

Long Beach's black gold

John Canalis, Los Angeles Newspaper Group, 12-26-09

One of the solutions to Long Beach's ongoing budget problems may be buried deep underground.

Complex contract negotiations involving the Wilmington Oil Field in and around the Port of Long Beach could uncover a cash gusher for public and private interests.

Preliminary 10-year financial projections associated with the project include eye-popping numbers:

- ◆ \$130 million for the city's general fund, which pays for services such as police and firefighting;
- ◆ \$150 million for the city's Tidelands Fund, which pays for services such as lifeguards and coastal development;
- ◆ \$240 million for Occidental Petroleum, which is under contract with the city to extract oil from the Wilmington field.

Though the formulas being used are proprietary to those in the negotiations, the forecasts are rooted in oil trading at an average of about \$80 a barrel, the value of the dollar - which tends to move in the direction opposite of oil prices - anticipated demand, and other factors.

In addition to sharing in the net profits that could result from future drilling, the city could realize other income from a 41-cent-per-barrel tax and utility-users' taxes on electricity and natural gas, both of which are used in oil production, Assistant City Auditor James Johnson said.

The Wilmington field deal is far from done, but if it is realized, it would pump more money into public coffers than any other publicly known project on Long Beach's financial horizon.

"In terms of actual revenue that will fund general fund requirements, additional police, additional recreation, there's nothing like this that I know of," said Mayor Bob Foster, who later added, "If you could see additional revenue without significant environmental impact, why wouldn't you do it?"

Foster made it clear, however, while the project is the biggest thing on the table for the city budget when examined in purely financial terms, it would not mean nearly as many jobs as some of the proposals being discussed for the former Boeing 717 site, such as an electric car plant or film studio.

Dissenting views

The oil project is not without critics. A group of environmentalists are outspoken about how the proposal and required legislation is coming together, as well as the general idea of bringing more oil to market when they would like to see a focus on alternative fuels.

Several city and state officials said in interviews over the last few months that the project would increase oil production without fouling the water or air, or widening the port's carbon footprint. Air pollution credits - exchanges between cleaner and more polluting projects - of some kind may be needed to achieve true neutrality, though.

Also, carbon dioxide and other emissions associated with oil production are markedly down in the port in the last decade, according to a Long Beach Gas & Oil Department chart shown to the City Council.

And the contract would need to pass muster with the state, which is controlled by a Democratic Legislature known for favoring the nation's tightest air quality regulations.

"We won't take anything to the commission for consideration if we are not comfortable with the environmental aspects of the project," said Greg Scott, chief of the State Lands Commission's Mineral Resource Management Division in Long Beach.

Because much of the oil field belongs to the state, administrators who work for the powerful State Lands Commission are in negotiations to increase production with the city's Gas & Oil Department and Westwood-based Occidental Petroleum.

City acts as trustee

The city oversees California's section of the oil field as a trustee, and money generated from production is paid into a trust that later goes to the state, explained Charles Parkin, a city attorney.

This is also why much of the money generated by the field feeds the city's Tidelands Fund, which can only be spent on a narrow range of coastal uses south of Ocean Boulevard, rather than the broader general fund for core services.

Negotiations are focused on the western flank of the Wilmington Oil Field, an area that roughly spans Pier J and Pine Avenue to the Dominguez Channel and the Los Angeles side of the harbor.

Occidental officials believe it would require a significant investment, some \$50 million, to use modern recovery techniques to extract harder-to-reach oil. So Occidental has asked for new contract terms in an area it is already drilling that would reallocate how revenue is shared among the city, state and the oil company to make additional investment worthwhile.

"They're the ones who take the (financial) risk out there," said Curtis Henderson, manager of oil operations for Long Beach Gas & Oil.

It is, however, a calculated risk. Occidental engineers know the field well and would use both new and existing wells to extract more oil.

"We're reasonably confident that the investment should pay off for everyone," said James Eastlack, an Occidental executive who serves as general manager of the city's unit on the western half of the oil field, Tidelands Oil Production Co., or TOPCO.

But there is only one way to find out.

"Until you start drilling a couple of wells out there, that's the only true way determine whether the oil is there or not," Henderson said.

Drilled for the last 77 years, the Wilmington Oil Field is not virgin territory, but some of the reserves are difficult to reach, particularly from land-based pumps that use slanted, snakelike wells to reach oil tucked beneath the harbor.

Though Occidental is going after new oil, those involved in the project are reluctant to call it "exploration."

"It's really trying to improve recovery," Eastlack said.

The area produces about 7,200 barrels a day.

The city's only investment in the deal will be staff time, Henderson said.

The Sacramento debate

Though there is much promise in the projections, there are myriad steps to climb before any of the involved parties can recover a drop of new oil - or revenue.

The proposal cleared its first major hurdle in the summer of 2008, when Foster flew to Sacramento and joined two Long Beach Democrats, state Sen. Alan Lowenthal and then-Assemblywoman Betty Karnette, in lobbying for a bill that would allow new contract negotiations on the western side of the Wilmington field - the TOPCO unit operated by Occidental.

Oxy also operates the city's other main unit, THUMS Long Beach Co. (long ago a consortium of Texaco, Humble, Union, Mobil and Shell) on the eastern side of the Wilmington Oil Field. THUMS territory spans from about Pier J to Seal Beach, and includes the oil production islands off downtown and Bluff Park, but that unit was not affected by the legislation or the contract negotiations.

The existing TOPCO contract gives Occidental the right to drill on the western flank of the Wilmington field, an area with 720 existing wells.

In essence, Karnette's bill allowed the three parties - the city, state and Occidental - to sit down and discuss new terms Occidental had sought.

Legislators passed Karnette's proposal, Assembly Bill 2165 - but not before a small group environmentalists from the Long Beach and L.A. sides of the San Pedro Bay protested.

Activist taken by surprise

Jesse Marquez, a well-known harbor-area activist with the Coalition for a Safe Environment, flew to Sacramento with two Long Beach area activists to oppose Karnette's bill before the Legislature.

In a recent interview, Marquez argued that the legislation was rushed through in the last legislative session of 2008, it was Labor Day weekend, and did not originate as unique legislation. An existing education-related bill was re-written through the so-called "gut-and-amend" process, which is when a bill on one topic - in this case, education - is rewritten on another.

Marquez, who watches the legislative calendar closely for environmental bills, said he was taken by surprise to learn of the bill in news stories, which originated when Karnette's office issued a press release. Foster's office also notified the City Council's legislative committee by copying it on a letter he sent to Sacramento in support of Karnette's bill.

"Since Betty Karnette is terming out now, no one is going to oppose her on her last bill, her last session, especially on a bill that's backed by the mayor, so two weeks before the end of the session they agreed to gut

and amend the bill," Marquez said. "The City Council was not even aware that this was happening."

Tom Modica, the city's director of legislative affairs, said the city pushed for the bill as soon as it became aware of the opportunity it posed for the city; it just happened to be near the end of the legislative session.

Because negotiations were expected to take a long time and since oil prices are time-sensitive, the city wanted to move forward quickly, he said, adding that the public will have an opportunity to comment in the future when and if a contract goes before other government bodies. Any contract that results from the negotiations would require the approval of the State Lands Commission and City Council - two panels that meet before the public.

Marquez said his group would have liked more time to negotiate mitigations for the deal on behalf of residents affected in Long Beach, Wilmington and other harbor communities - perhaps a biodiesel project. He also wanted an environmental impact report, or EIR, since new drilling would be performed.

City and Occidental officials said an EIR performed in the 1970s was adequate, as drilling has been taking place in the area for decades and that the state bill spoke chiefly to contractual - not environmental - issues.

Also, supporters said, any new drilling would be subject to modern state air- and water- quality regulations, which are stricter now than they were in the 1970s.

In a recent interview, Karnette said she would ultimately like to see a shift from oil toward less-polluting fuel sources, but until that day arrives Long Beach and the state may as well benefit from job creation and revenue.

"If we're going to use it (oil) anyway, and Long Beach is my district, my city, we should be the ones to use it and make it as clean as possible," she said. "We have to go green, and we also have to be realistic."

Lowenthal said there were assurances that the project would not lead to a significant spike in carbon emissions while also providing funding to the city and state.

"It really had a public benefit to it," he said in a recent interview.

Though proposals for offshore drilling get plenty of attention from environmentalists in places such as Santa Barbara, it remains less of an issue in modern Long Beach (it was a divisive issue in the last century) because drills operate from land, or landfill. Even the city's well-known oil islands are considered by the state to be on land.

Though drilling is largely in the harbor, a spokesman for the Port of Long Beach deferred questions to Long Beach Gas & Oil, which is in charge of the project for the city.

The investment

Of the \$50 million that Occidental would consider investing, about \$30 million would be sunk into the state Tidelands area, which is south of Ocean, and \$20 million in the city's Uplands area, the inland land north of Ocean and adjacent to the port.

Occidental's \$50 million investment will pay for engineers, geologists, reservoir studies and making realistic models of the field to determine the best locations to drill, Eastlack said.

Because Occidental has more technical resources on the eastern area of the Wilmington field, the THUMS zone, Eastlack and Henderson said a new contract would allow the company to leverage technology and personnel in the western area.

"They would like to have similar terms there and it becomes easier to share resources," Henderson said. "Then they can look at it as one big oil field rather than separate operations."

The agreement for the east side of the field, the THUMS area, was signed in 1991 with a previous contractor, Arco, which sold its interest to Occidental. Though THUMS is not affected by the current negotiations, Occidental is trying to secure terms similar to that 1991 agreement in the western TOPCO area.

The THUMS contract gives 8.5 percent of revenue to the city's Tidelands fund, 42.5 percent to the state and 49 percent to THUMS Occidental.

The city also withholds a flat \$1 million in revenue a year for the Tidelands fund, part of an agreement that dates to 1964.

In addition, funds - some \$300 million so far - are set aside by the state to pay for cleanup when the field is eventually abandoned, possibly in 20 years or so.

About 10 percent of the revenue from the THUMS area goes to various parties, including the city and private companies and individuals and companies with mineral rights. Of the remaining 90 percent, 70percent goes to the state, 25percent to THUMS, or Occidental, and 5 percent to the city's Tidelands fund.

In 2007-08, THUMS produced about \$120 million for the state, \$10 million for the Tidelands fund, and \$4 million for the city's general fund.

In the western TOPCO area, the terms are quite different. Even though West Wilmington is operated as one area, it is broken up into two distinct contractor agreements, Henderson said in a follow-up e-mail.

In the state Tidelands area about 95 percent of net profits go to the state, and 5 percent go to TOPCO.

And in the area outside the state Tidelands, TOPCO receives no net profit - a fact that will change soon following a Nov. 3 council action that changed contract terms, Henderson wrote. The city - acting as the city or as the port - along with other mineral interest owners receive the net profits.

In all of West Wilmington, the state receives about 65 percent of the net profit, the city (as the port and city) and others receive about 30 percent and TOPCO receives about 5percent of the net profit, Henderson explained.

In fiscal 2007-08, the last year for which complete totals were available, TOPCO generated about \$33 million for the state, \$6.5 million for the city's general fund and nothing for the city's Tidelands fund, but \$14.5 million for the port's harbor fund. The state received a transfer of \$381.4 million. Occidental received \$128.4 million.

The negotiations

Though the Karnette bill allowed negotiations to begin, it has not yet led to a new contract.

"We're still negotiating the desired outcome," Eastlack said. "The ideal is we would have a uniform set of terms between the eastern part and the western part of the Wilmington field."

The contract is based on numerous assumptions, one of them being that oil prices must be at least \$65 a barrel or greater. Light sweet crude futures closed near \$77 Thursday.

However, Wilmington oil is not priced as high as the well-known trading index West Texas Intermediate. The local crude is darker, thicker and more expensive to refine than light sweet crude and sells for 90 to 95 percent of the price.

Harbor-area refineries, such as Valero, Paramount Petroleum, ConocoPhillips and ExxonMobil, receive Wilmington oil via pipelines in the port and primarily refine it for gasoline and jet fuel. The local crude is also used to make petroleum products, such as asphalt, roof shingles, kerosene and plastics. Fuel made from the Wilmington oil mostly stays in California and the West.

Why the negotiations are taking so long is largely a confidential matter, those involved said.

But in general terms, the state and Occidental are trying to determine an appropriate baseline for how the Wilmington field would perform without adding new wells - meaning the status quo - in order to make appropriate projections about the future.

"The intent is to provide some incentives for Oxy, where they can, if they invest some risk money, there could be some enhanced opportunity for return," said Scott, the administrator with the State Lands Commission.

"It needs to be something that should be a win-win for everyone," he added later. "We haven't, until this time, come to consensus on what the arrangement should be and what some of the fundamental premises should be for moving forward."

Scott expects the Lands Commission staff to bring the issue before commissioners for formal review in late 2010 with a goal of "a fair rate of return to the state and city."

After finalization it would take six months to a year to perform engineering, modeling and other preparations before drilling would commence - in 2011 at the earliest.

Occidental employs about 130 people in the TOPCO area of the field, about 80 of them union laborers. It has about the same number of contractors, 130, in the field as well.

"More drilling is more jobs, more contractors for support," Eastlack said.

Exact numbers on how many new jobs would be provided were not available.

If and when new money flows into the city, it will not come in easy-to-budget streams. So even though the city expects \$130 million for the general fund, it may not receive \$13 million a year for 10 years.

Drilling tends to provide more oil at the back end, as the operation matures, Henderson explained.

Does the city get enough?

Many people, including some on the City Council, have asked why the city gets so little of the revenue from oil production in the Tidelands area.

The main reason is a 1955 state Supreme Court ruling that granted the mineral rights to the state since the oil was extracted from state land beneath the water, the Tidelands zone, said City Attorney Bob Shannon.

That decision does not allow the city to use Tidelands revenue for general fund uses.

Before the 1955 decision, things were different. Long Beach was awash in oil cash and used it for its general fund to pay for services.

If Long Beach could use Tidelands money today for its general fund it would likely have an easier time balancing its budget.

"Things would be quite different now, but that's the law and that's the way it is," Shannon said.