

**Minute Item
C51**

04/05/04
W23002
M. Steinhilber

**CALIFORNIA STATE LANDS COMMISSION
(INFORMATIONAL)**

Calendar Item C51: Commission listened to staff presentation.

This item was informational; no action was taken.

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MINUTE PAGE

INFORMATIONAL
CALENDAR ITEM

C51

A 54

04/05/04

S 27

W 12001

M. Steinhilber

**STAFF REPORT ON THE COMPLETION OF THE
FULL FIELD SAFETY AUDIT AS A PROVISION OF THE
EIGHTH AMENDMENT OF THE LONG BEACH HARBOR TIDELANDS
PARCEL AND PARCEL "A" OIL CONTRACT,
AND THE CONSENT TO ASSIGNMENT OF INTEREST
IN TIDELANDS OIL PRODUCTION COMPANY,
WILMINGTON OIL FIELD,
LOS ANGELES COUNTY.**

APPLICANT:

California State Lands Commission
100 Howe Avenue, Suite 100-South
Sacramento, CA 95825-8202

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 had previously been amended seven times since its inception. As a result of previous assignments, the Contractor was Tidelands Oil Production Company (Tidelands), a general partnership of Neste Oil Services, Inc. (Neste) and Chanse Long Beach Production Corporation (Chanse). Neste held a 79.9 percent interest in Tidelands, and Chanse held a 20.1 percent interest in Tidelands.

At the April 2003 meeting, the Commission approved the consent to assignment of interests where Neste assigned a 75 percent interest in Tidelands to Paramount Petroleum Corporation (Paramount) and a 4.9 percent interest in Tidelands to Chanse. As a result of the assignment, Paramount holds a 75 percent interest and Chanse holds a 25 percent interest in the Contractor.

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CALENDAR ITEM NO. C51 (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.

SAFETY AUDIT PROVISION OF THE ASSIGNMENT

A full field safety audit of the operations on the subject lands was required to be conducted as a part of the assignment and Eight Amendment and was detailed in the Agreement (Exhibit A, attached hereto). Commission staff costs associated with this audit, and the cost of contractors hired by the Contractor were to be paid as outlined in the Agreement.

RESULTS OF THE FULL FIELD SAFETY AUDIT:

Commission staff completed the full field safety audit and issued its report on December 30, 2003. The report included 565 action items that were to be corrected within 30, 120, and 180-day time frames based on the severity of the action items. There were three Priority One action items that were to be resolved within 30 days, and two were actually completed prior to the issuance of the report on December 30, 2003. The third Priority One item was completed on January 28, 2004.

There were 93 Priority Two action items and 469 Priority Three action items of lesser significance identified in the report. About eighty-four percent (84%) of all the action items were addressed while the report was being written in December of 2003. Within 60 days of the report being issued, Tidelands Oil Production Company had completed 98 percent (98%) of all the action items. All remaining items were completed by mid March, over a month before the 120-day deadline and four months before the final 180-day deadline. Commission staff has also inspected and verified proper completion of the items.

EXHIBIT:

- A. Consent to Assignment of Interest in and Eighth Amendment to Long Beach Harbor Tidelands Parcel and Parcel "A" Oil Contract

PERMIT STREAMLINING ACT DEADLINE:

N/A

Exhibit A**CONSENT TO ASSIGNMENT OF INTEREST IN AND EIGHTH AMENDMENT
TO LONG BEACH HARBOR TIDELANDS PARCEL AND
PARCEL "A" OIL CONTRACT**

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).

The City Manager and the Commission are willing to consent to the proposed assignment but only on the conditions in this Consent to Assignment and Amendment, including an amendment to Section 18.3 of the Contract to provide a different valuation for the oil to account for the reduction in the number of companies posting prices for crude oil in the Wilmington oil field and so that the return to the City and the Commission under the Contract will not be reduced substantially 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.

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

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

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

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

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

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

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

18.3. All oil shall be valued, accounted for and paid for 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 Union 76, ChevronTexaco, ExxonMobil Corporation, Shell Trading US and any other 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. The value shall be computed to the closest tenth of each degree of API gravity and the closest tenth of a cent per barrel.

If the Contractor or any person, firm or corporation comprising the Contractor sells, exchanges or otherwise disposes of any of the oil taken by it under this agreement to a third party at a price or other consideration that is more than the average of the prices posted in the five fields named above by the posters named above, it shall add to its next monthly payment to the City fifty percent (50%) of the difference between this greater amount and the average of prices posted in the five fields named above by the posters named above for the oil so sold, exchanged or otherwise disposed of. This difference shall not be used in computing Net Profits.

If the Contractor or any person, firm or corporation comprising the Contractor sells, exchanges or otherwise disposes of any of the oil taken by it under this agreement to any person, firm or

corporation other than a person, firm or corporation comprising the Contractor, at a price or other consideration that is less than the average of the prices posted in the five fields named above by the posters named above, it shall deduct from its monthly payment to the City fifty percent (50%) of the difference between this lesser amount and the average of prices posted in the five fields named above by the posters named above, for the oil so sold, exchanged or otherwise disposed of. This difference shall not be used in computing Net Profits. In the event that a Net Profits payment is not due in the following month, these deductions may accumulate and be deducted when a Net Profits payment is due.

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

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

agreements among the parties and their affiliates. The City or its authorized representatives shall be permitted at all reasonable times to examine the records of the Contractor and any person, firm or corporation comprising the Contractor for the purpose of verifying that the agreement is a good faith, arm's length agreement and fully discloses the understanding of and consideration passing among the parties and their affiliates. Notwithstanding any other provision of this agreement, the failure of the Contractor or any person, firm or corporation comprising the Contractor to disclose fully to the City all of the consideration received by it or any of its affiliates under any agreement for the sale, exchange or other disposition of oil taken by it under this agreement shall be a major breach of this agreement entitling the City immediately to terminate this agreement and to recover from the Contractor the damages it suffered as a result of the failure to disclose fully such consideration, plus a penalty equal to double the amount of such damages.

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

acquisition or disposition.

Any person, firm or corporation comprising the Contractor may elect to acquire for its own use all but not a part of the oil required to be taken by the Contractor under this agreement. This election may be made once a year and must be for a twelve-month period. Whenever any person, firm or corporation comprising the Contractor makes such an election, the oil acquired pursuant to this election shall be valued at the highest of the following: (a) the highest price obtained by the City or its marketing contractor in any single sale of at least 5,000 barrels per day (B/D) of crude oil in the Field and providing for delivery for not less than twelve (12) consecutive months and in effect in the month in which the election to take all of the oil is made, (b) the highest weighted average of prices obtained by the City or its marketing contractor in multiple sales of crude oil in the Field in any combination totaling 5,000 B/D and providing for delivery for not less than twelve (12) consecutive months and in effect in the month in which the election to take all of the oil is made or (c) the arithmetical average of the prices posted in the Field and in the Huntington Beach, Long Beach, Inglewood and Midway Sunset oil fields by Union 76, ChevronTexaco, ExxonMobil Corporation, Shell Trading US and any other 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. (a) and (b) shall be referred to as the City sales and (c) shall be referred to as the five field average. The value of the oil shall be computed to the closest tenth of each degree of API gravity and the closest tenth of a cent per barrel. The Contractor, however, shall pay to the City a price for the oil equal to the value of the City sales less fifty percent (50%) of the difference between the value of the City sales and the five field average or the five field average, whichever is higher. This difference, if any, shall not be used in computing Net Profits.

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

5. The parties may meet to conduct a review to renegotiate the crude oil valuation provisions in subsection 18.3 of the Contract no earlier than 24 months after the effective date of this Consent to Assignment.

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

7. The Long Beach Board of Harbor Commissioners assesses and collects on a monthly basis rentals for lands within the Long Beach Harbor District occupied by oil production operations carried out by the Contractor on the Subject Lands. This land rental charge is made to the Department of Oil Properties. Each month, the

Department of Oil Properties pays this charge and deducts it as a cost of administering oil operations when determining remaining oil revenue payable to the State pursuant to section 4(d) of Chapter 138, Statutes of 1964, 1st E. S. Beginning on the effective date of this Consent to Assignment and Amendment, the Department of Oil Properties will continue to charge the lands rentals as an administrative cost as long as the sum of the City's share of Net Profits (expressed as a positive amount), the share of the marketing bonus payable to the City under subsection 18.3 of the Contract and the dry gas revenue from the Subject Lands for the month exceeds the land rental charge for the same month. Whenever the sum of the City's share of Net Profits (expressed as a positive amount), the City's share of the marketing bonus and the dry gas revenue for any given month is less than the land rental charge for that month, the Department of Oil Properties shall charge the difference to the Contractor. The difference, when paid by the Contractor, shall not be deemed a Reimbursable Expense and, therefore, shall not be retained by the Contractor pursuant to subdivision (a) of subsection 21.3 of the Contract. Furthermore, the difference, when paid by the Contractor, shall not be deemed a cost of operations subject to the administrative overhead charge provided by Subarticle 5.5 of the Accounting Procedure that is Exhibit "B" to the Contract. The Contractor shall pay any difference from its own funds. The Contractor shall keep records of the amounts it has paid from its own funds and shall be entitled to treat these amounts as receivables that it may withhold from the Net Profits and the marketing bonus that become payable to the City in future months. However, the Contractor shall not be entitled to obtain any of these receivables in any future month in which the sum

of the Net Profits and the marketing bonus payable to the City is not a positive amount and the sum of the City's share of Net Profits, the City's share of the marketing bonus and the dry gas revenue does not exceed the land rental charge for that month. These receivable amounts shall bear no interest.

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

9. In order to satisfy the bonding or other security requirements of Section 28 of the Contract, as amended, Tidelands shall furnish a performance bond in the sum of \$4 million issued by a surety acceptable to the City Manager and in a form acceptable to

the City Attorney. The amount and type of the security may be adjusted as permitted by the terms of Section 28, which shall remain in full force and effect.

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

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

12. This Consent to Assignment and Amendment shall be effective May 1, 2003.

CITY OF LONG BEACH, a municipal corporation, as Tidelands Trustee and Unit Operator of Unit Segment I, Fault Block II Unit, Fault Block III Unit, Fault Block IV Unit and Fault Block V Ranger Zone Unit

Dated: _____

By _____
City Manager

CALIFORNIA STATE LANDS COMMISSION

Dated: _____

By _____
Executive Officer

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

Dated: _____

By _____

Title:

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