

MINUTE ITEM

This Calendar Item No. 30  
is approved as Minute Item  
by the State Lands  
Commission by a vote of 2  
at its 9/27/78  
meeting.

CALENDAR ITEM

30.

9/78  
Thompson

APPROVAL OF SPECIFICATIONS AND FORMS FOR THE  
NOTICE INVITING BIDS, THE BID AND THE CRUDE OIL  
SALES CONTRACT FOR SALE OF 4½ PERCENT OF THE  
CRUDE OIL, LONG BEACH HARBOR DEPARTMENT TIDELANDS PARCEL,  
CITY OF LONG BEACH, LOS ANGELES COUNTY

The City of Long Beach, in cooperation with the Commission's staff, has prepared the notice inviting bids, bid form and crude oil sales contract to be used for the contemplated sell-off of 4½% of the oil allocated to the Long Beach Harbor Department Tidelands Parcel in the City of Long Beach, which oil the City may take in kind pursuant to Section 18.2 of the Drilling and Operating Contract (Long Beach Harbor Department Tidelands Parcel).

The statutory authority for Commission approval of these specifications and forms is set forth in Section 10(a) of Chapter 29, Statutes of 1956, First Extraordinary Session. That section provides, in pertinent part, that all specifications and forms for the purpose of inviting bids in connection with the disposition of oil derived from the Long Beach tidelands shall be approved by the State Lands Commission prior to publication of notice to bidders.

The oil taken by the City's contractor, Long Beach Oil Development Company, is now valued at posted price, which is currently 25 cents per barrel below the ceiling price allowed by the Federal Department of Energy. As a result of approval by the Commission at their July 19 meeting, concerning the sell-off of the 8% oil increment, 4 bidders offered to pay ceiling prices. A fifth company, Powerine Oil Company, the existing purchaser of the sell-off oil, offered to match the bid and therefore was allowed to continue its purchases at the higher bid prices in accordance with the Federal Department of Energy's supplier-purchaser rule. In addition, the City of Long Beach has received 6 offers to pay ceiling prices for crude oil allocated to the City from their townlot tracts in the Long Beach unit.

This demonstration of willingness to pay ceiling prices for crude oil is encouraging, and is the basis for staff recommendation that the subject 4½% of crude oil from the Long Beach Harbor Department Tidelands Parcel be put up for sale at the maximum price permitted by law.

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S 27, 31

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To expedite the sell-off of this oil a waiver of the 180 day notice period to take the oil from the City's Contractor, Long Beach Oil Development Company, would be highly desirable. This possibility is being investigated.

The significant specifications set forth in the sell-off bid forms are as follows:

1. Amount:

The sell-off will be offered in one contract for 4½% of the crude oil allocated to the Long Beach Harbor Department Tidelands Parcel. Currently, this amount is 675 barrels of oil per day.

2. Price of Oil (Bid Factor):

For all oil subject to Federal price controls, purchaser shall pay the maximum price permitted by law. Purchaser shall account for all oil not subject to price controls on the basis of its value as computed under the crude oil valuation provisions of Section 18.3 of the Drilling and Operating Contract (Long Beach Harbor Department Tidelands Parcel). The price for all oil shall be computed to the closest tenth of each degree of API gravity and the closest tenth of a cent per barrel. Bids shall take the form of a commitment to pay the specified sell-off contract price.

3. Term:

The initial term of the sell-off contract shall commence on \_\_\_\_\_ 197\_. The term shall end on June 1, 1979, which is the date when mandatory price controls on first sales of domestic crude oil are to expire. The contract will be renewable for 3 additional fixed time periods upon the mutual assent of the purchaser, City and Commission given at least 30 days prior to the expiration date of the then existing term. The last date through which the contract may be renewed is September 30, 1981, which is the date to which the President may at his option extend price controls on crude oil. Even though the requirement of mutual assent for extension may not be satisfied, the contract may have to remain in existence beyond its initial term if the present supplier/purchaser rule of the Department of Energy remains in effect.

4. Cash Deposit:

Each bidder shall submit with this bid as evidence of good faith a deposit in the form of a certified or cashier's check in the amount of \$13,000.

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5. Surety:

A letter of credit from a California bank is required of the purchaser in the amount of \$300,000.

6. Insurance:

The purchaser shall maintain or procure personal liability insurance of at least \$500,000 per person, \$1,000,000 for more than 1 person, and property damage insurance of at least \$1,000,000.

7. Delivery:

All oil shall be taken from Wilmington Oil Field delivery points, as approved by the city, for the Fault Block II Unit, the Fault Block III Unit, the Fault Block IV Unit or the Fault Block V Ranger Zone Unit. The purchaser shall provide his own delivery equipment, subject to approval by the city, and at no expense to the city.

8. Selection of Successful Bidders:

The successful bidder for the sell-off oil shall be the responsible bidder making a commitment to pay the price specified in the sell-off contract. In the event that 2 or more responsible bidders make identical commitments to pay the contract price, the successful bidder for the sell-off oil shall be determined by lot from among all those responsible bidders making such identical commitments.

9. Responsibility:

Each bidder shall submit evidence of his ability to take the crude oil and shall also file a financial statement. The findings of the City Manager of Long Beach and the State Lands Commission as to these factors will be final.

10. Rejection of Bids:

The right to reject any and all bids will be reserved by the City of Long Beach and the State Lands Commission. The bid notices are on file in the State Lands Commission Office.

Bids received will be analyzed by the City of Long Beach and the Commission's staff and will be presented to the Commission for approval before acceptance.

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IT IS RECOMMENDED THAT THE COMMISSION, PURSUANT TO SECTION 10(a), CHAPTER 29, STATUTES OF 1956, 1ST E.S., APPROVE THE SPECIFICATIONS AND FORMS FOR THE NOTICE INVITING BIDS, THE BID AND THE CRUDE OIL SALES CONTRACT FOR THE SELL-OFF OF 4½% OF THE CRUDE OIL FROM THE LONG BEACH HARBOR DEPARTMENT TIDELANDS PARCEL, CITY OF LONG BEACH, WILMINGTON OIL FIELD, LOS ANGELES COUNTY.

31. PARTITION AND ASSIGNMENT OF INTERESTS IN TRACTS 1  
AND 2 OF THE LONG BEACH UNIT

The attached 54 pages, which is incorporated herein by reference, represent a complete verbatim transcript of this meeting's proceedings concerning an agreement and assignment to provide for partition of the Chevron/Atlantic Richfield jointly held 10 percent nonoperating contractors' interests in Tract 1, Long Beach Unit; agreement and assignment of the resulting five percent Atlantic Richfield Tract 1 interest and Atlantic Richfield's Tract 2 interest in the Long Beach Unit to Century Resources Development, Inc.; and agreement and assignment of Century's interests in Tracts 1 and 2 to Petro-Lewis Corporation.

Appearances in support of this item were made by the following people:

John Parkin, Department of Oil Properties, City of  
Long Beach  
Jeffrey Pendegraft, Attorney, Atlantic Richfield  
Company  
William D. Watson, Attorney (Holme, Roberts & Owen),  
representing Petro-Lewis Corporation  
Kenneth Blancett, Senior Vice President-Acquisition,  
Petro-Lewis Corporation  
Nancy Knight, Attorney (Sheldon Foreman), representing  
Century Resources Development, Inc.  
Morris L. Hodges, President, Century Resources Development,  
Inc.

At the conclusion of testimony, the Commission took no action, but instead scheduled it for consideration at a special meeting of the Commission to be held on October 11, 1978.

Attachment: Transcript (55 pages)  
Calendar Item 31 (1 page)

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1 MS. SMITH: No.

2 ACTING CHAIRPERSON McCAUSLAND: Without objection,  
3 Item 28 is adopted as submitted.

4 Item 29 is approving a maximum of \$10,000 in  
5 costs for General Subsidence Maintenance and Repair Work  
6 and conditionally approving the Emergency Subsidence  
7 Remedial Work in the Long Beach Harbor District. Any  
8 questions or objections?

9 MS. SMITH: No.

10 ACTING CHAIRPERSON McCAUSLAND: Item 29 will be  
11 adopted as submitted.

12 Item 30 is approving specifications and forms  
13 for the Notice Inviting Bids for the sale of 4-1/2 percent  
14 of the crude oil in the Long Beach Harbor Department  
15 Tidelands Parcel. Questions or objections?

16 MS. SMITH: No objections.

17 ACTING CHAIRPERSON McCAUSLAND: Without objection,  
18 Item 30 is approved as submitted.

19 Item 31 regards an agreement and assignment to  
20 provide for partition of the Chevron-Atlantic Richfield  
21 jointly held ten percent nonoperating contractors' interests  
22 in Tract 1, Long Beach Unit; agreement and assignment of  
23 the resulting five percent Atlantic Richfield Tract 1  
24 interest and Atlantic Richfield's Tract 2 interest in the  
25 Long Beach Unit to Century Resources Development, Inc.;

1 and agreement and assignment of Century's interests in  
2 Tracts 1 and 2 to Petro-Lewis Corporation. Mr. Northrop.

3 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, we  
4 have placed on the board, we've tried to graphically  
5 display how this program would take over. But in order to  
6 complete the chart, we have drawn several lines by  
7 inference and not by any direct documents. We still need,  
8 mainly, an executed agreement between Century and Petro-  
9 Lewis including the statement that Petro-Lewis will pay  
10 one million, twenty-two thousand, three hundred dollars  
11 to Century to pay Arco. We also need some kind of a  
12 statement that there are no other side letters, agreements  
13 or financial arrangements between Century Petroleum and  
14 Petro-Lewis and/or their subsidiaries, a statement of fact  
15 that there are none of those.

16 There is a problem, and we've discussed this with  
17 Arco. We feel this is not serious, but we should certainly  
18 have it as part of the package, a waiver of the one percent  
19 water cut requirements for the Four Corners Pipe Line; and,  
20 three, crude oil purchase agreements between Coastal  
21 Refiners and Century Resources. We need copies -- again,  
22 these are things that we should have in our package before  
23 we can make a meaningful recommendation to the Commission --  
24 side agreements to Coastal-Century, including exchange  
25 agreements. The fifth thing we feel we should have is a

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1 consent and assumption agreement between Partnership  
2 Properties Company and Century for Tract 2; and, B, the  
3 Partnership Properties and Century and the City as to  
4 Tract 1 must be modified to assure that the ten cents  
5 per barrel bonus payment is not run through the profits  
6 account.

7 In addition to that, not included in the package  
8 that we have, I have received this morning a letter from  
9 Macmillan Ring Free Oil Company that indicates a willingness  
10 to stand in Century's stead should something untoward  
11 happen to Century financially.

12 I have a letter from CIPA, California Independent  
13 Producers Association, signed by Doctor Morris Frankel,  
14 President, in which he supports this proposed transfer.

15 In addition, I have some other documents from  
16 Morris Hodges from Century regarding a review program.

17 I think at this time, with the Commission's  
18 permission, I would like to have Alan Hager and Mr.  
19 Thompson, who worked extensively trying to put this  
20 package together, to perhaps go over the details as we  
21 see them now and as we tried to graphically display on the  
22 board and have it reduced in your package.

23 ACTING CHAIRPERSON McCAUSLAND: Fine.

24 MR. THOMPSON: Part of our problem, of course, is  
25 we received many of these documents this last Friday and

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1 we're still trying to analyze them.

2 One change that should be made in this calendar  
3 item is in the third paragraph it talks about an assignment  
4 from Century to Petro-Lewis Corporation, and this should  
5 be changed to Partnership Properties Company, also referred  
6 to as PPC. They would be substituted and they would be  
7 the nonoperating contractor in Tracts 1 and 2 if this  
8 assignment were approved.

9 Now, to explain the substitution, I'll try and  
10 give you our analysis of what the interrelationship is  
11 between Petro-Lewis and Partnership Properties Company.  
12 Partnership Properties Company is a general partnership  
13 formed by certain officers of Petro-Lewis Corporation to  
14 be a nominee to hold title to all the properties owned by  
15 Petro-Lewis Producing Company, Roman Numeral Number I,  
16 which is a limited partnership in which Petro-Lewis Funds,  
17 Incorporated is a general partnership, and they hold 20  
18 percent plus of the general partnership and four percent  
19 plus of the limited partnerships in Petro-Lewis Funds, Inc.  
20 This Petro-Lewis Funds, Inc. is a subsidiary of Petro-Lewis  
21 Corporation which owns 75 percent of the Class A voting  
22 common stock and a hundred percent of the Class B nonvoting  
23 stock in Petro-Lewis Funds, Inc. They're the operator  
24 for all these partnerships.

25 Now, as an incentive for approving this assignment

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1 which isn't in the calendar item, Partnership Properties  
2 Company is proposing to pay a bonus of ten cents for each  
3 barrel of oil allocated to these two properties. Now,  
4 again, as part of this assignment, there are crude oil  
5 purchase agreements between Partnership Properties Company,  
6 which would be the nonoperating contractor for five percent  
7 of Tract 1 and for Tract 2, and Century Resources Development Company.  
8 This is the one that has the first assignment from Arco.  
9 These then are subject to additional crude oil purchase  
10 agreements. For Tract 1 for a six-month period Arco would  
11 take from Century Resources Development this oil, and then  
12 it would go to Coastal Petroleum Refiners of Bakersfield.  
13 For Tract 2 then, Century Resources Development would sell  
14 2,000 barrels per day to Macmillan Refining Company.

15 Again, most of these documents, again, we've  
16 gotten various documents again this morning which extend  
17 Macmillan's desire to take this oil from -- Properties  
18 Producing Company is assigning crude oil purchased to  
19 Century Resources Development. They also have a desire to  
20 take all of that oil and would take it through the year 2000.

21 I think right now we have tried to diagram this  
22 up here as we understand it. About all we can say is there  
23 are certain parts of the agreement we think the language  
24 has to be improved, and we're a little bit under a time  
25 bind in this situation.

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1           ACTING CHAIRPERSON McCAUSLAND: What is the  
2 time bind, Mr. Thompson?

3           MR. THOMPSON: The original assignment from Arco  
4 to Century Resources Development terminates October 15th.  
5 I don't know whether that can be extended or not. It's  
6 my understanding from the letters we've seen from Arco  
7 that they do not want to extend that and also they have  
8 answered, I think, the question the Commission had before of  
9 whether they would guarantee any of the performance. They have answered  
10 in the negative, they would not guarantee. They're here  
11 and they can speak for themselves, I think, on that issue.

12          ACTING CHAIRPERSON McCAUSLAND: So in all  
13 fairness to Century Resources, we should say yes or no  
14 to this sometime next week?

15          MR. THOMPSON: Yes, I think because they have  
16 an agreement that will terminate on October 15th. What  
17 you're looking at here is a situation where if the present  
18 situation continues, you'll have a very stable situation.  
19 You have in Tract 1 Atlantic and Chevron as partners in  
20 ten percent. The net profits percent of that is,  
21 99.771 percent goes to the City who are partitioned. Then  
22 99.542 percent on the net profit would go to the City on  
23 that.

24                 In Tract 2 there's 96.25 percent of the net  
25 profits go to the State. So at the present time you have a

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1 very stable situation with a high net profit percent. Of  
2 course, on the other side now you're offered a bonus  
3 that would go through the life of this. You would get  
4 ten cents a barrel for each barrel that we're allocated  
5 on this. This is a considerable sum of money.

6 So, again, it's a question of the continuity  
7 of this, and I think this is what the Commission has to  
8 evaluate going from a very stable situation you have now  
9 to a situation where you have additional financial  
10 advantage but potentially with a little more risk.

11 ACTING CHAIRPERSON McCAUSLAND: What is the  
12 role of the City in the approval of this relationship?

13 MR. THOMPSON: They also would have to approve  
14 it.

15 ACTING CHAIRPERSON McCAUSLAND: And what is  
16 their schedule for consideration?

17 MR. THOMPSON: This would come up before a  
18 City Council meeting and they normally meet on Tuesday.  
19 I think this has to be on their agenda by the previous  
20 Wednesday. There are people here from the City that could  
21 answer that question better than I could.

22 MR. PARKIN: October the 10th.

23 ACTING CHAIRPERSON McCAUSLAND: Can they act  
24 on it before we act on it?

25 MR. THOMPSON: Yes, I don't think there's any

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1 requirement that we act before or after the City as far  
2 as I'm concerned.

3 MR. PARKIN: We could.

4 ACTING CHAIRPERSON McCAUSLAND: We've already  
5 seriously considered having a meeting on the 11th if we  
6 couldn't come to resolution of these things today. It  
7 sounds to me, well, let me find out. It sounds to me like  
8 you're describing a number of technical difficulties in  
9 the documents that you would like clarified before you  
10 make a firm recommendation to the Commission for adoption.  
11 Is it your belief that those are technical clarifications  
12 or is there truly a substantive problem here that leads  
13 you to believe that you're going to have serious problems  
14 with this? Because I'm inclined to believe that all  
15 parties have entered into an agreement and it doesn't  
16 look like a bad agreement to me if we could iron out the  
17 details. Do you see it as a detail problem or as a  
18 substantive problem?

19 EXECUTIVE OFFICER NORTHROP: As far as we know,  
20 Mr. Chairman, it is a detail problem unless there are  
21 side letters or agreements that we're not aware of. That  
22 becomes substantive. So I think, to answer your question,  
23 basically it's technical problems that we're trying to  
24 iron out at the present time.

25 ACTING CHAIRPERSON McCAUSLAND: Is there anyone  
here -- I think we have quite a few people who came on this

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1 -- is there anyone today who would like to discuss this  
2 proposal with us and also to make sure you understand  
3 what it is that the staff is looking for clarification on?

4 MR. THOMPSON: One issue you might point to is  
5 I know they're referring to using this oil to burn under  
6 boilers for steaming. I think the DOE has had a hearing  
7 on this and I think they have cleared the nonrefining  
8 use of crude oil in this particular case.

9 ACTING CHAIRPERSON McCAUSLAND: You think they  
10 have cleared it?

11 MR. THOMPSON: I think they have, but I'm not  
12 sure.

13 ACTING CHAIRPERSON McCAUSLAND: That's something  
14 that requires a little research.

15 MR. THOMPSON: Yes.

16 MR. PENDERGRAFT: My name is Jeff Pendergraft.  
17 I'm an attorney for Atlantic Richfield Company.

18 I had come here today with the idea of making  
19 a formal presentation addressed to the substantive issues  
20 of approval. It occurs to me that if, in fact, all we're  
21 dealing with is some technical problems that the staff  
22 needs additional information on, that we'd certainly be  
23 willing to cooperate and provide that information in  
24 contemplation of making a formal presentation at the next  
25 hearing. If that's what we're directed, I'll defer any  
formal comments at this time. I'm pleased to answer any

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1 questions you might have.

2 ACTING CHAIRPERSON McCAUSLAND: If you are able  
3 to come back, your formal presentation would be most  
4 beneficial at that time.

5 MR. PENDERGRAFT: Right.

6 ACTING CHAIRPERSON McCAUSLAND: Perhaps there  
7 are some questions that we should deal with today.

8 MR. PENDERGRAFT: Let me go on to talk about  
9 just for a minute this October 15th deadline. We have an  
10 October 15th deadline in both the assignment between  
11 Atlantic Richfield and Chevron and in the assignment  
12 between Atlantic Richfield and Century Resources Develop-  
13 ment, and then by reference in the subsequent assignments.  
14 The agreement would not become effective in any event  
15 until November 1st because they become effective on the 1st  
16 of the month following approval. I don't know when the  
17 Commission scheduled their next meeting, but really what  
18 we'd like to do -- there's a long history of this and  
19 it's been going on for almost a year or two years -- what  
20 we'd like to do is point towards some resolution. We're  
21 really looking forward to an effective date of November 1.  
22 Speaking for Atlantic Richfield, if the Commission  
23 is not going to meet before October 15th, but October 19th  
24 or 20th or something like that instead, I don't think that  
25 that would be a problem in changing the date and the  
contract. It's a matter of paper work we'd rather avoid

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1 if we could. I don't know when your next meeting is  
2 scheduled.

3 ACTING CHAIRPERSON McCAUSLAND: Well, let me  
4 make a proposal to you. Sometimes it's best for us to  
5 all work under pressure. Let us assume that we will meet  
6 on October 11th and that the City of Long Beach will meet  
7 on October the 10th. Barring serious problems, you will  
8 be able to close your package on October the 15th.

9 MR. PENDERGRAFT: That sounds entirely satisfac-  
10 tory to me, and we'll be in here on the 11th to provide  
11 a formal presentation and answer any questions you have  
12 and work with the staff in the meantime on any information  
13 they may need.

14 ACTING CHAIRPERSON McCAUSLAND: Is that agreeable  
15 to everyone?

16 One of the things we do have on the record,  
17 and let me make certain that I heard it correctly. If  
18 we do find that we have some serious problems and the 15th  
19 slips away, you're still very interested in the November 1st  
20 date, but your feet have not been set in concrete on the  
21 October 15th date?

22 MR. PENDERGRAFT: Well, a couple of things. I'm  
23 speaking only for Atlantic Richfield. Our feet are set  
24 in concrete because we've entered into these agreements  
25 with various parties and those parties have entered into  
agreements with others, all keyed to this October 15th date.

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1 So it requires everybody agreeing to extend it. All I'm  
2 saying is I don't think Atlantic Richfield Company would  
3 have any problem in extending it so long as we're still  
4 working toward a November 1 effective date. So that means  
5 extending it for no more than 15 days. But there is a lot  
6 of difficulty just in terms of paper work, amending all  
7 these documents.

8 ACTING CHAIRPERSON McCAUSLAND: Knowing how  
9 much paper work we can generate, I have some small hint  
10 of how much paper work you can generate. So let me try  
11 and stick with the October 15th date.

12 MR. PENDERGRAFT: Thank you.

13 ACTING CHAIRPERSON McCAUSLAND: Does anyone else  
14 wish to address this item at this time?

15 MR. WATSON: Yes, sir. My name is Bill Watson.  
16 I'm an attorney representing Petro-Lewis Corporation.

17 First, we were here today hoping we could answer  
18 any questions about the suitable economic stature of  
19 Petro-Lewis and its affiliates who take part in this  
20 transaction. Looking to a delay, I assume that the  
21 Commission is not necessarily interested in hearing that  
22 whole presentation today.

23 ACTING CHAIRPERSON McCAUSLAND: I'm not certain.  
24 I'd like staff to address that. This may be a perfect  
25 opportunity for you and staff to enter into a dialogue that

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1 will get on the record some of the questions that we  
2 were seeking answers for.

3 MR. WATSON: If I could defer, I'm not the  
4 appropriate witness for that, but we do have a Vice-  
5 President of the corporation present who would be capable  
6 to supplement the reported financial data that's been  
7 submitted to the Commission and the staff.

8 One thing I wanted to mention that did not come  
9 up in the summary and I think is relatively important to  
10 the factors we're representing to adequately protect the  
11 State is that although P.P.Co. would be the title holder  
12 or, I've been told by the staff several times that title  
13 may not be the right word. They would be the contracting  
14 party. There has been what I would characterize as an  
15 unlimited guarantee by Petro-Lewis Corporation of the  
16 obligations of P.P.Co. delivered together with the other  
17 documents for approval. So that I hope that your staff  
18 and legal advisors will tell you that it is the credit of  
19 Petro-Lewis Corporation that is to be considered rather  
20 than the relatively insubstantial credit of P.P.Co.

21 We are geared to go forward in whatever timetable  
22 is appropriate to hopefully obtain approval. I'm a little  
23 concerned about relying on representations that it appears  
24 that the timing problems can be worked out. We've had,  
25 I think, some substantial difficulties keeping this deal

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1 together and I've been very concerned that we will lose  
2 the entire transaction by missing the October 15th date.  
3 If you'll excuse me for being paranoid, I'm not convinced  
4 that the deal will stay together until we have that  
5 amendment in writing if we cannot make the October 15th  
6 date.

7 One point I also would suggest that we need  
8 some clarification from -- I hope it's not too important --  
9 is the request that we give assurances that we have no  
10 other transactions with Century group. In one sense that  
11 is not true. Petro-Lewis is constantly engaged in the  
12 process of acquiring oil and gas properties and related  
13 properties and we are in fact discussing other acquisitions  
14 with Century in considering other deals. So we cannot  
15 give a cosmic representation because there are other things  
16 pending. I think we can make a response that there's  
17 nothing that we see as relevant to this transaction that  
18 has not been presented to the staff. We are talking about  
19 other properties in California. If they have anything  
20 else for sale in California or elsewhere, we will be talking  
21 to them if they make it known to us because we are in the  
22 business of buying properties. But I believe that it would  
23 be accurate and fair for us to say that everything that's  
24 relevant to this particular transaction, to the extent we  
25 know anyway, has been either submitted to the staff or is

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1 here today to hand to them.

2 ACTING CHAIRPERSON McCAUSLAND: Ms. Smith.

3 MS. SMITH: Perhaps the staff should clarify  
4 exactly what information they're seeking.

5 EXECUTIVE OFFICER NORTHROP: Thank you. Ms.  
6 Smith, Chairman, if there wasn't any, we wouldn't ask  
7 the question. But the problem is, I want to make sure  
8 that on this agreement here, and that's all I'm speaking  
9 to, staff wants to be sure there is not some side letter  
10 agreements which we have not seen or have not been made  
11 available to us. If both Century and Petro-Lewis say  
12 that this deal stands on its own and there is no quid pro  
13 quo, I think the lawyers say, in other deals for this  
14 deal, then we would be satisfied. But we want to make  
15 sure because it affects our eventual pricing on the entire  
16 Long Beach Unit. Any agreement that comes between the two  
17 of them, any additional moneys, affects the price that we  
18 see for our crude oil on the entire Long Beach Unit. So  
19 if there are additional moneys, we would like to know that  
20 because it not only affects this, but it has a direct  
21 bearing on everything that is produced in that Unit because  
22 of the contracts, the other contracts we have with the  
23 other producer.

24 Secondly, I would like to address the fact that  
25 Friday afternoon at 3:06 p.m. I received in the Long Beach

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1 office two and a half to three inches of documents that  
2 we have worked on Friday and most of the weekend and  
3 Monday. In addition, we still do not have documents that  
4 we feel are important. So I think we have been working  
5 under a time constraint that has really not been fair for  
6 me. I've pressed the staff and they have responded very  
7 well, but to attempt to put together something on paper,  
8 diagrams that complicated, I just don't think it's fair  
9 to ask us -- for me to ask the staff to come up today with  
10 a recommendation. I think the 11th which you have  
11 discussed previously is perhaps a timely date and it makes  
12 us work very hard to get that together in that length of  
13 time.

14 ACTING CHAIRPERSON McCAUSLAND: What would you  
15 like to get on the record today?

16 EXECUTIVE OFFICER NORTHROP: There's several  
17 things, the admission -- the reference to the financial  
18 capabilities of Century that was just made. So I don't have  
19 to draw that inference. It's already been drawn.

20 MR. WATSON: Excuse me. I don't believe I said  
21 anything about Century, sir.

22 EXECUTIVE OFFICER NORTHROP: I beg your pardon.

23 I think it would be important that we might  
24 consider some sort of a -- we might like some kind of  
25 assurance that if, for whatever reason, the State's money

1 was not paid very, very promptly, we would consider that  
2 a default and proceed on default in that area. Is there  
3 anything else you'd like to add on that, Alan, questions  
4 that you'd like to raise?

5 MR. HAGER: On that point, that particular point,  
6 no, but on a few other things.

7 ACTING CHAIRPERSON McCAUSLAND: Let me stay with  
8 that point for a minute and then we'll go on with Mr.  
9 Hager's line of thought.

10 What do you mean by very, very promptly? Default  
11 is a fairly serious course to pursue, and very, very  
12 promptly is a little bit of an ambiguous way to move into  
13 it.

14 EXECUTIVE OFFICER NORTHROP: I think really what  
15 I was trying to imply was I would like to see the cure  
16 for a default be the revocation of a contract, for the  
17 State to take the oil back itself. From that point of  
18 view, if the payment is not made promptly because we have  
19 a 50-day float period, we're more than -- we're in a bill  
20 on the 10th day, pay on the 20th. So we're on a 50-day  
21 float as it is now. Once that float gets out of hand  
22 and it exceeds, our indications now, it exceeds anything  
23 that Century has put up or whoever is putting the money up.

24 ACTING CHAIRPERSON McCAUSLAND: So you're saying  
25 the amount of the float exceeds the total --

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1 EXECUTIVE OFFICER NORTHROP: The one million  
2 invested, correct.

3 MR. THOMPSON: The one thing I'd like to clear  
4 up also is the question that CRD has a right to come back  
5 in and cure a default of this other program. We're not  
6 too sure that that is a -- might not be an impediment  
7 rather than a help. We'd like to get that whole point  
8 clarified so we don't have another party coming in to cure  
9 the default and that might interrupt our ability to be  
10 the first in line.

11 MS. SMITH: That was my basic question, is  
12 whether or not the Applicant had proposed a means of  
13 curing the defaults. I'd like for you to explain exactly  
14 how they would propose to do that. Perhaps the attorney  
15 can address that issue and satisfy us that the party who  
16 would --

17 MR. WATSON: We have not proposed any changes  
18 in the existing contract for the handling of this field.  
19 We hope that we have presented evidence. Unfortunately,  
20 I'm not sufficiently versed in accounting to quote figures.  
21 I believe the annual reports that have been submitted and  
22 I think I would ask perhaps we defer to Mr. Blancett to  
23 describe the economic stability of Petro-Lewis Corporation.  
24 Although these are substantial payments, they are not  
25 unusual for the company. I believe the company has a good

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1 credit rating. I've never asked for a formal report on it.  
2 The discussion, although I recognize the State's concern,  
3 it seems rather strange to be approaching this with the  
4 question of how we cure a default. The procedure exists  
5 in the contract for dealing with the defaults by any  
6 contracting party, be it Petro-Lewis or Arco. We think  
7 we've submitted sufficient data to show that the company  
8 has the financial stability and magnitude to deal with  
9 the amount of payments that are involved. We are unaware  
10 of any outstanding allegations that the company doesn't  
11 pay its bills on time.

12 ACTING CHAIRPERSON McCAUSLAND: Go ahead.

13 MS. SMITH: What does the contract term provide  
14 for curing of defaults or the action that we can take in  
15 the event of default?

16 MR. HAGER: There is a period, and I'm trying  
17 to think exactly. It's like 20 days or 30 days in which  
18 the contractor has a right to cure a default.

19 MS. SMITH: Have the Applicants suggested  
20 amending that provision?

21 MR. HAGER: No.

22 EXECUTIVE OFFICER NORTHROP: Staff has been  
23 working under the impression that perhaps we'll be  
24 replacing Arco and the substantial bidders with a company  
25 not generally considered a major oil company, and I have



1 no belief one way or another for major oil companies for  
2 this discussion. But the financial substance of an Arco  
3 and a Chevron, that's who you're replacing, with someone  
4 of Century or Petro-Lewis may well be something that staff  
5 may in conversations with them in the very near future  
6 want to make a change in that part of the contract or at  
7 least suggest to the Commission that perhaps it would be  
8 well to consider making a change in that portion of the  
9 contract for Petro-Lewis or Century, whomever winds up  
10 as responsible from that area. That was what prompted  
11 the question.

12 ACTING CHAIRPERSON McCAUSLAND: First of all,  
13 let me say that I thought you carried water for the  
14 independent segment of the industry on most occasions and  
15 so your statements today are enlightening.

16 EXECUTIVE OFFICER NORTHROP: I qualified it  
17 with a caveat.

18 ACTING CHAIRPERSON McCAUSLAND: It sounds to me  
19 like there may be another agenda here that is of interest  
20 to the Commission. That is that if you do have an opportunity  
21 to change the default provisions of this contract or any  
22 contract, you're interested in doing so because I think  
23 I hear you saying the State might want to be in a position  
24 of taking back virtually all of its oil if the opportunity  
25 presented itself. You don't want too many outs in the

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1 default provisions of the contract because rather than  
2 have third, fourth or fifth and sixth parties step in  
3 to save a contract, you think maybe the State would be  
4 better reclaiming the oil itself.

5 EXECUTIVE OFFICER NORTHROP: That is an alterna-  
6 tive I think we should present to the Commission, yes.

7 ACTING CHAIRPERSON McCAUSLAND: So that it's  
8 not necessarily relevant to just say that a relationship  
9 between Century and Petro-Lewis is the issue here. The  
10 fundamental issue is what rights does the State want to  
11 retain under any default circumstances.

12 EXECUTIVE OFFICER NORTHROP: Right.

13 MR. WATSON: Sir, may I point out that the  
14 provision that they're referring to in our agreement with  
15 Century does not have any provision for Century becoming  
16 a party to the contract. We negotiated that originally  
17 at some length and Century insisted upon it to protect  
18 their position and be able to purchase the oil. The only  
19 relationship that this proceeding would create between  
20 Century and the State would be that the money would come  
21 from Century. I understand the staff's concern, and perhaps  
22 if it is a goal of the State to restructure these contracts  
23 so that the deal can be more easily broken, this is a  
24 possibility. But the only thing that Century has insisted  
25 upon is that if we are not paying bills which, again, is an

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1 event I don't really like to discuss because nobody suggested why we  
2 shouldn't or that we aren't capable of it, but they insisted to protect  
3 themselves that if for some reason green dollars are not  
4 flowing appropriately from Petro-Lewis to the State,  
5 Century could step in and put its own dollars forward.  
6 There is no requirement in that that the State recognize  
7 any different owners or that the State set forward any  
8 different standards for default than already exist. So  
9 it seems to me this is not a complication any more than  
10 if someone else decided to step forward and pay all Petro-  
11 Lewis' bills as a gift.

12 ACTING CHAIRPERSON McCAUSLAND: Does the staff  
13 want any guidance from the Commission in this matter or  
14 shall we move on?

15 MR. THOMPSON: I think we're discussing this  
16 Item 3 that's a point on this.

17 One other point that we might want to bring up  
18 is the question that the Petro-Lewis Fund now will be  
19 committing money to in effect purchase this interest. I  
20 believe we, Mr. Alan Hager and I, discussed this before,  
21 was the fact that in our interpretation now you would not  
22 have a mineral interest in these properties. Therefore,  
23 if you're going to pledge money against them, it would be  
24 our interpretation -- I think the lawyer could perhaps  
25 speak to this -- that you do not have a mineral interest,

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1 you have a producing right, but not a mineral interest.

2 MR. WATSON: I have been corrected several times  
3 for speaking to transactions in terms of more common to  
4 the standard lease. I apologize for using the wrong words  
5 if I have on occasion. We are buying whatever that  
6 contract creates, and whatever it should be called we will  
7 buy it by that name.

8 ACTING CHAIRPERSON McCAUSLAND: Let us make  
9 certain that we understand what it is that you're buying  
10 before we all sign the documents because I would prefer to  
11 have us come to that sense of mutuality here rather than  
12 in a courtroom.

13 MR. WATSON: Yes, sir.

14 ACTING CHAIRPERSON McCAUSLAND: Do you understand  
15 what it is that we're selling?

16 MR. WATSON: Yes, sir.

17 ACTING CHAIRPERSON McCAUSLAND: And we understand  
18 what it is you're buying.

19 MR. WATSON: We're not buying anything from the  
20 State, sir. We're buying an interest indirectly from Arco  
21 and Chevron. We have described it in all of our conveyance  
22 documents by reference to the document which creates the  
23 original rights. I think that Mr. Thompson has been very  
24 helpful in making us, perhaps beating us over the head  
25 from time to time to make sure that we understand.

1           ACTING CHAIRPERSON McCAUSLAND: We call him  
2       Moose around here.

3           (Laughter.)

4           MR. WATSON: It has been made clear to us that  
5       this is not a standard oil and gas lease. As I said, I  
6       have mental lapses and may have from time to time referred  
7       to it in terms that are more appropriate for a standard oil and  
8       gas lease. We are relying entirely upon the documents we  
9       have submitted in writing, all of which are references to  
10      the original contract.

11           If I might, before I suggest that if you're  
12      interested Mr. Blancett might be an appropriate witness,  
13      I would like to go back and perhaps put in my own testimony  
14      on the question of     arrangements or other transactions.  
15      I would speak only from what I have reviewed because I am  
16      not an officer of the company, but I have not reviewed any  
17      documents or seen any evidence of any other documents other  
18      than those that have been submitted to the staff and made  
19      known to the staff. Apparently the staff has not seen the  
20      main purchase agreement between Petro-Lewis and Century.  
21      But with that caveat, as far as I understand it, I have not  
22      reviewed or been involved in the preparation of any  
23      document that involves consideration relating to this  
24      transaction. I have not been involved in the preparation  
25      or review of any document that has any other pricing

1 provisions for oil to be produced or sold in relation  
2 to these properties, nor have I been involved in preparing  
3 or reviewing any documents which is contingent upon the  
4 approval of this transaction other than those that have  
5 been submitted to staff.

6 Finally, Petro-Lewis Corporation is not one of  
7 the seven sisters, but it is a nationally listed company,  
8 full reporting to the SEC and I believe is recognized in  
9 the country as one of the largest independent producers.

10 ACTING CHAIRPERSON McCAUSLAND: Yes, sir. Would  
11 it be appropriate for Mr. Blancett to --

12 MR. THOMPSON: I think it would be well because,  
13 of course, we have people from the City of Long Beach here  
14 and they're hearing on this the same way as we are on the  
15 first time and they'll have to consider the same thing  
16 before the next council meeting.

17 ACTING CHAIRPERSON McCAUSLAND: Well, let me ask  
18 if the representative from the City would care to join us  
19 here at the table and participate in clarifying any  
20 questions you may have in your mind, if that's all right  
21 with you, sir.

22 MR. THOMPSON: This is John Parkin with the  
23 Department of Oil Properties, City of Long Beach.

24 MR. BLANCETT: My name is Ken Blancett. I'm a  
25 Senior Vice-President of Property Acquisition at Petro-Lewis.

1           ACTING CHAIRPERSON McCAUSLAND: Would you like  
2 to make any opening comments on the basis of the discussion  
3 you've heard thus far?

4           MR. BLANCETT: Yes, something about Petro-Lewis.  
5 Petro-Lewis is an independent company that was formed ten  
6 years ago. We have grown from nothing to about 15,000  
7 barrels a day production to this point. Our main method  
8 of growth is through our oil income program which we sell  
9 to the public and have raised money to buy producing  
10 properties which have very little risk. By the same token,  
11 relatively low, stable rate of return on the order of  
12 ten or twelve percent. This is a method that Petro-Lewis  
13 has grown and has offered the service both to the public  
14 and to companies that wish to sell property. The way that  
15 we buy property is to have the engineering work done by  
16 a third party consultant so that we know what we're getting.  
17 Then we finance the acquisition with about 40 percent bank  
18 loans so that it gives a better rate of return to our  
19 investor. So far these programs have been very successful  
20 and have made money for our countless investors that number  
21 over 10,000.

22           We plan to put this property into three programs  
23 which are 78-1, 2 and 3, which have a total value of  
24 approximately \$45 million. This would be a minor part of  
25 the property that is in those programs.

1           ACTING CHAIRPERSON McCAUSLAND: Would you spend  
2 just a moment describing the programs for us in a little  
3 bit more detail. Are these closed partnerships?

4           MR. BLANCETT: We form a partnership each month  
5 and it's registered in all 50 states, sold in California.  
6 The amount of money varies that's raised from each  
7 partnership, varies from month to month, but it's approxi-  
8 mately eight to twelve million dollars, eight to twelve  
9 million dollars a month. Using this money, we leverage  
10 it with 40 percent, say, so that we can buy maybe \$20 million  
11 worth of property per month. This property being just over  
12 a million dollars will constitute a small percentage of  
13 what goes into the partnership to determine what the income  
14 is from those partnerships. We like to do several  
15 acquisitions, put several acquisitions into each partner-  
16 ship so that we have a diversity. It protects our  
17 investors so that if one property for some reason falls  
18 on its face, the others can pick up the slack. Historically,  
19 it has proven to be a sound method of investing for the  
20 public.

21           ACTING CHAIRPERSON McCAUSLAND: They buy a  
22 general partnership interest?

23           MR. BLANCETT: Yes. They buy general partnership  
24 interest and then that interest is allocated to each  
25 investor and he is paid each quarter with the proceeds from



1 the income from the properties, limited partnership interest.

2 ACTING CHAIRPERSON McCAUSLAND: It's not a  
3 general partnership?

4 MR. BLANCETT: No. Petro-Lewis is a general  
5 partner and then the investor is a limited partner.

6 ACTING CHAIRPERSON McCAUSLAND: Thank you. I  
7 appreciate that.

8 MR. BLANCETT: I might say one other thing to  
9 give you an idea of the financial background of Petro-  
10 Lewis. Our lead bank is the Security Pacific in Los  
11 Angeles. Our other banks are over the country, including  
12 the Bank of Montreal and the Continental in Illinois which at the  
13 present time, with our 15,000 barrels per day or so  
14 production, we are in the range, Petro-Lewis and its  
15 associates, over a hundred million dollar company. Last  
16 year our oil income program raised and purchased about  
17 a hundred and thirty million dollars' worth of property.  
18 That gives you the size of our activities.

19 We do have currently approximately 1,500 barrels  
20 per day production in California from the Sacramento Valley  
21 down to Redondo Beach.

22 ACTING CHAIRPERSON McCAUSLAND: Are you the  
23 operator?

24 MR. BLANCETT: Yes.

25 ACTING CHAIRPERSON McCAUSLAND: Would you be

1 willing to give us a general overview of the question  
2 raised by Mr. Northrop concerning other arrangements  
3 between Petro-Lewis and Century Resources?

4 MR. BLANCETT: Yes. I'm an officer of Petro-  
5 Lewis, and it is my responsibility to buy producing  
6 properties and to sign the deals that we have with various  
7 companies. I can say that we have no side letters of  
8 any kind with Century pertaining to this property that  
9 we haven't given the Commission.

10 ACTING CHAIRPERSON McCAUSLAND: Questions?

11 MS. SMITH: I understood the question to be  
12 whether or not you had any side letters with any parties.

13 MR. BLANCETT: We have no side letters with  
14 any parties.

15 ACTING CHAIRPERSON McCAUSLAND: Do you want to  
16 narrow that down to any parties --

17 MR. BLANCETT: Any parties in relation to  
18 our acquisition of this Tract 1 and 2.

19 ACTING CHAIRPERSON McCAUSLAND: Okay.

20 MR. THOMPSON: Also, as far as any partners that  
21 would pick up and take crude oil underneath the purchase  
22 agreement.

23 MR. BLANCETT: We have no side letters with  
24 anybody.

25 MR. THOMPSON: Did I characterize the handling of

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1 the organization properly in the fact that the funds going  
2 to Petro-Lewis Funds and then they're going into this  
3 other properties and then --

4 MR. BLANCETT: Say that again.

5 MR. THOMPSON: Just right now that the funds  
6 that you get every month go into this Petro-Lewis Fund,  
7 Incorporated. They buy the properties and actually are  
8 putting up the moneys to purchase these two properties  
9 you're talking about?

10 MR. BLANCETT: That's correct.

11 MR. THOMPSON: Then that goes into Petro-Lewis  
12 Producing Company, Roman Numeral Number I?

13 MR. BLANCETT: No. This will go into these  
14 three partnerships that I mentioned, 78-1, 78-2 and 78-3.  
15 Those are different partnerships than Petro-Lewis Producing  
16 Company I. To give you people more background, Petro-Lewis  
17 Producing Company I is a more or less unionization of the  
18 first 65 partnerships that Petro-Lewis formed into one  
19 super partnership. It covers property all over the country.  
20 These partnerships that this Long Beach property will go  
21 into is not that. It's the three new partnerships that  
22 has a total value of about 45 million.

23 MR. THOMPSON: Now, this Partnership Properties  
24 Company again is the nominee to hold title for these three  
25 partnerships?

1 MR. BLANCETT: That's right.

2 MR. THOMPSON: Again, this Producing Properties  
3 Company is a group of the officers of Petro-Lewis,  
4 Incorporated?

5 MR. WATSON: Yes, sir. The three general  
6 partners of Partnership Properties Co. are Jerome A. Lewis,  
7 the President of Petro-Lewis, David A. Frawley who is  
8 the Executive Vice-President, and Dwight Moorhead who is  
9 an Executive Vice-President. Unfortunately, I must assume  
10 from my law firm some of the responsibility for the  
11 complexity of this situation. This general partnership  
12 was formed to hold title on our advice that it was the  
13 easiest vehicle for dealing with the kind of multiple  
14 ownership that the spread of exposure and risk that we  
15 recommended for the formation of these partnerships. I  
16 don't know what the California situation is, but in many  
17 states it is a difficult mechanical problem to show title  
18 in that many parties, and particularly if they're limited  
19 partnerships. The Partnership Properties Co. exists for  
20 the sole purpose of holding title for the benefit of these  
21 partnerships and some other minor affiliates of the  
22 corporation.

23 MR. THOMPSON: Does this also then bridge you  
24 back to Petro-Lewis Corporation itself then? Are these  
25 three partnerships on their own then?

1           MR. WATSON: Each of these partnerships is an  
2 independent entity formed under the Uniform Partnership  
3 Law of the State of Colorado and appropriately filed with  
4 whatever file is necessary to do business in California  
5 or any other state where they hold property. The way that  
6 we get back to Petro-Lewis Corporation is by two separate  
7 routes. The one that I think is most relevant to the  
8 matter we're considering is the Petro-Lewis Corporation  
9 has delivered its guarantee of all obligations to  
10 Partnership Properties Co. It has I think promised to  
11 the State that if anything goes wrong, the credit of  
12 Petro-Lewis Corporation is available to back up the  
13 obligations of P.P.Co.

14           If you wish to trace the economic benefits of  
15 the transaction and you have P.P.Co. as what we would call  
16 a bare nominee, serves no purpose other than appearing in  
17 whatever records exist to show who owns it and who would  
18 sign conveyances, it holds entirely for the economic  
19 benefit of the three partnerships that have been identified.  
20 Each of those partnerships is a separate entity. Petro-  
21 Lewis Funds, Inc. as general partners of those partnerships  
22 shares in whatever economic benefit those partnerships  
23 create. As a subsidiary of Petro-Lewis Corporation with  
24 the economic benefits to Petro-Lewis Funds, Inc. are  
25 channeled back as economic benefits to Petro-Lewis

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1 Corporation and, of course, ultimately to its shareholders.  
2 So that there are those two different ways to get back  
3 to Petro-Lewis Corporation from P.P.Co.

4 I hope, as I said before, that you'll be  
5 satisfied that the guarantee we've delivered as a single  
6 step transaction will be sufficient for your purposes.

7 ACTING CHAIRPERSON McCAUSLAND: Are there further  
8 questions?

9 MR. BLANCETT: Mr. Chairman, I'd like to make  
10 a correction on these partnerships. It looks like they  
11 are in 77-10, 11 and 12, the last three partnerships of  
12 1977. They're equally divided in a third in each one of  
13 those partnerships.

14 ACTING CHAIRPERSON McCAUSLAND: Is that a  
15 calendar year?

16 MR. BLANCETT: Yes, calendar year, 1977.

17 ACTING CHAIRPERSON McCAUSLAND: So you essentially  
18 have some assets acquired from limited partners in '77  
19 that you have yet to actively --

20 MR. BLANCETT: In other words, we'd like to fill  
21 up the earlier partnerships first. The reason being that  
22 we don't like to keep uninvested funds.

23 MR. WATSON: There is another reason, and I'm  
24 not sure -- these partnerships are offered to the public  
25 on what's called a blind pool. The way we present them to

1 the public, we can only use the money that they subscribe  
2 to acquire properties that are purchased by the corporation  
3 after the funds arrive. Petro-Lewis has on occasion for  
4 substantial purchases modified this to identify properties  
5 as being an inventory. But at the current time, the  
6 standard offering to the public and modifications in  
7 compliance with the SEC laws in notifying the public what  
8 it is that is an inventory when the partnerships are going  
9 to be available. But as we present these to the public  
10 and the way that we have operated in the past, it would  
11 not be appropriate for us to put any of this acquisition  
12 into a partnership form after we have reached the stage  
13 when we thought the acquisition was going forward.

14 ACTING CHAIRMAN McCAUSLAND: I understand that.  
15 This may be a question beyond the scope of what's  
16 reasonable for us to ask for and you don't have to answer  
17 it. If you are in the process now of placing a million  
18 dollars over three partnerships from calendar year 1977  
19 and you're taking in what you described earlier as eight  
20 to twelve million dollars a month, are you currently  
21 managing a fairly large fund of short-term investments  
22 or have you found producing properties for the bulk of  
23 your 1978 partnership contributions?

24 MR. BLANCETT: Both. We are actively and have  
25 signed contracts for substantial property purchases like

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1 this. We've been working on this since last April. It  
2 takes a long time to close. We have just closed a \$50  
3 million acquisition that we were on almost a year. But  
4 the funds were tied up for that long and like the effective  
5 date on this will be April, but the closing will be  
6 hopefully November. This is a relatively small acquisition.  
7 We've got uninvested funds that we keep in short-term  
8 paper to make our investors as much money as possible  
9 during that time.

10 ACTING CHAIRPERSON McCAUSLAND: Is your short-  
11 term paper outperforming your producing properties this  
12 year?

13 MR. BLANCETT: No, it sure isn't, not even at  
14 the high interest rate. Our average is about 12 percent  
15 for our investor over the life of the properties. But that  
16 is over the life of the properties, not on one year to the  
17 other.

18 ACTING CHAIRPERSON McCAUSLAND: All right. Any  
19 questions?

20 EXECUTIVE OFFICER NORTHROP: I have a couple.

21 ACTING CHAIRPERSON McCAUSLAND: Mr. Northrop.

22 EXECUTIVE OFFICER NORTHROP: I have a couple, and  
23 it's just for the Chairman. We've already exceeded my knowledge of the  
24 economic world --

25 ACTING CHAIRPERSON McCAUSLAND: I don't answer



1 questions.

2 EXECUTIVE OFFICER NORTHROP: -- but I would like  
3 to just for my own edification get a couple of questions  
4 answered.

5 You talked about leverage, and in my mind  
6 leverage means on the other side of a fulcrum there is a  
7 chance you won't be able to move it and it will break the  
8 stick.

9 ACTING CHAIRPERSON McCAUSLAND: That's why you're  
10 working for the State Lands Commission now instead of  
11 Petro-Lewis.

12 (Laughter.)

13 EXECUTIVE OFFICER NORTHROP: That's right. I  
14 don't understand leverage and how you work that.

15 Does that mean in this leverage you're pledging  
16 the State owned reserves on other notes?

17 MR. WATSON: We have not fully, I don't think,  
18 been told by the bank how to react to this. If you will  
19 look at the underlying contractor's agreement, you'll see  
20 a provision that the City or State, depending on which  
21 one can pull the cord in the event of bankruptcy. The  
22 primary value that a bank places on collateral is how it  
23 looks after the borrower has gone bankrupt. I believe the  
24 situation we'll face is that the bank will refuse to  
25 accept these properties as collateral for anything. I

1 think Mr. Blancett's comments on leveraging was to explain  
2 the difference between the buying power of the program  
3 and its initial subscriptions, and he was speaking of the  
4 programs as a total. I don't think that Petro-Lewis would  
5 wish to say that it wouldn't try to get a loan against  
6 these properties if it could, but at the current time it  
7 looks like it may be unavailable because the collateral  
8 looks very fragile.

9       ACTING CHAIRPERSON McCAUSLAND: This is a fairly  
10 small asset in terms of your overall --

11       MR. BLANCETT: Yes. In the total program of  
12 those three programs, the 45 million just wouldn't have  
13 much affect on what the collateral value is it may have.

14       ACTING CHAIRPERSON McCAUSLAND: Want to pursue  
15 that?

16       EXECUTIVE OFFICER NORTHROP: Yes, I would.  
17 Because it's one of our babies, I don't like to see it  
18 belittled. When you look at the amount of money that  
19 they're paying --

20       ACTING CHAIRPERSON McCAUSLAND: I wouldn't  
21 leverage anything off of it either.

22       EXECUTIVE OFFICER NORTHROP: When you consider  
23 what Petro-Lewis is paying for these properties for the  
24 small percentage of the properties they're getting, when  
25 you take a look at that in ratio to the percentage and give

1 it present worth -- again, I'm a country boy and I don't  
2 understand all these economic things --

3 ACTING CHAIRPERSON McCAUSLAND: Good words,  
4 you're doing fine.

5 EXECUTIVE OFFICER NORTHROP: You see that we  
6 have got numbers, very high hundreds of million dollar  
7 numbers is the value. So I just don't take kindly to  
8 them belittling our property and, in fact, I think they  
9 have a significant piece of property with a fantastic  
10 amount of leverage available if they are able to pledge it.  
11 This is the question we should know going in, that we may  
12 well be buying an encumbrance on our own properties if  
13 we haven't got this cleared up. That was why my naive  
14 question --

15 ACTING CHAIRPERSON McCAUSLAND: Let me ask a  
16 question regarding that. I recall when Arco was being  
17 written up in Fortune and Business Week for the tremendous  
18 amount of extension involved in the construction of the  
19 Alaskan Pipe Line. While they were spread that thin, I  
20 don't believe we were asking them if our leases in  
21 California were pledged against the encumbrances associated  
22 with the Alaskan Pipe Line. But I understand the issue  
23 you're raising and I think all business corporations that  
24 we deal with will leverage everything they have an opportunity  
25 to leverage if the interest rates allow it. The situation

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1 here, I assume, is that you're looking at the overall  
2 financial structure of the organizations you're dealing  
3 with and expressing a little more concern. Go ahead and  
4 proceed.

5 EXECUTIVE OFFICER NORTHROP: No, I think your  
6 point's a good one and I think you're where I am. You're  
7 well to point out the apparent inconsistencies in the  
8 argument, but the argument is something that they came in  
9 on the beginning of the development of the field and they  
10 were in place. We have a chance now of someone else coming  
11 in. I think it behooves staff to at least ask these  
12 questions.

13 ACTING CHAIRPERSON McCAUSLAND: So the question  
14 is: Will this property be pledged as collateral against  
15 loans, and the answer is if they get a chance, they will.

16 EXECUTIVE OFFICER NORTHROP: Okay. That's a  
17 good answer. That concludes my questioning unless staff  
18 has questions.

19 ACTING CHAIRPERSON McCAUSLAND: Do you have any  
20 more comments you'd like to offer for the record?

21 MR. BLANCETT: I don't think so, Mr. Chairman.

22 ACTING CHAIRPERSON McCAUSLAND: This has been  
23 an enlightening discussion for me.

24 MR. BLANCETT: Thank you very much.

25 ACTING CHAIRPERSON McCAUSLAND: Anyone else wish

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2 financial structure of the organizations you're dealing  
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23 an enlightening discussion for me.

24 MR. BLANCETT: Thank you very much.

25 ACTING CHAIRPERSON McCAUSLAND: Anyone else wish

1 to offer any comments, observations, testimony on Calendar  
2 Item 31?

3 MS. KNIGHT: Good morning. I'm Nancy Knight.  
4 I represent Century Resources Development. This is Mr.  
5 Morris Hodges.

6 ACTING CHAIRPERSON McCAUSLAND: Would you be  
7 willing to tell us where you graduated from law school?

8 MS. KNIGHT: UCLA.

9 (Laughter.)

10 MS. KNIGHT: Am I surrounded by USC?

11 ACTING CHAIRPERSON McCAUSLAND: The Lieutenant  
12 Governor's Legal Counsel thought he recognized you.

13 MS. KNIGHT: Mr. Hodges is here and would be  
14 happy to answer any questions that the Commission Members  
15 may have.

16 MR. HODGES: Mr. Chairman, I'm here to answer  
17 any questions that you might have. I want to commend the  
18 staff on that mini Arco that we have got there on the wall.  
19 That's what it looks like, a mini conglomerate.

20 ACTING CHAIRPERSON McCAUSLAND: Now I'm beginning  
21 to understand how people get lost.

22 MR. HODGES: I'd like to begin by saying that  
23 the original intent of our trying to develop, putting  
24 together something here that would hopefully benefit two  
25 or three independent refiners in California that are

1 presently having some serious problems, crude oil supply  
2 problems. One of them is Demmeno Resources in Compton,  
3 California, that is presently rated at about 8,000 barrels  
4 a day and are only able to run 3,500 because of their  
5 inability to receive or obtain a supply of crude oil  
6 locally. The supply of crude that they are getting is  
7 coming from local producers. They are trucking some crude  
8 in from the Imperial Valley at a very high cost to them.  
9 It's not economically feasible for them to continue that.

10 In the case of Macmillan Ring Free of which  
11 you have copies and the staff has copies of those contracts,  
12 they are presently in a position to handle 4,000 plus  
13 barrels a day of Wilmington crude. They can take delivery  
14 by pipe line of this crude. They have indicated by letter  
15 to the staff -- I believe you have copies of those letters  
16 -- their desire to obtain as much of the 5,000 approximate  
17 barrels per day as they can get.

18 What we tried to do here is allocate the crude  
19 to three refineries. One would be Macmillan Ring Free,  
20 number one. Number two would be Demmeno Resources in  
21 Compton. We have made commitments, Century Resources has  
22 made commitments to Demmeno Resources. Third would be  
23 Coastal Petroleum Refineries, Inc. of Bakersfield,  
24 California. Now, we would expect that in the next six  
25 to eight months to be able to deliver some of that crude

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1 to Coastal by virtue of an exchange. We're working on  
2 that now whereby the local crude would be run by the two  
3 refineries and we in turn, they would in turn buy crude  
4 in the San Joaquin Valley and deliver those barrels to  
5 Coastal Petroleum Refiners. That was the original intent  
6 of Century Resources to get involved, was to ensure a  
7 supply of crude oil to a refinery in the Bakersfield area  
8 that we are financially involved in with a number of  
9 independent producers in the San Joaquin Valley. A  
10 substantial commitment has been made in this refinery in  
11 Bakersfield and we are in escrow with Gulf Oil who we  
12 purchased the unit from. We have negotiated ground leases  
13 with Tenneco Oil Company for the land. We are presently  
14 before the EPA and the Kern County Air Pollution Control  
15 District for our permits. We would expect to have clearance  
16 on those permits by the middle of October or the first of  
17 November.

18 We have natural gas supply for our refinery  
19 which allowed us to proceed under limitations that wouldn't  
20 impair quality. So that's the reason for our being able  
21 to get these permits.

22 Other than that, we started this back in April  
23 or May, '77, to try to ensure that we would have a viable  
24 supply of crude for these refineries. You can have a  
25 refinery, but without a viable supply of crude you don't

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1 have much of a refinery. There are economic limits that  
2 these small refiners, even though they do receive certain  
3 benefits from the Federal Government, there are certain  
4 problems they do face. If they don't run a minimum amount  
5 of crude oil, their operating costs are fixed, whether  
6 they run 3,000 barrels a day or seven or eight thousand  
7 barrels a day. From our economic analysis, if a refinery  
8 is running less than 5,000 barrels a day, they have serious  
9 problems. Basically, I think that hopefully sums up what  
10 we intended or tried to do in negotiating with Atlantic  
11 Richfield and obtaining the supply of crude oil. It became  
12 apparent to me at least in my conversations with both the  
13 City and State, that although Century Resources is a small  
14 company, much smaller than Petro-Lewis, that we did not  
15 have the financial background or financial wherewithal to  
16 satisfy both the City and State that we could potentially,  
17 although you did have an opportunity for us to present our  
18 financial information, although we did send financial  
19 information on energy production and sales which is  
20 connected with -- it's on the chart -- with Century Resources  
21 to Mr. Northrop and Mr. Brock. of the City of Long Beach,  
22 I felt in my conversations with the staff it would take  
23 somebody much stronger than Century Resources. Hence,  
24 the reason for us bringing in Petro-Lewis to participate  
25 with us as a financial partner.

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1                   ACTING CHAIRPERSON McCAUSLAND: Questions.

2                   MR. THOMPSON: You mentioned a third refinery  
3 here. Now, does this show up in any of your crude oil  
4 purchase ?

5                   MR. HODGES: No. We have not formulated a  
6 purchase agreement with Coastal Petroleum Refiners, Inc.  
7 because between Demmeno Resources right now, Mr. Thompson,  
8 and Macmillan Ring Free, we have tentatively committed  
9 all this crude when and if it is available to them in the  
10 immediate future. It will be essential that these two  
11 refiners purchase a supply, at least a portion of this  
12 crude, and return those barrels back to Coastal Petroleum  
13 Refiners for their refinery in the Valley. This is common  
14 practice done in the industry. In other words, a refinery  
15 in the Valley may own crude in Wilmington. They in turn  
16 will take barrels back. We want barrels back for our  
17 refinery in the San Joaquin Valley, but only a portion  
18 of the 5,000 barrels per day are we asking.

19                   MR. THOMPSON: This is Demmeno, D-e --

20                   MR. HODGES: D-e-m-m-e-n-o, Demmeno Resources.

21                   MS. KNIGHT: Mr. Thompson, it's anticipated that  
22 the Coastal Petroleum Refinery will go on stream about  
23 June 1, and Demmeno has agreed to terminate or make exchange  
24 crude available in the San Joaquin Valley in 1979.

25                   MR. THOMPSON: This is a plant that is in

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1 existence?

2 MS. KNIGHT: No, it's a plant that's under  
3 construction and is now getting the Air Quality Control  
4 approval. It is not on stream and will not be on stream  
5 until June 1.

6 MR. THOMPSON: What would happen if the permits  
7 were not granted?

8 MR. HODGES: The crude would continue in the  
9 hands of both Macmillan and Demmeno.

10 MS. KNIGHT: Century has been unwilling to make  
11 longer term commitments, although both Macmillan and  
12 Demmeno would prefer a longer term commitment because they  
13 want the crude for the new refinery.

14 MR. THOMPSON: Am I to understand now that  
15 Demmeno, there should be a crude oil purchase agreement  
16 then between Century Resources Development and Demmeno  
17 that will take part of that bottom line there now that  
18 we have going to either Coastal Petroleum or to Macmillan?  
19 Where do we come in on this?

20 MS. KNIGHT: It's actually the Tract 1 crude  
21 that Century has been discussing with Demmeno.

22 MR. THOMPSON: Arco's going to take that for  
23 six months?

24 MS. KNIGHT: Right. And after Arco no longer  
25 takes it, then the Tract 1 crude will go to Demmeno if

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1 Demmeno can make available a comparable volume in the  
2 Valley.

3 MR. THOMPSON: That's very essential that we  
4 see that crude oil purchase agreement and the validity of  
5 that because that's the basis for our pricing.

6 MS. KNIGHT: We understand.

7 MR. THOMPSON: The validity of that agreement  
8 is what we need to step up, and that's a crucial part of  
9 the whole thing.

10 MS. KNIGHT: I would like to clarify those  
11 agreements that you do need. You'd like to see the  
12 contract with Demmeno?

13 MR. THOMPSON: We need to know any crude oil  
14 purchase that is going to be in effect in your sale from  
15 Century Resources Development that will represent.

16 MS. KNIGHT: So the Demmeno and the Coastal  
17 Petroleum which will not take effect immediately.

18 MR. THOMPSON: Because in all cases, Partnership  
19 Properties Company is going to sell to Century Resources  
20 Development?

21 MR. HODGES: That's correct. All of the crude  
22 from Tract 1 and Tract 2.

23 MS. KNIGHT: The Tract 2 crude, however, is going  
24 to Macmillan, and you have that contract. The State's oil is going  
25 to Macmillan.

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1 MR. THOMPSON: And that is the one in which  
2 they've offered to extend to the year 2000 --

3 MS. KNIGHT: Right. That's a five-year contract.

4 MR. THOMPSON: -- 2,000 barrels a day, and now  
5 they'll take it all?

6 MR. HAGER: They will take all of Tract 2;  
7 is that correct?

8 MS. KNIGHT: Yes.

9 MR. HAGER: And they will convince themselves  
10 to taking it through 2000?

11 MS. KNIGHT: Yes.

12 MR. THOMPSON: Coastal Petroleum Refiners then  
13 drops out and Demmeno --

14 MS. KNIGHT: If they drop out -- they're on  
15 Tract 1. Demmeno may take it on the interim exchange  
16 until the Coastal Petroleum Refiners goes on stream at  
17 which time it will be exchanged for Valley crude. But if  
18 you want to know where it is going locally, where it's  
19 physically going to be delivered, it will probably continue  
20 to be delivered to Demmeno. If for some reason Demmeno  
21 cannot make such an exchange, then it would be trucked to  
22 the Valley.

23 MR. THOMPSON: In all cases we need to follow  
24 because it's actually how that crude will move.

25 MS. KNIGHT: Right. That is on the Tract 1 crude.

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1 MR. THOMPSON: If something messes up, then all  
2 of a sudden you have crude to dispose of.

3 MR. HODGES: Macmillan Ring Free has offered,  
4 but we're reluctant to sign that contract, to take all  
5 of the crude in Tract 1 and Tract 2.

6 MS. KNIGHT: Macmillan, however, has furnished  
7 a letter, of which you have a copy of, that they will  
8 take all of the Tract 1 and Tract 2 crude in the event  
9 that Century is unable for any reason to take it over the  
10 life of the contract.

11 MR. HODGES: This is in Tract 2. It doesn't  
12 say Tract 1. They have offered to take all of the crude  
13 from Tract 1 and Tract 2 since they're short approximately  
14 four to five thousand barrels a day. But I told Macmillan  
15 Ring Free that that's not possible because part of this  
16 crude is committed to Demmeno Resources. Of the total  
17 5,500 barrels a day, because now we're talking about  
18 Tract 1 and Tract 2, we talk about the total commitment  
19 of Tract 1 and Tract 2, all of Tract 2 is committed to  
20 Macmillan.

21 EXECUTIVE OFFICER NORTHROP: Did I understand  
22 if Demmeno could not make a satisfactory exchange, you  
23 would be then trucking to the Valley?

24 MR. HODGES: Well, we have a possibility of  
25 crude being delivered into Macmillan's refinery, and then

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1 in turn MacMillan will make the crude available to us.  
2 They'll take delivery of the entire 5,000. We could,  
3 Bill, back haul the crude to the Valley in an emergency.  
4 I think the contingency items that potentially could be  
5 done, we don't like to do it, but it can physically be done.  
6 I believe that the exchange will be worked out between  
7 Demmeno Resources and Standard Oil of California who  
8 they're negotiating with -- they were in San Francisco  
9 yesterday -- to take delivery of Wilmington crude, whereby  
10 Standard will take delivery of Wilmington crude and  
11 Standard will deliver to Demmeno in Compton by pipe line --  
12 the pipe line's only 300 feet from Demmeno Resources  
13 property line. They have requested through Standard Oil  
14 people a connection at that point. They're negotiating  
15 that right now. They wanted to know how firm our deal was.  
16 I said that we hoped that it was very firm, that they  
17 could go to Standard Oil now and talk to them about the  
18 exchange. If that is done, then Demmeno will take pipe  
19 line delivery of crude oil into their refinery and not have  
20 to truck the crude.

21 MR. THOMPSON: Another question. I hate to bring  
22 a third party into this, but CIPA has written a letter  
23 in which they say Century Resources Development informed  
24 us that they intend to exchange some of the lower tier  
25 crude oil attributable to these interests with Independent

1 Oil Producers, San Joaquin Valley, for use in steam  
2 generators in the field.

3 MR. HODGES: That's correct.

4 MR. THOMPSON: This would be an unrefining use  
5 of the oil?

6 MR. HODGES: That's right. That's a deemed  
7 exchange whereby the physical barrels --

8 MS. KNIGHT: It's a nonrefining use, and under  
9 the present regulation it would probably not bear an  
10 entitlement burden as leased crude.

11 MR. THOMPSON: Is there a possibility of this  
12 being changed in the future?

13 MS. KNIGHT: Yes. In which case it might not  
14 be advisable for any of these parties to do it. But this  
15 is while it is available, those producers in San Joaquin  
16 Valley would like to take advantage.

17 MR. THOMPSON: What percent of this crude then  
18 do you think will end up to be burned as fuel for steam?

19 MS. KNIGHT: I think it's a relatively small  
20 percent.

21 MR. HODGES: 500 barrels a day, potentially may  
22 be 1,500 barrels a day. A minimum of five and a maximum  
23 of about fifteen hundred.

24 There are producers in the Valley that could use  
25 this lower tier crude to burn in their generators. The

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1 fact of the matter is, I believe some of the Tract 4 crude  
2 that presently is being sold is being trucked back,  
3 delivered to the Valley for generator purposes. The fuel  
4 costs are eight or nine dollars a barrel in the Valley,  
5 and the lower tier crude in Wilmington is only \$5.20.  
6 You can see the economic benefit to those producers. It's  
7 a considerable savings. And these producers, some of them  
8 burn five hundred to a thousand barrels a day of this crude  
9 in an enhanced recovery project.

10 So there are many possibilities with the  
11 Wilmington crude. Our problem is we have to get it first  
12 before we can deal on it.

13 MR. THOMPSON: I think, again, this points out  
14 the thing we've been belaboring for many years about the  
15 value of our crude oil in different places and different  
16 ways and the strange things the entitlements program does.

17 EXECUTIVE OFFICER NORTHROP: I think it's  
18 important to point out, Mr. Chairman and Ms. Smith, that  
19 this deal is very, very attractive today because of the  
20 change in the entitlements program. But what they can  
21 change with the stroke of a pen, they can unchange, and  
22 we could well be -- and this is one of the reasons staff  
23 has been very, very cautious about moving to an area that  
24 looks attractive to people now because there's a tremendous  
25 profit in it. But it could evaporate very quickly.

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1 MS. KNIGHT: Mr. McCausland, I would like to  
2 point out that these negotiations with Arco were begun  
3 a year and a half ago or more at a time when the  
4 entitlements picture was not attractive, and Mr. Northrop  
5 was the one that was working very hard getting that whole  
6 situation turned around.

7 Our clients feel that, we hope that the  
8 Department of Energy has learned something over the last  
9 few years and that such a situation should not come up  
10 again, but there are enough alternatives here that we  
11 should never find ourselves in a situation where it was  
12 so unattractive that it was an impossibility.

13 ACTING CHAIRPERSON McCAUSLAND: Governments are  
14 able to unlearn very rapidly.

15 MS. KNIGHT: I guess that's something that we  
16 need to be aware of.

17 ACTING CHAIRPERSON McCAUSLAND: Anything else  
18 this morning on this item? All right. We'll see you  
19 on the 11th.

20 MS. KNIGHT: Thank you.

21 ACTING CHAIRPERSON McCAUSLAND: In the meantime,  
22 make sure that the City of Long Beach is satisfied so  
23 that you'll stay on a timely basis.

24 If it's all right with everyone, we'll conclude  
25 our discussion of Item 31 for today. Does staff have any

1 last comments? Okay.

2 Mr. Thompson, you've been requested by Ms.  
3 Smith to provide her with a copy of your introductory  
4 comments as soon as they're transcribed.

5 MR. THOMPSON: If I can recall those words that  
6 are up here somewhere, we will get them back to you.

7 ACTING CHAIRPERSON McCAUSLAND: She wants to  
8 use them in her novel, I believe.

9 (Laughter.)

10 ACTING CHAIRPERSON McCAUSLAND: Calendar Item  
11 32 regards the Final Report and Closing Statement of the  
12 1977-78 Plan of Development and Operations and Budget for  
13 the Long Beach Unit of the Wilmington Oil Field.

14 MR. THOMPSON: This is merely a closing of  
15 what happened last year. In essence, we didn't make as  
16 much money as we had originally estimated.

17 ACTING CHAIRPERSON McCAUSLAND: You're going to  
18 make more money next year, though, and without objection,  
19 Item 32 is approved.

20 Item 33 is an information item regarding  
21 Micellar-Polymer waterflooding techniques.

22 MR. THOMPSON: In a point of brevity, we are  
23 moving along in this program and we hope to be putting  
24 this slug in the ground sometime in the next six months  
25 and we should see some results in 1979.

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TELEPHONE (916) 383-3601

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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.

IN WITNESS WHEREOF, I have hereunto set my  
hand this 2nd day of October, 1978.

CATHLEEN SLOCUM  
Certified Shorthand Reporter  
License No. 2822