

**Minute Item
C79**

05/10/07
W 17028
F. Velez
D. Mercier

**CALIFORNIA STATE LANDS COMMISSION
(INFORMATIONAL)**

**Item C79 was INFORMATIONAL only.
No vote was taken.**

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**INFORMATIONAL
CALENDAR ITEM
C79**

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**STAFF REPORT ON THE
AUDIT OF THE LONG BEACH UNIT,
THE CITY OF LONG BEACH, OPERATOR,
THUMS LONG BEACH COMPANY, FIELD CONTRACTOR,
WILMINGTON OIL FIELD,
LOS ANGELES COUNTY**

APPLICANT:

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

BACKGROUND:

The Long Beach Unit (Unit) is an oil production operation that includes offshore and onshore lands in the City of Long Beach (City). There are three areas in the Unit. Tract 1 is the largest area by far and consists of tide and submerged lands granted in trust to the City without a reservation of minerals to the State. Tract 2 is a small parcel of tide and submerged lands granted in trust to the City with the minerals reserved to the State. Lastly, the Townlot tracts consist of publicly and privately owned uplands in downtown Long Beach. The Unit was begun in the 1960s. It has produced over 900 million barrels of oil. Wells are drilled from four offshore artificial islands and from Pier J. The Unit's environmental record has been exemplary. Unit operations are under the control of the City. The City's contractor, OXY Long Beach, Inc., a subsidiary of Occidental Petroleum Corporation, conducts these operations. The original contractor was a consortium of Texaco, Humble (now Exxon), Union, Mobil and Shell, hence the acronym THUMS for the entity formed by these companies to act as their agent in performing their contractual obligations to the City.

The City's responsibilities for oil production operations on these tide and submerged lands and the formula pursuant to which the City is required to share

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with the State the oil and gas revenues from these lands are found in Chapter 138 of the Statutes of 1964, 1st Extraordinary Session, and its amendments. The major amendment was Chapter 941, Statutes of 1991, which authorized an Optimized Waterflood Program pursuant to which the contractor made substantial capital investments in the field at its risk in order to secure additional production and, in turn, received a greater share of the net profits from that additional production.

The State has received by far the greatest share of the net profits from the oil and gas production from the Long Beach tide and submerged lands. To date, the State has received over \$4 billion in revenues from these production operations. Although production has declined over the years, the State is expected to receive about \$225 million from the Long Beach tide and submerged lands, \$166 million from the Unit portion alone, for the current fiscal year. Because the State receives a share of net profits, it is concerned with the expenses that are deducted from gross revenues to arrive at these net profits. The audit findings are set out below.

SUMMARY OF AUDIT FINDINGS

1. The audit provides for the exclusion of more than \$6,300 of training and related expenses. THUMS and CSLC have mutually agreed that all training and related expenses benefit both Occidental Petroleum and THUMS and have further agreed on a method for allocating such expenses - over the next 30 years the State could save over \$180,000,
2. The audit provides for the exclusion of \$50,000 of Unit expenditures (legal fees pertaining to an employee lawsuit) from receiving four percent (4%) Administrative Overhead (A/O). This will result in a savings of \$2,000. Legal fees are considered "professional consultant" fees, and are excluded from the calculation of Administrative Overhead under Exhibit F, Section 5.15 of the Long Beach Unit Operating Agreement.
3. The audit recommends procedures be modified to provide for Voting Parties to consider whether an expenditure qualifies for administrative overhead at the time they approve the expenditure. Expenditures on independent contractors do not qualify for overhead charges.
4. The audit recommends establishing guidelines on valuation and allowability of certain expenditures for PRC 186. This is a lease that is adjacent to the Unit and was reactivated in early 2006. Because wells into

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PRC 186 are developed from Unit property, the production from this lease is commingled with Long Beach Unit production and is subject to an allowance for oil dehydration and transportation costs.

5. The audit determined that THUMS has accurately calculated the power plant "make whole" payment. The power plant runs on natural gas. The City no longer takes the Long Beach Unit natural gas due to its high CO2 content. Therefore, THUMS must utilize that gas as fuel for the power plant even when it is uneconomical. The State has agreed to make the Unit "financially whole" when the power plant is operating but is uneconomic to run. This audit found that these "make whole" calculations were correct.
6. The audit verified that the Tract 2 "taken-in-kind" payment was properly calculated – (information item, no finding). Article 7(e) of the Tract 2 agreement provides that at any time within nine months after the end of any calendar or fiscal year, the State shall review and, if necessary adjust, the oil value during such year on the basis of all available relevant and reliable information. The audit found that the State was paid correctly in accordance with the agreement.
7. The audit provides for the exclusion of a \$195 license fee paid to the State of Alaska from receiving A/O. THUMS paid this fee on behalf of one of its employees.
8. The audit recommends that THUMS restore the "Compliance Analyst" position. THUMS previously had a position responsible for performing contract compliance audits and reviewing employee expense claims. Restoration of this position would free the State auditors to perform only spot analysis of these areas.

PERMIT STREAMLINING ACT DEADLINE:

N/A (not a "development project" subject to the Act).