

MINUTE ITEM

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CALENDAR ITEM

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APPROVAL OF SETTLEMENT AGREEMENT WITH
PETRO-LEWIS REGARDING WINDFALL PROFIT TAXES

Partnership Properties Company is the record title holder of the Contractor's interest in the Tract No. 2 Agreement and the 2-1/2 percent, 1-1/2 percent and one percent (total five percent) Nonoperating Contractors' interests in the Contractors' Agreement for Tract 1 of the Long Beach Unit in the Wilmington Oil Field. Partnership Properties Company holds these interests as nominee for certain limited partnerships which are part of Petro-Lewis Corporation's oil income program and for Petro-Lewis Funds, Inc., the general partner and a wholly owned subsidiary of Petro-Lewis Corporation. Petro-Lewis' interests in Tracts 1 and 2 are held 20 percent by the general partner and 80 percent by about 57,000 limited partners. The Tract No. 2 Agreement is with the State and covers the State-owned tidelands tract in the Long Beach Unit. The Contractors' Agreement is with the City of Long Beach and covers the Long Beach granted tidelands in the Long Beach Unit.

Since March 1, 1980, when the Crude Oil Windfall Profit Tax Act of 1980 became effective, Petro-Lewis has paid and charged to its net profits accounts under the Tract No. 2 Agreement and the Contractors' Agreement, windfall profit taxes assessed against the crude oil allocated to its interests. Until the Technical Corrections Act of 1982 was enacted, the extent of Petro-Lewis' interests was coextensive with its economic interests under the Contractors' Agreement

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and the Tract No. 2 Agreement which far exceeded its net profits percentage interests in the contracts. With the enactment of the Technical Corrections Act, the extent of its interests in the crude oil for the purpose of assessing the windfall profit tax was reduced to its net profits percentage interest which are 3.75 percent under the Tract No. 2 Agreement and 0.46 percent under the Contractors' Agreement. This change was made retroactive to March 1, 1980.

As a result of the amendment in the Technical Corrections Act, there were substantial refunds available for windfall profit taxes previously paid and charged by Petro-Lewis to its net profits accounts. The City and the State demanded that Petro-Lewis obtain these refunds in their entirety and credit them to the net profits accounts. The City's and State's net profits share of the refunds is about \$9.6 million which is about 99 percent of the total refund. Petro-Lewis claimed that it had no contractual obligation to seek the refunds or credit them to the net profits accounts. The real problem, however, is that Petro-Lewis Corporation and its subsidiary entities cannot obtain a large part of the refunds from the Internal Revenue Service. Under the terms of the Windfall Profit Tax Act, the taxes are paid by and refunds are payable to producers. When oil interests are held by partnerships, the individual partners not the partnership are the producers. While the law was changed to permit partnerships to act for the partners in paying taxes and collecting refunds, the change was effective for taxes paid after January 1, 1983. This change provides no help for refunds for windfall profit taxes paid from March 1, 1980 through December 31, 1982. Therefore, Petro-Lewis can only obtain refunds of windfall profit taxes attributable to its general partner's share in the partnership interest in Tracts 1 and 2. The 57,000 limited partners would have to file for and collect their refunds, and Petro-Lewis allegedly cannot compel them either to claim the refunds or reimburse the City and the State. In order to avoid lengthy and complex litigation, the parties have agreed to the following resolution of their controversy:

1. Refunds presently obtained directly by Petro-Lewis as general partner, which for the interests in Tracts 1 and 2 total about \$2.2 million, will be paid by Petro-Lewis. Payments will be made to the City for the Tract 1 share and to the State for the Tract 2 share within five days after all parties have executed the agreement.

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2. Sixty percent of the refunds that have already been obtained by the limited partners will be paid by Petro-Lewis. These refunds for the interests in Tracts 1 and 2 total about \$5.2 million, 60 percent of which is \$3.1 million. Payments will be made to the City for the Tract 1 share and to the State for the Tract 2 share in 12 equal quarterly installments beginning the last quarter of 1983. The payments will bear interest at the rate for the State's pooled money investments in effect on the date of the settlement.
3. Money still held by the United States Treasury and available for refund to the limited partners for Tracts 1 and 2 totals about \$2.2 million. The State, the City and Petro-Lewis, after talking with the Internal Revenue Service and concluding that an administrative remedy is impossible, will work together to secure passage of a bill having the approval of the Treasury Department that will permit Petro-Lewis as general partner to obtain on behalf of the partnership the entire \$2.2 million refund due the limited partners. When the bill is passed and the refund obtained, Petro-Lewis will pay to the City the Tract 1 share and to the State the Tract 2 share. If the bill is not passed by the end of 1986, 60 percent of the \$2.2 million or about \$1.3 million will be paid by Petro-Lewis itself. Payments will be made to the City for the Tract 1 share and to the State for the Tract 2 share in two equal installments, the first to be made by January 2, 1987, and the second by January 2, 1988. The second payment will bear interest as computed above from January 2, 1987.

Under the agreement, and assuming the proposed legislation passes, the City and the State will get a total of \$7.5 million (\$2.2 + \$3.1 + \$2.2) plus interest for a \$9.6 million claim. If the bill does not pass, the City and the State will receive \$6.6 million (\$2.2 + \$3.1 + \$1.3) plus interest. The present prospects for the passage of the bill are very good.

The agreement leaves to be resolved the question of whether under the terms of the Tract No. 2 Agreement and the Contractors' Agreement, windfall profit taxes properly assessable against Petro-Lewis' net profits percentage interests on the basis of the amendment to the Crude Oil Windfall Profit Tax Act of 1980 by the Technical Corrections Act of 1982 are reimbursable to the Contractor out of net profits.

Revised 10/25/83.

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The Attorney General's office, working with the Commission's staff, and the Long Beach City Attorney negotiated this agreement and are of the opinion that the agreement is in the best interests of the State.

IT IS RECOMMENDED THAT COMMISSION APPROVE THE SETTLEMENT AGREEMENT WITH PETRO-LEWIS REGARDING WINDFALL PROFIT TAXES AS DESCRIBED ABOVE AND AUTHORIZE THE EXECUTIVE OFFICER TO EXECUTE THE AGREEMENT ON BEHALF OF THE STATE LANDS COMMISSION OF THE STATE OF CALIFORNIA.