT BOTH THE STATE AND THE CITY OF LONG BEACH PRESERVE THEIR RESPECTIVE RIGHTS OF INTERPRETATION AND FUTURE ACTION AS IDENTIFIED IN THE PROPOSED SETTLEMENT AGREEMENT.

3. APPROVES THAT SETTLEMENT AGREEMENT APPROVED BY THE LONG BEACH BOARD OF HARBOR COMMISSIONERS ON SEPTEMBER 22, 1976, AND APPROVED BY THE LONG BEACH CITY COUNCIL ON SEPTEMBER 28, 1976; SAID AGREEMENT IS ON FILE WITH THE STATE LANDS COMMISSION AND BY REFERENCE MADE A PART HEREOF.

4. AUTHORIZES THE EXECUTIVE OFFICER TO EXECUTE THAT SETTLEMENT AGREEMENT AND TO RECEIVE, ACKNOWLEDGE, RECORD AND FILE ANY NECESSARY SUPPORTING DOCUMENTS.

B. INTEREST ON OIL REVENUE

THE STATE LANDS COMMISSION:

1. FINDS THAT IT IS IN THE BEST INTEREST OF THE STATE TO ACHIEVE A RESOLUTION OF THE ISSUES INVOLVED IN THE MATTER OF THE CITY OF LONG BEACH'S PRESENT RETENTION OF INTEREST EARNED ON PRE-SPLIT OIL REVENUE.

2. AUTHORIZES THE OFFICE OF THE ATTORNEY GENERAL TO TAKE WHATEVER STEPS ARE NECESSARY, INCLUDING LITIGATION, TO EFFECT A RESOLUTION OF THE DISPUTE REGARDING THE DISPOSITION OF INTEREST EARNED BY THE CITY OF LONG BEACH ON PRE-SPLIT OIL REVENUE.