

MINUTE ITEM 44
This Calendar Item No. 44
was approved as Minute Item
No. 44 by the State Lands
Commission by a vote of 2
to 0 at its 12/13/88
meeting.

CALENDAR ITEM

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APPROVAL OF AWARD OF LONG BEACH HARBOR
TIDELANDS PARCEL AND PARCEL "A" OIL CONTRACT
AND OF ASSIGNMENT OF INTERESTS FROM CHANSE
ENERGY CORPORATION TO CHANSE LONG BEACH
PRODUCTION CORPORATION AND FROM NESTE HOLDING
(USA), INC. TO NESTE OIL SERVICES, INC.

Oil and gas production operations in the portion of the Long Beach tidelands outside the areas committed to the Long Beach Unit are located in the Long Beach Harbor District and on Parcel "A". This area is commonly referred to as the "prior development" since it is the area in the tidelands where the development of tidelands oil and gas resources first occurred. Oil and gas operations in this area are currently conducted under the Drilling and Operating Contract (Long Beach Harbor Department Tidelands Parcel) and the Parcel "A" Oil Contract. Both contracts will expire on March 1, 1989.

The Drilling and Operating Contract (Long Beach Harbor Department Tidelands Parcel) is held by a group of companies consisting of American Energy Operations, Inc., Exxon Corporation, Conoco Inc., CM Oil Company and the Long Beach Oil Development Company ("LBOD"). LBOD is the operator. The Parcel "A" Oil Contract is held by Edgington Oil Company, Inc. and Powerine Oil Company. LBOD is also the operator of this parcel. Both contracts are net profits agreements where the contracting companies have the right and obligation to take the oil and must pay to the City a share of the net profits. The City's share of net profits under both contracts is ninety-one percent (91%).

The City of Long Beach prepared and the Commission approved the forms, including the contract, and the specifications for

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inviting bids on a new net profits contract to be known as the Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract ("Contract"). The Contract will consolidate the operations on the Long Beach Harbor Department Tidelands Parcel and Parcel "A" into a single operation. The Contract will run from March 1, 1989 to April 1, 2000, so that its termination date will coincide with those of the Contractors' Agreement for Tract 1 of the Long Beach Unit and the Tract No. 2 Agreement. This will provide the City and the Commission with an opportunity to assess and provide for the future development of all Long Beach tidelands oil and gas resources in 2000.

After receiving Commission approval of the bid forms and specifications, the City advertised for bids on the Contract. The bid factor was the percentage of net profits payable to the City. However, the City's notice inviting bids stated that while the bid percentage of net profits would be a major factor considered in the award of the Contract, other factors, including proven performance in oil field operations, expertise in the area of environmental regulation as applied to oil properties and qualifications of key managerial personnel, would be considered. Also, the bidders were required to provide evidence of ability to take the oil and to meet the financial responsibilities under the contract. Five bids were received. They were opened on September 19, 1988.

The following is a list of the bidders and their bid percentage of net profits payable to the City:

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|---|--------|
| 1. Chasse Energy Corporation/Neste Holding (USA), Inc. | 95% |
| 2. Bechtel Petroleum Operations, Inc. | 91% |
| 3. Long Beach Oil Development Company | 90.51% |
| 4. Lawrence-Allison Division of John Brown, E & C, Inc. | 88% |
| 5. Barto Signal Petroleum | 23.5% |

At the bid opening, Barto stated that it had mistakenly inserted the percentage of net profits it intended to retain rather than the percentage payable to the City. Since its bid was the lowest in any event, it withdrew its bid at the close of the bid opening session. Upon closer examination of the bids, the City found that Bechtel had conditioned its bid on the City's acceptance of an amendment to the Contract's termination provision. Since the bidding procedures prohibit

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any deviation from the requirements or provisions of the Contract, Bechtel's bid was disqualified.

The City, working with the Commission's staff, began a thorough analysis of the qualifications of the three remaining bidders, Chanse/Neste, LBOD and Lawrence-Allison. Based on this analysis, the City and the staff have concluded that the highest responsible bidder is Chanse/Neste.

The Chanse/Neste bid is a joint bid of Chanse Energy Corporation, a privately held and minority owned domestic independent oil and gas production company, and Neste Holding (USA), Inc., a wholly owned subsidiary of Neste Oy, the national oil company of Finland. Chanse will be responsible for conducting the field operations, and Neste will provide the financial backing and will take the oil. The combination of what the City and staff have found to be a responsible and environmentally conscious operator and a financially sound, integrated oil company promises to provide the City and the State with a responsible contractor for the continued production of Long Beach tidelands oil and gas resources for the benefit of the people of California.

Chanse Energy Corporation is a wholly owned subsidiary of Chanse Petroleum Corporation, a privately held and minority owned oil and gas company founded in 1974 by Kai S. Chang. Chanse's headquarters are in New York City, and it has operations offices in Shreveport, Louisiana and Jefferson, Ohio. It is a small independent oil producer with operations primarily in the east and the south. A check of its financial and operational references indicates that it has very limited financial resources and a very good operational record. Chanse has stated that if the Chanse/Neste bid is accepted, Chanse will retain most all of the current LBOD operational staff for the purpose of performing the field operations.

Chanse Energy has formed a wholly owned subsidiary named Chanse Long Beach Production Corporation, a Delaware corporation, for the purpose of conducting the operations under the Contract. This separate entity will be devoted solely to the operation of the Long Beach tidelands property and will insulate this operation from any adverse financial consequences of other projects in which Chanse is involved. Chanse Energy will guarantee the performance of Chanse Long Beach. Chanse Energy will execute the Contract as bidder, but requests that the

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assignment of its interest to Chalse Long Beach be approved at the time the award of the Contract is approved.

Neste Holding (USA), Inc. of Houston is a wholly owned subsidiary of Neste Oy, the national oil company of Finland and the second largest business entity in Scandinavia. Neste Oy has annual revenues exceeding \$7 billion and over 11,000 employees worldwide engaged in all phases of the oil and gas industry. The company is wholly owned by the government of Finland, is headquartered in Helsinki and has over 112 wholly owned companies throughout the world. Neste Holding (USA), Inc. is a holding company for Neste Oy and is designed to investigate and acquire business opportunities for Neste Oy in the United States. Because Neste Holding is not an operations entity, it will not conduct the operations under the Contract. Neste Holding has formed a subsidiary known as Neste Oil Services, Inc., a Texas corporation, to perform the functions of the Contractor. Neste Oil Services is wholly owned by Neste Holding which, in turn, is wholly owned by Neste Oy. Neste Holding will execute the Contract as bidder and then will immediately assign its interest to Neste Oil Services. Accordingly, Neste Holding is requesting that the Commission approve the assignment from Neste Holding to Neste Oil Services at the time it approves the award of the Contract to the Chalse/Neste bidders.

The staff of the City's Department of Oil Properties and the Commission's staff have investigated the organizational structure of Neste Oy's business operations in the United States. In the area of petroleum trading and marketing, Neste forms subsidiary corporate entities to conduct its business operations in the United States. This is done primarily for tax reasons. In the area of exploration and development, where the tax treatment is more favorable, Neste Oy conducts the operations directly. Neste correctly views the Contract, which involves the operation of a developed oil property and the acquisition of the oil produced from that property, as a trading and marketing enterprise. Because the Contract is a unique operation for Neste, it has formed a subsidiary whose sole purpose will be to operate the Contract.

Neste Oil Services' only significant asset is the interest in the Contract. Funds necessary to meet the initial working capital requirements under the Contract will be provided by Neste Oy in the form of a guarantee of a line of credit or possibly by a direct payment. Neste Oy will also provide the required bond. Neste Holding will guarantee performance by Neste Oil Services, Inc. The security in this venture is provided by the fact that Neste Oil Services is part of a

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financially sound, international business organization with a worldwide reputation. It is owned by the government of Finland whose relationships with the United States involve more than just commercial interests. All oil produced under the Contract will be acquired pursuant to a long term, arms length arrangement with East Texas Crude Company, a Neste affiliate. The crude will be priced according to the crude valuation provision of the Contract. This provides assurance that all oil can be marketed throughout the life of the Contract without incurring losses from spot sales at times of low demand.

The Contractor will be a partnership to be formed by Chanse and Neste immediately after the award of the Contract. The partnership, to be called Tidelands Oil Production Company, will be composed of Chanse Long Beach Production Corporation and Neste Oil Services, Inc., as general partners.

The staffs of the City's Department of Oil Properties and the Commission met with representatives of Chanse and Neste and discussed the operational and financial responsibilities of the Contractor under the Contract and the abilities of Chanse and Neste to continue to meet those responsibilities throughout the term of the Contract. Financial and operational references were also contacted. Based on a thorough review of the bid and of the qualifications of the bidders, the City and the staff, acting with the advice of the City Attorney, the Commission's staff counsel and the Attorney General, have concluded that the Chanse/Neste bid meets the terms of the bid offering, that Chanse and Neste are qualified to perform the Contractor's obligations under the Contract and that their bid represents the highest responsible bid.

At its meeting on November 1, 1988, the Long Beach City Council accepted the Chanse/Neste bid as the highest responsible bid for the Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract and approved the assignments of Chanse Energy's interest to Chanse Long Beach and of Neste Holding's interest to Neste Oil Services, Inc.

Under Section 10(a) of Chapter 29, Statutes of 1956, First Extraordinary Session, any contract relating to the drilling for, developing, extracting, taking or removing, or disposition of oil, gas and other hydrocarbons from the Long Beach tidelands shall be made and entered into only with the highest responsible bidder upon competitive bidding and shall be of no effect unless and until approved by the Commission. Under Section 34 of the Contract, the assignment of any interest in the Contract is not valid unless approved by the City and the Commission.

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AB 884: N/A.

OTHER PERTINENT INFORMATION:

1. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (14 Cal. Code Regs. 15061), the staff has determined that this activity is exempt from the requirements of the CEQA because the activity is not a "project" as defined by CEQA and the State CEQA Guidelines.

Authority: P.R.C. 21065 and 14 Cal. Code Regs. 15378.

IT IS RECOMMENDED THAT THE COMMISSION:

1. FIND THAT THE ACTIVITY IS EXEMPT FROM THE REQUIREMENTS OF THE CEQA PURSUANT TO 14 CAL. CODE REGS. 15061 BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY P.R.C. 21065 AND 14 CAL. CODE REGS. 15378.
2. APPROVE THE ACCEPTANCE BY THE CITY OF LONG BEACH OF THE JOINT BID BY CHANSE ENERGY CORPORATION AND NESTE HOLDING (USA), INC. AS THE HIGHEST RESPONSIBLE BID FOR THE LONG BEACH HARBOR TIDELANDS PARCEL AND PARCEL "A" OIL CONTRACT.
3. APPROVE THE ASSIGNMENT BY CHANSE ENERGY CORPORATION OF ITS ENTIRE INTEREST UNDER THE LONG BEACH HARBOR TIDELANDS PARCEL AND PARCEL "A" OIL CONTRACT ("CONTRACT") TO CHANSE LONG BEACH PRODUCTION CORPORATION ON THE CONDITIONS THAT ALL TERMS OF THE CONTRACT REMAIN THE SAME AND THAT CHANSE ENERGY, AS ASSIGNOR, REMAIN FULLY LIABLE UNDER THE CONTRACT, ANY CONDITIONS IN THE ASSIGNMENT AGREEMENT TO THE CONTRARY NOTWITHSTANDING.
4. APPROVE THE ASSIGNMENT BY NESTE HOLDING (USA), INC. OF ITS ENTIRE INTEREST UNDER THE LONG BEACH HARBOR TIDELANDS PARCEL AND "A" OIL CONTRACT ("CONTRACT") TO NESTE OIL SERVICES, INC. ON THE CONDITIONS THAT ALL TERMS OF THE CONTRACT REMAIN THE SAME AND THAT NESTE HOLDING, AS ASSIGNOR, REMAIN FULLY LIABLE UNDER THE CONTRACT, ANY CONDITIONS IN THE ASSIGNMENT AGREEMENT TO THE CONTRARY NOTWITHSTANDING.
5. AUTHORIZE THE EXECUTIVE OFFICER TO EXECUTE WHATEVER DOCUMENTS ARE NECESSARY TO CONVEY THE COMMISSION'S APPROVAL OF THE ACCEPTANCE OF THE CHANSE/NESTE BID AND THE ASSIGNMENTS.