

MINUTE ITEM

This Calendar Item No. 38 was approved as Minute Item No. 38 by the California State Lands Commission by a vote of 3 to 0 at its 4-7-03 meeting.

**Minute Item
38**

A 57, 58

S 29

04/07/03
W 12001
A. Reid
M. Voskanian

CITY OF LONG BEACH (APPLICANT)

Regular Calendar Item 38: Staff made presentation to Commission pertaining to the amendment of the Long Beach parcel and Parcel A oil contract with Tidelands Oil Production. The item was approved unanimously as presented.

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MINUTE PAGE

CALENDAR ITEM

38

A 57, 58

04/07/03

W 12001

S 29

A. Reid

M. Voskanian

**CONSIDER AMENDMENT OF LONG BEACH HARBOR TIDELANDS
PARCEL AND PARCEL "A" OIL CONTRACT, AND THE ASSIGNMENT OF
OWNERSHIP INTERESTS IN TIDELANDS OIL PRODUCTION COMPANY,
LONG BEACH TIDELANDS, WILMINGTON OIL FIELD,
LOS ANGELES COUNTY**

APPLICANT:

City of Long Beach, Department of Oil Properties
Mr. Dennis Sullivan, Director
211 East Ocean Blvd., Suite 500
Long Beach, CA 90802

BACKGROUND:

In January 1989, the City of Long Beach (City) entered into the Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract (Contract) with Neste Holding (U.S.A.), Inc., Chanse Energy Corporation and Tidelands Oil Production Company, which together constituted the Contractor. The Contract has been amended seven times since its inception. As a result of assignments, the Contractor now is Tidelands Oil Production Company (Tidelands), a general partnership of Neste Oil Services, Inc. (Neste) and Chanse Long Beach Production Corporation (Chanse). Neste holds a 79.9 percent interest in Tidelands, and Chanse holds a 20.1 percent interest in Tidelands. Neste is proposing to assign a 75 percent interest in Tidelands to Paramount Petroleum Corporation (Paramount) and a 4.9 percent interest in Tidelands to Chanse, so that, following the assignment, Paramount will hold a 75 percent interest and Chanse will hold a 25 percent interest in the Contractor.

Section 34 of the Contract provides that the Contractor or its successors or assigns may assign all or any part of its rights, privileges or obligations under the Contract only after first obtaining the written consent of and subject to the terms and conditions as may be prescribed by the City Manager and the State Lands Commission (Commission).

CALENDAR ITEM NO. 38 (CONT'D)

Paramount, a Delaware corporation, is an independent refiner of petroleum products. Paramount's refinery, located in Paramount, California, has a refining capacity of 49,000 barrels of crude oil per day. In addition, Paramount owns petroleum product tank farms and asphalt terminals in Southern, Central and Northern California.

Paramount has indicated its intent to purchase the oil from the Contract to run through its refinery. The City Manager and the Commission are willing to consent to the proposed assignment on the conditions in the Consent to Assignment and Amendment, including an amendment to Section 18.3 of the Contract. This amendment provides a different method for valuing the oil to account for the reduction in the number of companies that post crude oil prices in the Wilmington Oil Field (Field). This valuation method also will provide a financial return to the City and the Commission under the Contract will not be altered by virtue of a decision by the Contractor or any person, firm or corporation comprising the Contractor to take the oil and run it in its refinery rather than marketing it to a third party.

THE CONSENT TO ASSIGN AGREEMENT

In order to permit the assignment to be made and to provide a financial return to the City, the Commission and the Contractor reasonably commensurate with their financial return since the inception of the Contract, the Commission Staff recommends amending Section 18.3 of the Contract. The Consent to Assign Agreement amends Section 18.3 of the contract with the following provisions:

- 1) All oil shall be valued at the arithmetic average of the prices posted in the Field, and in the Huntington Beach, Long Beach, Inglewood and Midway Sunset oil fields by any person, firm or corporation operating a refinery in California with a throughput capacity of at least thirty thousand (30,000) barrels per day, for oil of like gravity on the day the oil is run into the Contractor's tanks and/or pipelines (Five Field Average). The value shall be computed to the closest tenth of each degree of API gravity and the closest tenth of a cent per barrel.
- 2) Provisions are included for sales of oil to entities other than Paramount to provide for sharing the amount of sales at greater than, or less than the posted Five Field Average, with 50 percent of the amount greater than the Five Field Average being paid to the City by the Contractor, and when

CALENDAR ITEM NO. 38 (CONT'D)

appropriate, 50 percent of the amount less than the Five Field Average being recouped by the Contractor.

- 3) Because Paramount is a refiner and may, under certain circumstances take all of the oil into its refinery, provisions are included for determining the value of the oil, including a bonus value.

OTHER PROVISIONS OF THE ASSIGNMENT

- 1) The Consent to Assignment Agreement contains an additional amendment to the Contract that requires the Contractor, under certain circumstances to pay land rental costs presently deducted from revenues payable to the City.
- 2) A full field safety audit of the operations on the subject lands will be conducted. State Lands Staff costs associated with this audit, and the cost of contractors hired by the Contractor will be paid for as outlined in the agreement.
- 3) The past parent company of Neste was Neste OY, which has merged with a large Finish power company. The merged entity is Fortum Oil and Gas OY (Fortum). Fortum is the guarantor of the Contractor's performance under the Contract. Tideland's Oil has agreed to assume Fortum's guarantor responsibilities under the Contract, which will take the form of a performance bond in the amount of \$4 million.

FINANCIAL REVIEW:

State Lands Commission staff have reviewed year 2000 and 2001 audited financial statements submitted by Paramount. Six critical economic indicators were compared with industry standards, as shown in Exhibit B, attached hereto, and these indicators show that Paramount has better than adequate financial strength. Financial Statements for 2002 were being prepared at the time of this report and not currently available.

OPERATIONS REVIEW:

Staff has reviewed Paramount's operating history for safety and environmental compliance and has found their operating record to be satisfactory and comparable to other petroleum refining facilities within the Southern California area.

CALENDAR ITEM NO. 38 (CONT'D)

STATUTORY AND OTHER REFERENCES:

- A. Public Resources Code sections: Division 6, Parts 1 and 2: Division 13.
- B. California Code of Regulations section: Title 3, Division 3 Title 14, Division 6

OTHER PERTINENT INFORMATION

- 1. In its meeting of February 18, 2003 the Long Beach City Council approved the assignment of interest to Paramount and authorized the City Manager to execute the Consent to Assignment of Interest in and Eighth Amendment to the Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract.
- 2. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines [Title 14, California Code of Regulations, section 15060(c)(3)], the staff has determined that this activity is not subject to the provisions of the CEQA because it is not a "project" as defined by the CEQA and the State CEQA Guidelines.

Authority: Public Resources Code section 21065 and Title 14, California Code of Regulations, sections 15060 (c)(3) and 15378

EXHIBITS:

- A. Consent to Assignment of Interest in and Eighth Amendment to Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract
- B. Table of Paramount Petroleum's Financial Statement Analysis

PERMIT STREAMLINING ACT DEADLINE:

N/A

RECOMMENDED ACTION:

IT IS RECOMMENDED THAT THE COMMISSION:

CEQA FINDING:

FIND THAT THE ACTIVITY IS NOT SUBJECT TO THE REQUIREMENTS OF THE CEQA PURSUANT TO TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15060(c)(3) BECAUSE THE ACTIVITY IS NOT A PROJECT AS DEFINED BY PUBLIC RESOURCES CODE SECTION 21065 AND TITLE 14, CALIFORNIA CODE OF REGULATIONS, SECTION 15378

CALENDAR ITEM NO. 38 (CONT'D)

AUTHORIZATION:

APPROVE THE CONSENT TO ASSIGNMENT OF INTEREST IN AND EIGHTH AMENDMENT TO LONG BEACH HARBOR TIDELANDS PARCEL AND PARCEL "A" OIL CONTRACT, AS SET FORTH IN EXHIBIT A, ATTACHED HERETO.

1 **CONSENT TO ASSIGNMENT OF INTEREST IN AND EIGHTH AMENDMENT**
2 **TO LONG BEACH HARBOR TIDELANDS PARCEL AND**
3 **PARCEL "A" OIL CONTRACT**
4

5 In January 1989, the City of Long Beach (City) entered into the Long Beach
6 Harbor Tidelands Parcel and Parcel "A" Oil Contract (Contract) with Neste Holding
7 (U.S.A.), Inc., Chanse Energy Corporation and Tidelands Oil Production Company,
8 which together constituted the Contractor. The Contract has been amended seven times
9 since its inception. As a result of assignments, the Contractor now is Tidelands Oil
10 Production Company (Tidelands), a general partnership of Neste Oil Services, Inc.
11 (Neste) and Chanse Long Beach Production Corporation (Chanse). Neste holds a 79.9
12 percent interest in Tidelands, and Chanse holds a 20.1 percent interest in Tidelands.
13 Neste is proposing to assign a 75 percent interest in Tidelands to Paramount Petroleum
14 Corporation (Paramount) and a 4.9 percent interest in Tidelands to Chanse, so that,
15 following the assignment, Paramount will hold a 75 percent interest and Chanse will hold
16 a 25 percent interest in the Contractor.

17 Section 34 of the Contract provides that the Contractor or its successors or
18 assigns may assign all or any part of its rights, privileges or obligations under the
19 Contract only after first obtaining the written consent of and subject to the terms and
20 conditions as may be prescribed by the City Manager and the State Lands Commission
21 (Commission).

22 The City Manager and the Commission are willing to consent to the proposed
23 assignment but only on the conditions in this Consent to Assignment and Amendment,
24 including an amendment to Section 18.3 of the Contract to provide a different valuation
25 for the oil to account for the reduction in the number of companies posting prices for
26 crude oil in the Wilmington oil field and so that the return to the City and the
27 Commission under the Contract will not be reduced substantially by virtue of a decision
28 by the Contractor or any person, firm or corporation comprising the Contractor to take

1 the oil and run it in its refinery rather than marketing it to a third party.

2 Throughout the life of the Contract, the Contractor has marketed to third parties
3 under arm's length contracts, all of the oil produced from and allocated to the Contract
4 lands, except for oil taken in kind by the City pursuant to subsection 18.2 of the Contract.
5 The Contractor has obtained a price for this oil that has been significantly above the
6 posted price and has shared 50 percent of this marketing bonus with the City as provided
7 in subsection 18.3 of the Contract. If Paramount assumes Neste's interest in Tidelands,
8 Tidelands may sell the oil to Paramount to use in its refinery. Such a sale, however, may
9 not be considered an arm's length agreement as provided in subsection 18.3 of the
10 Contract.

11 Therefore, in order to permit the assignment to be made, to provide a return to the
12 City, the Commission and the Contractor reasonably commensurate with their return
13 since the inception of the Contract, to provide for Paramount's using the oil in its
14 refinery and to provide other assurances to the City and to the Commission, the City
15 Manager, the Commission, Tidelands, Neste, Chasse and Paramount agree as follows:

16 1. The City Manager is willing to consent and does consent to the assignment by
17 Neste to Paramount and Chasse of Neste's interest in Tidelands on the conditions that
18 the Contract and all amendments to the Contract remain fully in force and effect,
19 anything in any other agreement to the contrary notwithstanding, and that all terms of this
20 Consent to Assignment and Amendment are satisfied, including amendments to Sections
21 13.4 and 18.3 of the Contract to read as provided, respectively, in paragraphs 3 and 4
22 below.

23 2. The Commission is willing to consent and does consent to the assignment by
24 Neste to Paramount and Chasse of Neste's interest in Tidelands on the conditions that
25 the Contract and all amendments to the Contract remain fully in force and effect,
26 anything in any other agreement to the contrary notwithstanding, and that all terms of this
27 Consent to Assignment and Amendment are satisfied, including amendments to Sections
28 13.4 and 18.3 of the Contract to read as provided, respectively, in paragraphs 3 and 4

1 below.

2 //

3 3. Section 13.4 of the Contract is amended to read as follows:

4 13.4. Any City Property which is no longer needed in
5 connection with operations under this agreement, and which the Contractor
6 is required or permitted by the terms of this agreement or by written order
7 of the Director to remove from the Subject Lands, shall become the
8 property of the Contractor upon its removal. However, the full reasonable
9 salvage value of such removed property shall be treated as a credit to be
10 handled in the manner prescribed for handling credits in Exhibit "B"
11 (Accounting Procedures).

12 4. Section 18.3 of the Contract is amended to read as follows:

13 18.3. All oil shall be valued, accounted for and paid for at
14 the arithmetic average of the prices posted in the Field and in the
15 Huntington Beach, Long Beach, Inglewood and Midway Sunset oil fields
16 by Union 76, ChevronTexaco, ExxonMobil Corporation, Shell Trading US
17 and any other person, firm or corporation operating a refinery in California
18 with a throughput capacity of at least thirty thousand (30,000) barrels per
19 day, for oil of like gravity on the day the oil is run into the Contractor's
20 tanks and/or pipelines. The value shall be computed to the closest tenth of
21 each degree of API gravity and the closest tenth of a cent per barrel.

22 If the Contractor or any person, firm or corporation
23 comprising the Contractor sells, exchanges or otherwise disposes of any of
24 the oil taken by it under this agreement to a third party at a price or other
25 consideration that is more than the average of the prices posted in the five
26 fields named above by the posters named above, it shall add to its next
27 monthly payment to the City fifty percent (50%) of the difference between
28 this greater amount and the average of prices posted in the five fields

1 named above by the posters named above for the oil so sold, exchanged or
2 otherwise disposed of. This difference shall not be used in computing Net
3 Profits.

4 If the Contractor or any person, firm or corporation
5 comprising the Contractor sells, exchanges or otherwise disposes of any of
6 the oil taken by it under this agreement to any person, firm or corporation
7 other than a person, firm or corporation comprising the Contractor, at a
8 price or other consideration that is less than the average of the prices posted
9 in the five fields named above by the posters named above, it shall deduct
10 from its monthly payment to the City fifty percent (50%) of the difference
11 between this lesser amount and the average of prices posted in the five
12 fields named above by the posters named above, for the oil so sold,
13 exchanged or otherwise disposed of. This difference shall not be used in
14 computing Net Profits. In the event that a Net Profits payment is not due in
15 the following month, these deductions may accumulate and be deducted
16 when a Net Profits payment is due.

17 Whenever there are not at least two (2) different posters
18 among all the companies posting in the five fields named above, the
19 Contractor, the City and the Commission may renegotiate this subsection
20 18.3 to provide another method of valuating the oil in light of these
21 changed circumstances.

22 All agreements made by the Contractor or any person, firm or
23 corporation comprising the Contractor for the sale, exchange or other
24 disposition of the oil taken under this agreement shall be good faith, arm's
25 length agreements. Copies of all such agreements shall be furnished to the
26 City when they are made. The agreements shall reflect the total
27 understanding of the parties, shall show the entire consideration passing
28 among the parties and their affiliates and shall be unrelated to any other

1 agreements among the parties and their affiliates. The City or its
2 authorized representatives shall be permitted at all reasonable times to
3 examine the records of the Contractor and any person, firm or corporation
4 comprising the Contractor for the purpose of verifying that the agreement is
5 a good faith, arm's length agreement and fully discloses the understanding
6 of and consideration passing among the parties and their affiliates.

7 Notwithstanding any other provision of this agreement, the failure of the
8 Contractor or any person, firm or corporation comprising the Contractor to
9 disclose fully to the City all of the consideration received by it or any of its
10 affiliates under any agreement for the sale, exchange or other disposition of
11 oil taken by it under this agreement shall be a major breach of this
12 agreement entitling the City immediately to terminate this agreement and to
13 recover from the Contractor the damages it suffered as a result of the
14 failure to disclose fully such consideration, plus a penalty equal to double
15 the amount of such damages.

16 The Contractor shall also furnish to the City an accurate list
17 of purchases and other acquisitions, including acquisitions on exchange,
18 and sales and other dispositions, including dispositions on exchange, by it,
19 and by all persons, firms and corporations comprising the Contractor, of oil
20 in the Field and in the Huntington Beach, Long Beach, Inglewood and
21 Midway Sunset oil fields. This list shall include the price or value placed
22 on the oil, the volume and gravity of the oil, and the date or dates of its
23 acquisition or disposition.

24 Any person, firm or corporation comprising the Contractor
25 may elect to acquire for its own use all but not a part of the oil required to
26 be taken by the Contractor under this agreement. This election may be
27 made once a year and must be for a twelve-month period. Whenever any
28 person, firm or corporation comprising the Contractor makes such an

1 election, the oil acquired pursuant to this election shall be valued at the
2 highest of the following: (a) the highest price obtained by the City or its
3 marketing contractor in any single sale of at least 5,000 barrels per day
4 (B/D) of crude oil in the Field and providing for delivery for not less than
5 twelve (12) consecutive months and in effect in the month in which the
6 election to take all of the oil is made, (b) the highest weighted average of
7 prices obtained by the City or its marketing contractor in multiple sales of
8 crude oil in the Field in any combination totaling 5,000 B/D and providing
9 for delivery for not less than twelve (12) consecutive months and in effect
10 in the month in which the election to take all of the oil is made or (c) the
11 arithmetical average of the prices posted in the Field and in the Huntington
12 Beach, Long Beach, Inglewood and Midway Sunset oil fields by Union
13 76, ChevronTexaco, ExxonMobil Corporation, Shell Trading US and any
14 other person, firm or corporation operating a refinery in California with a
15 throughput capacity of at least thirty thousand (30,000) barrels per day, for
16 oil of like gravity on the day the oil is run into the Contractor's tanks and/or
17 pipelines. (a) and (b) shall be referred to as the City sales and (c) shall be
18 referred to as the five field average. The value of the oil shall be computed
19 to the closest tenth of each degree of API gravity and the closest tenth of a
20 cent per barrel. The Contractor, however, shall pay to the City a price for
21 the oil equal to the value of the City sales less fifty percent (50%) of the
22 difference between the value of the City sales and the five field average or
23 the five field average, whichever is higher. This difference, if any, shall
24 not be used in computing Net Profits.

25 All assigned oil shall be taken in the manner prescribed in the
26 provisions of the applicable Unit Agreement and /or Unit Operating
27 Agreement.

28 5. The parties may meet to conduct a review to renegotiate the crude oil valuation

1 provisions in subsection 18.3 of the Contract no earlier than 24 months after the effective
2 date of this Consent to Assignment.

3 6. The fifty percent (50%) share of the marketing fee charged by the Contractor
4 shall not be charged as a Reimbursable Expense whenever Paramount is receiving at
5 least eighty percent (80%) of the oil required to be taken by the Contractor under the
6 Contract.

7 7. The Long Beach Board of Harbor Commissioners assesses and collects on a
8 monthly basis rentals for lands within the Long Beach Harbor District occupied by oil
9 production operations carried out by the Contractor on the Subject Lands. This land
10 rental charge is made to the Department of Oil Properties. Each month, the Department
11 of Oil Properties pays this charge and deducts it as a cost of administering oil operations
12 when determining remaining oil revenue payable to the State pursuant to section 4(d) of
13 Chapter 138, Statutes of 1964, 1st E. S. Beginning on the effective date of this Consent
14 to Assignment and Amendment, the Department of Oil Properties will continue to charge
15 the lands rentals as an administrative cost as long as the sum of the City's share of Net
16 Profits (expressed as a positive amount), the share of the marketing bonus payable to the
17 City under subsection 18.3 of the Contract and the dry gas revenue from the Subject
18 Lands for the month exceeds the land rental charge for the same month. Whenever the
19 sum of the City's share of Net Profits (expressed as a positive amount), the City's share
20 of the marketing bonus and the dry gas revenue for any given month is less than the land
21 rental charge for that month, the Department of Oil Properties shall charge the difference
22 to the Contractor. The difference, when paid by the Contractor, shall not be deemed a
23 Reimbursable Expense and, therefore, shall not be retained by the Contractor pursuant to
24 subdivision (a) of subsection 21.3 of the Contract. Furthermore, the difference, when
25 paid by the Contractor, shall not be deemed a cost of operations subject to the
26 administrative overhead charge provided by Subarticle 5.5 of the Accounting Procedure
27 that is Exhibit "B" to the Contract. The Contractor shall pay any difference from its own
28 funds. The Contractor shall keep records of the amounts it has paid from its own funds

1 and shall be entitled to treat these amounts as receivables that it may withhold from the
2 Net Profits and the marketing bonus that become payable to the City in future months.
3 However, the Contractor shall not be entitled to obtain any of these receivables in any
4 future month in which the sum of the Net Profits and the marketing bonus payable to the
5 City is not a positive amount and the sum of the City's share of Net Profits, the City's
6 share of the marketing bonus and the dry gas revenue does not exceed the land rental
7 charge for that month. These receivable amounts shall bear no interest.

8 8. A full field safety audit of the operations on the Subject Lands shall be
9 conducted by the Commission's staff and its consultants and any contractors hired by the
10 Contractor; provided that the Contractor shall have the right to approve the consultants
11 and the Commission's staff shall have the right to approve the contractors, which
12 approvals shall not unreasonably be withheld. The audit shall be completed by October
13 31, 2003; provided, however, that this time may be extended so long as the audit process
14 has proceeded and continues to proceed diligently. The costs for this audit that are
15 incurred by the Commission's staff shall be reimbursed to the Commission by the
16 Contractor in an amount not to exceed \$625,000. The Contractor may treat the costs up
17 to \$625,000 of reimbursing the Commission' staff and all costs for the consultants and
18 contractors as Reimbursable Expenses under the Contract. The Contractor shall remedy
19 to the satisfaction of the Commission's staff and the City all noncompliance items found
20 in the audit within the times prescribed in the audit. The costs for remedying these
21 noncompliance items may also be treated as Reimbursable Expenses under the Contract.

22 9. In order to satisfy the bonding or other security requirements of Section 28 of
23 the Contract, as amended, Tidelands shall furnish a performance bond in the sum of \$4
24 million issued by a surety acceptable to the City Manager and in a form acceptable to the
25 City Attorney. The amount and type of the security may be adjusted as permitted by the
26 terms of Section 28, which shall remain in full force and effect.

27 10. This Consent to Assignment and Amendment shall be governed by the laws
28 of the State of California.

1 11. This Consent to Assignment and Amendment may be executed in counterpart
2 copies, and each executed counterpart copy shall have the same force and effect as an
3 original and shall be enforceable to the same extent as if all parties had executed the
4 same document.

5 12. This Consent to Assignment and Amendment shall be effective May 1, 2003.
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8 CITY OF LONG BEACH, a municipal
9 corporation, as Tidelands Trustee and
10 Unit Operator of Unit Segment I,
11 Fault Block II Unit,
12 Fault Block III Unit,
13 Fault Block IV Unit and
14 Fault Block V Ranger Zone Unit

15 Dated: _____

16 By _____
17 City Manager

18 CALIFORNIA STATE LANDS
19 COMMISSION

20 Dated: _____

21 By _____
22 Executive Officer

23 NESTE OIL SERVICES, INC., a Delaware
24 corporation and General Partner in
25 TIDELANDS OIL PRODUCTION
26 COMPANY, assignor

27 Dated: _____

28 By _____
Title:

CHANCE LONG BEACH PRODUCTION
CORPORATION, a Delaware corporation
and General Partner in TIDELANDS OIL

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PRODUCTION COMPANY, assignee

Dated: _____

By _____

Title:

PARAMOUNT PETROLEUM
CORPORATION, a Delaware corporation,
assignee

Dated: _____

By _____

Title:

TIDELANDS OIL PRODUCTION
COMPANY, a Texas general partnership and
Contractor

Dated: _____

By _____

Title:

Exhibit B**Paramount Petroleum's Financial Statement Analysis**

03/27/2003

			Audited		Unaudited	Industry Median ¹
			2000	2001	2002 ²	
Solvency	Current Ratio	(Current assets) / (current liabilities)	1.37	1.78	1.38	1.4
	Quick Ratio	(Cash + net receivables + marketable securities) / (current liabilities)	0.67	0.81	0.93	0.6
Leverage	Debt to Equity	(Total liabilities) / (assets - liabilities)	1.25	0.87	0.98	1.82
Profitability	Return on Sales	(Net income after tax) / (sales)	2.7%	1.8%	0.1%	4.7%
Company Growth	ROE	(Net income after tax) / (assets - liabilities)	24.9%	12.5%	0.1%	26.5%

Notes:

- 1) Based on 11 establishments as stated in D&B report dated June 3, 2002
2) In year 2002 profit margins in the asphalt business dropped.