



# AGENDA ITEM

Item Number:  
**10**

**TO: CITY COUNCIL**  
**FROM: CITY MANAGER**

**Submitted By:**   
Douglas Dumhart,  
Community Development  
Director

**Meeting Date:**  
February 5, 2013

**Subject:** Operating Covenant and Restrictive Covenants Affecting Interest in Real Property Agreement with Tesoro Refining & Marketing Company, LLC

## RECOMMENDATION:

It is recommended that the City Council adopt a Resolution approving an Operating Covenant and Restrictive Covenants Affecting Interest in Real Property Agreement with Tesoro Refining & Marketing Company, LLC and authorizing the Mayor to execute.

## SUMMARY:

On or about August 16, 2012, BP West Coast Products, LLC announced its intention to sell its Carson Refinery and ARCO Retail Network throughout the Southwest United States to Tesoro Companies, Inc. The City of La Palma's Centerpointe Development has been host to ARCO and its successor in interest, BP West Coast Products, LLC for their Southwest U.S. offices since Fiscal Year 1996-97.

The City of La Palma desires for Tesoro Companies, Inc. (Tesoro), the apparent successor in interest of BP's Carson Refinery and ARCO Retail Network in the US Southwest, to continue to operate and expand those business operations within the City. Their sales activities generate sales taxes, under Section 7200 of the California Revenue and Taxation Code. The City relies on those sales taxes to fund essential general governmental services such as police and public safety, maintenance of public infrastructure, and code enforcement and building safety.

Tesoro has expressed a willingness to maintain the sales arm of their operations in La Palma under a mutually beneficial public-private partnership. To that end, Tesoro is amenable to entering an Operating Covenant Agreement in exchange for a tax sharing arrangement. Staff has negotiated an Operating Covenant and Restrictive Covenants Affecting Interests in Real Property for the City Council's consideration. The Operating Covenant can be found as Exhibit "A" of the draft Resolution provided as Attachment 1 to this report.

**BACKGROUND:**

ARCO (Atlantic Richfield Co.) located their offices in the Centerpointe Development in FY 1996-97, prior to British Petroleum's 2000 acquisition of ARCO. British Petroleum (BP) recently elected to sell its Carson Refinery and ARCO Retail network, among other international assets, to repay costs stemming from the April 20, 2010, Deepwater Horizon oil rig explosion in the Gulf of Mexico. Last August, BP announced Tesoro as the buyer for its California assets.

In BP's press release it states, "BP will sell the ARCO retail brand rights and exclusively license those rights from Tesoro for Northern California, Oregon, and Washington and continue to produce transportation fuels at its Cherry Point, Washington refinery. BP will also retain ownership of the AM/PM convenience store brand and franchise it to Tesoro for use in the Southwest."<sup>1</sup>

According to the Wall Street Journal, Tesoro expects to close the deal—which is subject to regulatory and other approvals—for the 266,000 barrel per day (bpd) Carson refinery, and its associated network of pipelines and storage terminals, and the ARCO-branded retail network, by the middle of 2013.

Tesoro agreed to pay \$1.18 billion for the refinery and 800 Arco-branded gas stations and a further \$1.3 billion for the refinery's inventory.<sup>2</sup>

Tesoro's purchase of the Carson Refinery would bring the number of its California refineries to three, (Wilmington, Martinez, and now Carson) accounting for 60% of the company's total refining capacity. The Carson refinery shares a fence line with Tesoro's 97,000 bpd Wilmington refinery, allowing Tesoro to combine the two into one facility and realize about \$250 million in cost savings.<sup>3</sup>

The BP deal would double Tesoro's refining operations in California, and would make the San Antonio-based company the second-largest refiner in the state after Chevron Corp. BP is keeping its Cherry Point Refinery located in northwest Washington. That refinery has a production capability of 230,000 bpd.

Tesoro has negotiated a lease agreement with TA Realty Fund #IX for 22,491 gross square feet at 6 Centerpointe Drive. The space comprises the entire 5<sup>th</sup> floor of the seven story building. Floor plans for the 20,903 sf of occupiable space indicate 103 offices and modular workstations and eight conference rooms. Tesoro's lease is contingent upon securing approval of an Operating Covenant with the City. The Operating Covenant Agreement is provided as Attachment 1 to this report.

The salient terms and conditions of the Operating Covenant provide for the following:

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<sup>1</sup> BP's news release dated, August 13, 2012. [www.bp.com](http://www.bp.com)

<sup>2</sup> The Deal Pipeline. *BP Sells refinery to Tesoro*. August 13, 2012, Paul Whitfield

<sup>3</sup> The Wall Street Journal. *BP Reaches \$2.5 Billion Tesoro Deal*. August 13, 2012, Ben Lefebvre and Selena Williams

- The City will provide financial consideration in exchange for Tesoro maintaining or causing to be used, a fee simple or leasehold interest in a La Palma, CA 90623 property as offices, for their point of sale for certain business activities and transactions generated from the Carson Refinery and ARCO retail network that are subject to sales taxes.
- The term of the Operating Covenant shall be for twenty (20) years and shall automatically renew for an additional ten (10) years thereafter unless Tesoro provides written notice not less than 90 days before to the expiration date. Tesoro may terminate this agreement at any time upon 180 days with prior written notice to the City.
- City shall rebate to Tesoro on a calendar quarterly basis an amount equal to one-half (50%) of all of the net sales tax up to \$3,000,000 and 70% of all net sales tax in excess of \$3,000,000 received by the City from the sale of Tesoro petroleum products connected with this location.
- Rebate payment to Tesoro shall be made in quarterly installments by City, after receipt of sales tax revenue, attributable to these Tesoro's operations, approximately 90 days after close of quarter.
- City shall take commercially reasonable steps to expedite building permits, certificates of occupancy/final inspection and other permits to facilitate any tenant improvements conducted on behalf of Tesoro in La Palma.
- City agrees to facilitate and assist Tesoro in establishing its corporate identity in proximity to the 91 Freeway in order to promote and grow Tesoro's sales.
- Tesoro shall use its best efforts, consistent with the requirements of law, to maximize its Sales Tax generation, and to designate La Palma as the point of sale for the Designated Sales, and/or consumption of tangible personal property.
- Both parties may jointly defend the Operating Covenant from Third Party challenges.

**ANALYSIS:**

The City of La Palma's City Council adopted Economic Development Plan establishes a variety of goals and guiding principles for the community's leadership. In accordance with the adopted Economic Development Plan these specific goals and objectives which are served by this transaction are:

- Protect and expand La Palma's General Fund revenue base;
- Retain La Palma's Top 10 Income-Generating Businesses;

- Promote the economic well being of the community by encouraging the diversification of its commercial base and of employment opportunities; and,
- Provide the opportunity for increased sales, business licenses, and other fees, taxes, and revenues to the City of La Palma

In consideration for Tesoro's performance under the covenant, the City will agree to make a payment to Tesoro, measured by a portion of the net sales tax generated by Tesoro on the site. City and Tesoro have agreed that the amount to be paid by City to Tesoro during the Operating Period is a fair exchange for the consideration to be furnished by Tesoro to City during the Operating Period.

Such agreements are not uncommon. According to a Government Finance Officers Association (GFOA) publication, *An Elected's Guide to Economic Development*, "Economic Development incentives are tools used by state and local governments to retain or attract jobs and/or tax base." The Operating Covenant Agreement ensures that Tesoro maintains a petroleum business presence dealing with its sales operation, and thus provides additional sales tax to the City of La Palma. The arrangement is a mutually beneficial one and it is recommended that the City approve the Operating Covenant Agreement.

By its approval of this Operating Covenant, the City Council would be finding that it is of benefit to the City and its citizens for Tesoro to continue BP/ARCO's sales operations at the site, and generating the additional sales tax that the City will receive. Additionally, by approving the Operating Covenant, the City Council also finds that the proposed transaction constitutes valid public purposes under Article XVI, Section 6 of the California Constitution, as necessary for the economic enhancement of the City and to preserve, even on a short-term basis, a revenue source for the City's general fund that supports services for the health, safety and welfare of the residents of the City. Finally, the City Council would also be finding that the use and operation of the site as contemplated in this Operating Covenant will assist in the generation of additional sales and use tax revenues to City and therefore City desires to obtain such Operating Covenants and use restrictions on the site.

### CEQA

The Operating Covenant to be acquired by the City does not include any activity which may cause either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment. The operating covenant does not require any change or intensification in land use or density. Tesoro is not required to secure any other Government Approvals pursuant to the Operating Covenant that would trigger California Environmental Quality Act (CEQA) review. Therefore, in light of the whole record, it can be seen with certainty that the project has no potential to cause a significant effect on the environment. As such, the City finds that the project is exempt from the provisions of CEQA pursuant to CEQA Guidelines Section 15061(b)(3) ("general rule exemption").

**FISCAL IMPACT:**

Section 7056 of the California Revenue and Taxation Code sets forth certain requirements and conditions for the disclosure of Franchise Tax Board records, and establishes criminal penalties for the unlawful disclosure of information contained in, derived from, the sales and use tax records of the Franchise Tax Board. While designated municipal officials may receive and review sales tax data, it is prohibited to make public the names of sales tax generators, and the amounts they generate.

The exact amount of the transaction expense to the City is predicated on the volume of sales which will occur by Tesoro in the future. Estimates based on past results cannot be disclosed due to California Revenue and Taxation Code confidentiality requirements.

Tesoro's purchase of BP's assets is subject to review and approval by the Federal Trade Commission (FTC.) Estimated timeline for FTC approval has been stated in industry trade sources as mid-2013. Once approved Tesoro estimates at least six months to reorganize and realign their operations. Thus under the definition section of the Covenant the Commencement date for transactions to start occurring in La Palma are projected at six months after the FTC approved the sale. Should the FTC not render a decision on the sale of BP's assets until the end of 2013, there is a possibility that La Palma would not see any tax revenues in FY 2013-14.

Attachments:           1.     Draft Resolution Approving Operating Covenant and Restrictive Covenants Affecting Interest in Real Property Agreement

**RESOLUTION NO. 2013-\_\_****A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF PALMA APPROVING AN OPERATING COVENANT AND RESTRICTIVE COVENANT AFFECTING INTEREST IN REAL PROPERTY BY AND BETWEEN THE CITY OF LA PALMA AND TESORO MARKETING AND REFINING COMPANY, LLC**

**WHEREAS**, On or about August 16, 2012, BP West Coast Products, LLC announced its intention to sell its Carson Refinery and ARCO Retail Network in US Southwest to Tesoro Marketing and Refining, LLC.; and

**WHEREAS**, The City of La Palma's Centerpointe Development has been host to ARCO and its successor in interest, BP West Coast Products, LLC for their Southwest U.S. offices since 1996-97, which was the site of a sales facility for the sale of petroleum products and ancillary products and services produced at the BP Carson Refinery; and

**WHEREAS**, The City of La Palma desires for Tesoro Marketing and Refining, LLC, (Tesoro) the apparent successor in interest of BP's Carson Refinery and ARCO Retail Network in the US Southwest, to continue to operate and expand those business operations within the City; and

**WHEREAS**, The City relies on sales taxes generated from the sale of petroleum and incidental products produced at BP's Carson Refinery and ARCO Retail Network and sold in La Palma to fund essential general governmental services such as police and public safety, maintenance of public infrastructure, and code enforcement and building safety; and

**WHEREAS**, Tesoro has expressed a willingness to maintain the sales arm of its Carson Refinery operations in La Palma under a mutually beneficial public-private partnership by entering into an Operating Covenant and Restrictive Covenant Affecting Interest in Real Property Agreement provided herein, as Exhibit "A" (the "Operating Covenant"), in exchange for financial consideration; and

**WHEREAS**, The Operating Covenant to be acquired by the City does not include any activity which may cause either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment. The Operating Covenant does not require any change or intensification in land use or density. Tesoro is not required to secure any other Government Approvals pursuant to or to implement the Operating Covenant that would trigger California Environmental Quality Act (CEQA) review.

**WHEREAS**, this Operating Covenant is of benefit to the City and its residents for the above-described petroleum product sales to be conducted on the Site, and that the

imposition of certain operating covenants and use restrictions upon the Site for such uses and the City's payment of the City Consideration described herein constitute valid public purposes under Article XVI, section 6 of the California Constitution as necessary for the economic enhancement of the City and to contribute to the City's general fund that supports services for the health, safety and welfare of the residents of the City; and,

**WHEREAS**, The City Council has further found and determined that the use and operation of the Site as contemplated in this Operating Covenant will assist in the generation of additional sales and use tax revenues to City as well as assist in the creation and maintenance of additional jobs and economic opportunities for the residents of the City, and therefore City desires to obtain such Operating Covenant on the Site,

**NOW, THEREFORE**, the City Council of the City of La Palma resolves as follows:

**SECTION 1.** The foregoing Recitals are incorporated herein and made a part hereof.

**SECTION 2.** The City Council finds and determined that it is of benefit to the City and its residents for the sale of petroleum and related products from the former BP Carson Refinery to be conducted on the Site, and that the imposition of the Operating Covenant upon the Site for such uses and the City's payment of the City Consideration described in the Operating Covenant constitute valid public purposes under Article XVI, Section 6 of the California Constitution as necessary for the economic enhancement of the City and to contribute to the City's general fund that supports services for the health, safety and welfare of the residents of the City.

**SECTION 3.** The City Council does further find and determine that the use and operation of the Site as contemplated in the Operating Covenant will assist in the generation of additional sales and use tax revenues to City, as well as, assist in the creation and maintenance of additional jobs and economic opportunities for the residents of the City, and therefore the City desires to obtain the Operating Covenant on the Site.

**SECTION 4.** The Operating Covenant to be acquired by the City does not include any activity which may cause either a direct physical change in the environment, or a reasonably foreseeable indirect physical change in the environment. The Operating Covenant does not require any change or intensification in land use or density. Tesoro is not required to secure any other discretionary government approvals pursuant to the Operating Covenant that would trigger California Environmental Quality Act (CEQA) review. Therefore, in light of the whole record, it can be seen with certainty that the project has no potential to cause a significant effect on the environment. As such, the City finds that the project is exempt from the provisions of CEQA pursuant to CEQA Guidelines Section 15061(b)(3) ("general rule exemption").

**SECTION 5.** The Operating Covenant is hereby approved. The Mayor is authorized and directed to sign the Operating Covenant on behalf of the City.

**SECTION 6.** The City Manager and her authorized designees are authorized and directed to take such other and further actions, and to sign such other and further documents and instruments, as may be necessary to implement and affect this Resolution and the Operating Covenant on behalf of the City.

**PASSED, APPROVED, AND ADOPTED** this 5th day of February, 2013.

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Steve Hwangbo,  
Mayor

ATTEST:

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Laurie A. Murray, CMC  
City Clerk

STATE OF CALIFORNIA )  
COUNTY OF ORANGE ) SS  
CITY OF LA PALMA )

I, LAURIE A. MURRAY, City Clerk of the City of La Palma, HEREBY DO CERTIFY that the foregoing resolution was adopted at a regular meeting of the City Council of the City of La Palma, held on the 5th day of February, 2013.

AYES:           COUNCIL MEMBERS:  
NOES:           COUNCIL MEMBERS:

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Laurie A. Murray, CMC,  
City Clerk

RECORDING REQUESTED BY AND  
WHEN RECORDED MAIL TO:

City of La Palma  
7822 Walker Street  
La Palma, CA 90623-1771  
Attn: City Clerk

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(Space above for recorder’s use.)

This document is recorded at the request of and for the benefit of the City of La Palma and is exempt from the payment of recording fees pursuant to Government Code § 27383.

**OPERATING COVENANT AND RESTRICTIVE COVENANTS AFFECTING INTERESTS IN REAL PROPERTY**

This OPERATING COVENANT AND RESTRICTIVE COVENANTS AFFECTING INTERESTS IN REAL PROPERTY (“**Covenant**”) is entered into as February \_\_\_\_, 2013, by and between the CITY OF LA PALMA, a California municipal corporation (“**City**”), and TESORO REFINING & MARKETING COMPANY LLC, a Delaware limited liability company (“**Tesoro**”).

**R E C I T A L S**

A. Tesoro is the lessee of that certain real property located at 6 Centerpointe Drive, La Palma, California, and more particularly described in the legal description attached hereto as Exhibit “A” (“**Site**”). This Covenant is recorded against the leasehold interest in the Site. All references in this Covenant to the term “Site” shall be deemed to refer to Tesoro’s leasehold interest in the Site and this Covenant shall not encumber the fee interest of the owner of the Site.

B. Tesoro is purchasing certain assets of BP West Coast Products, LLC (“BP”), including but not limited to the BP refining facility and ancillary assets located in Carson, California (the “**Carson Refining Facilities**”). If it completes the purchase from BP, Tesoro intends to operate on the Site a petroleum products sales facility for products produced from the Carson Refining Facilities, as more particularly described herein (“**Petroleum Business**”).

C. In consideration for Tesoro’s performance under this Covenant, City has agreed to pay to Tesoro certain payments, measured by a portion of the Sales Tax generated by the conduct of its “Required Operations” (as defined below) on the Site, provided that Tesoro causes Required Operations to be conducted on the Site during the term of this Covenant and complies with the other terms and conditions set forth in this Covenant, as more particularly set forth herein. City and Tesoro have agreed that the amount to be paid by City to Tesoro hereunder is a fair exchange for the consideration to be furnished by Tesoro to City.

D. By its approval of this Covenant, the City Council of City has found and determined that it is of benefit to the City and its residents for the Required Operations to be conducted on the Site, and that the imposition of certain operating covenants and use restrictions upon the Site for such uses and the City's payment of the City Consideration described herein constitute valid public purposes under Article XVI, section 6 of the California Constitution as necessary for the economic enhancement of the City and to contribute to the City's general fund that supports services for the health, safety and welfare of the residents of the City. The City Council has further found and determined that the use and operation of the Site as contemplated in this Covenant will assist in the generation of additional sales and use tax revenues to City as well as assist in the creation and maintenance of additional jobs and economic opportunities for the residents of the City, and therefore City desires to obtain such operating covenants and use restrictions on the Site, subject to the terms hereof.

E. By its execution of this Covenant, Tesoro is willing to enter into and be bound by such operating covenants and use restrictions.

### C O V E N A N T S

Based upon the foregoing Recitals and for good and valuable consideration, the receipt and sufficiency of which is acknowledged by both parties, City and Tesoro hereby agree as follows:

1. DEFINED TERMS.

The following terms when used in this Covenant shall have the meanings set forth below:

**"City Consideration"** shall mean the amounts to be paid by City to Tesoro for Tesoro's conduct of the Required Operations during the Operating Period. The City Consideration paid for the Operating Period shall be an amount equal to (i) fifty percent (50%) of up to \$3,000,000 of sales tax generated from the Required Operations during each Contract Year on the Site, plus (ii) seventy percent (70%) of any Sales Tax exceeding \$3,000,000 generated from the Required Operations during that Contract Year on the Site.

**"Commencement Date"** shall mean the date on which Tesoro completes the purchase of the Carson Refining Facilities, from BP, as set forth in a written notice from Tesoro to the City. Notwithstanding the foregoing, the City and Tesoro acknowledge that Tesoro may not commence using the Site as the point of sale for Petroleum Business products and services until Tesoro completes construction of tenant improvements at the Site and thereafter relocates sales staff and initiates sales activities at the Site. The parties anticipate that such sales may not commence until six (6) months following the actual Commencement Date.

**"Contract Year"** shall mean the period from July 1 to June 30 during each year of the Operating Period. For the purposes of this Covenant, the first Contract Year ends on June 30, 2014.

**"Covered Parties"** shall mean the City and its elected and appointed boards, members, officials, officers, agents, representatives, employees and volunteers.

**“Effective Date”** shall mean the date first written on page 1 of this Covenant.

**“Operating Period”** shall mean the period commencing as of the Commencement Date, and continuing until and expiring on June 30, 2033; provided, however, that the term of the Operating Agreement shall automatically be extended for ten (10) additional years (for a term totaling 30 years from the Effective Date) unless either Tesoro or the City provides written notice of expiration not less than ninety (90) days prior to the expiration of the Operating Period. Notwithstanding the foregoing, Tesoro may terminate this Covenant for any reason (or no reason) at any time upon one hundred eighty (180) days’ written notice to the other party.

**“Petroleum Business”** refers to the operation on the Site of a sales facility selling petroleum products and products ancillary to the sale of petroleum refined at the Carson Refining Facilities that generate Sales Tax revenue; provided, however that Tesoro may in its business discretion generate petroleum product and service sales from the Site in addition to those products refined at the Carson Refining Facilities, if Tesoro determines that the relocation of such sales activities comply with all applicable laws.

**“Quarter”** shall mean any three (3) month period commencing on January 1, 2013 and thereafter on April 1, July 1, October 1, or January 1. If the quarterly or other periods used by the State Board of Equalization in calculating or making Sales Tax payments to City differ from City’s fiscal quarters described above, the parties shall modify the timing (but not the amount) of the City Consideration payments to coincide with the periods used by the State Board of Equalization.

**“Required Operations”** shall collectively refer to the following on and with respect to the Site: (i) Tesoro retaining and continuing to own a leasehold interest in all or such lesser portion of the Site sufficient to allow the Petroleum Business to be conducted; (ii) Tesoro’s operation of the Petroleum Business on the Site; and (iii) Tesoro not transferring or otherwise relocating the retail sales operation or the point of sale as reported to the State Board of Equalization for the Petroleum Business to another facility or location outside of the City.

**“Sales Tax(es)”** means that portion of taxes that is allocated, paid to, and actually received by City from the imposition of the Bradley-Burns Uniform Sales and Use Tax law (commencing with Section 7200 of the California Revenue and Taxation Code), or any successor law thereto, arising from all taxable sales transactions, occurring from Required Operations on the Site conducted in the Operating Period. “Sales Tax” shall not include sales tax revenues that are provided to a city based upon a special election and are limited to be used for a specified governmental function or functions.

**“Sales Tax Reports”** shall include, for each Quarter (i) a statement identifying the amount of Sales Tax from the Site paid by the party operating the Required Operations during the Quarter; and (ii) copies of all statements and quarterly reports filed with the State Board of Equalization.

**“Site”** shall have the meaning ascribed in Recital A of this Covenant.

**“Termination Date”** shall mean June 30, 2033, subject to extension or earlier termination of the Operating Period as set forth in this Covenant.

## 2. TESORO OBLIGATIONS.

2.1 Operating Covenant; Continuous Operation. Tesoro hereby covenants and agrees to continuously conduct or cause to be conducted Required Operations on the Site during the entire Operating Period. Such continuous operations shall be subject to the force majeure provisions of Section 5.12 hereof.

2.2 Maximization of Sales Tax. At all times during the Operating Period, Tesoro shall designate the Site as the point of sale for sales and use tax purposes in all Petroleum Business and related sales that originate from the Site. Further, Tesoro shall use its best efforts, consistent with the requirements of law, to maximize its generation of Petroleum Business and related sales, so as to maximize Sales Tax originating from the Site, and to designate City as the point of sale for the Petroleum Business and related sales by Tesoro.

2.3 Payment of Taxes. Tesoro shall pay or cause to be paid any and all taxes applicable to or arising out of Tesoro's lease, operation and/or use of the Site (including, without limitation, all taxes attributable to sales occurring on the Site), except that Tesoro retains its right to protest and contest County of Orange decisions related to the value of its interest in the Site. Tesoro shall make or cause to be made timely sales and use tax payments to the State Board of Equalization.

2.4 Compliance with Laws. Subject to Tesoro's right to contest same, Tesoro shall conduct or cause to be conducted all activities on the Site and shall perform its obligations under this Covenant and cause any construction on the Site to be in conformity with all applicable federal, state, and local laws, ordinances, and regulations. Nothing in this Agreement is a representation or warranty by City that any tenant improvement or other construction work performed on the Site on or after the date of this Agreement is not a public work as defined in Labor Code Sections 1720, et seq., including but not limited to Sections 1771 and 1781. In addition to any other Tesoro indemnifications of City or the Covered Parties set forth in this Covenant, Tesoro shall indemnify, defend, and hold the Covered Parties harmless from and against any and all liability, loss, damage, cost or expenses (including but not limited to reasonable attorneys' fees, expert witness fees, court costs, and costs incurred related to any inquiries or proceedings) arising from or related to the noncompliance by Tesoro of Labor Code Sections 1720, et seq., including but not limited to Sections 1771 and 1781. Tesoro acknowledges and agrees that it shall be independently responsible for reviewing the applicable laws and regulations and effectuating compliance with such laws. Tesoro, on behalf of itself and its affiliates and successors, knowingly and voluntarily waives and discharges any and all claims against the City arising out of or related to Labor Code Section 1781. This provision shall survive the termination of this Agreement.

## 3. CITY CONSIDERATION PAYMENTS.

### 3.1 Payment of City Consideration to Tesoro.

3.1.1 Calculation of City Consideration. In consideration for Tesoro's undertakings pursuant to this Covenant, City shall make payments of City Consideration to Tesoro after the end of each Quarter, as follows:

3.1.1.1 Subject to Paragraph 3.1.1.2 (ii) below, for Required Operations conducted by Tesoro in the Operating Period, City shall pay Tesoro the City Consideration based on the actual net amount of Sales Tax directly received by the City from the State Board of Equalization during that Quarter. Subject to the terms of Section 3.1.2, the payment of City Consideration for each Quarter shall be made in a single lump sum payment within ninety (90) days following the end of that Quarter.

3.1.1.2 City Consideration shall be payable from any source of funds legally available to City. In this regard, it is understood and agreed that the Sales Tax from the Site is being used merely as a measure of the amount of City Consideration payments that are periodically owing by City to Tesoro, and that City does not and legally cannot pledge any portion of the Sales Tax from the Site to Tesoro.

### 3.1.2 Payment Procedure.

3.1.2.1 After the end of each Quarter, and no later than thirty-five (35) days after Tesoro's payment of the Sales Tax to the State Board of Equalization for that Quarter, Tesoro shall submit to City the Sales Tax Reports for the preceding Quarter and a written request for payment of the City Consideration owing to Tesoro.

3.1.2.2 Payment of the amount determined by City to be owing to Tesoro for each Quarter shall be made by City within thirty (30) days after the later of the following: (i) Tesoro's submission of its completed payment request; and (ii) City's verification (based upon corroborating information provided to City by either the State Board of Equalization and/or the sales tax consultant retained by City) that City has received the Sales Tax attributable to sales from all Required Operations on the Site for the applicable Quarter. Any disapproval by City of a Tesoro payment request shall state in writing the reasons for disapproval and shall be provided to Tesoro within fifteen (15) days after City has received information necessary to make the determination that the payment request cannot be approved. City agrees to expeditiously process Tesoro's requests for payment of City Consideration. Tesoro expressly understands that nothing contained in this Covenant shall obligate or otherwise commit City to pay the City Consideration for a Quarter unless and until City receives reasonably satisfactory verification that City has received the Sales Tax attributable to sales from the Required Operations on the Site for that Quarter.

3.1.2.3 In the event that the State Board of Equalization conducts a review or audit of Tesoro's Required Operations or Sales Tax payments during the Operating Period that results in loss or reduction of monies that City has already paid to Tesoro as City Consideration for one or more Quarters, Tesoro shall, within thirty (30) days of its receipt of written notice by the City, return that portion of the City Consideration attributable to the monies that were lost or reduced. The provisions of this paragraph shall survive the termination of this Covenant.

3.1.2.4 The parties acknowledge that certain payments of Sales Tax received by City may be based on estimates and that such amounts will be periodically reduced or increased by the State Board of Equalization to reflect the actual amount of Sales Tax owed to City. The City Consideration payments shall be adjusted accordingly as necessary to

conform to such reconciliations. The adjustment shall be made within sixty (60) days through a payment by Tesoro to City in the case of an overpayment to Tesoro, or a payment by City to Tesoro in the case of an underpayment to Tesoro.

3.1.2.5 Within ninety (90) days following the end of each Contract Year, the City shall conduct an accounting of all of Tesoro's Required Operations and Sales Tax payments during the immediately preceding Contract Year, and the amount of the City Consideration payments made to Tesoro for each Quarter during that immediately preceding calendar year. The City shall provide Tesoro a copy of that accounting and reconciliation upon its completion. In the event that the accounting and reconciliation identifies a disparity between the Required Operations, Tesoro's Sales Tax payments, or City Consideration during that immediately preceding calendar year, appropriate adjustments shall be made within sixty (60) days by a payment from Tesoro to City in the case of an overpayment to Tesoro, or a payment from City to Tesoro in the case of an underpayment to Tesoro.

3.1.3 No Acceleration. It is acknowledged by the parties that any payments by City provided for in this Covenant may only be paid for those periods in which City receives the performance of Tesoro pursuant to this Covenant. Therefore, the failure of City to make any payments or the failure by City to perform any of its other obligations hereunder shall not cause the acceleration of any anticipated future City Consideration payments by City to Tesoro.

3.2 Conditions Precedent to City's Obligations. City's obligation to perform hereunder, including without limitation its obligation to pay the City Consideration pursuant to Section 3.1 of this Covenant, shall be contingent and conditional upon Tesoro's full and satisfactory performance of its obligations set forth in this Covenant.

3.3 Disclosure of Payments. Tesoro agrees that the City Consideration payments and the amounts thereof do not constitute a violation of Revenue and Taxation Code Section 7056 or any other provision of law pertaining to the disclosure of sales tax information, shall be a matter of public record, may be disclosed to any person, and may be included on the City's warrant register. Tesoro waives any law that is contrary to any of the agreements in this Section 3.3.

3.4 City Facilitation of Site Improvements. The City shall take commercially reasonable steps to expedite the review and processing of building permits, certificates of occupancy and final instruction, and other permits, approvals and entitlements needed by Tesoro in connection with its construction of tenant improvements at the Site.

3.5 Assisting in Tesoro Brand Recognition. The City understands that its central location in the Greater Los Angeles/Orange County metropolitan marketplace is in a critical trade corridor for successful corporations to establish their brand recognition. Accordingly, the City agrees (but without any obligation to expend any significant funds) to facilitate and assist Tesoro in establishing its corporate identity in proximity to State Highway 91 in order to promote and grow Tesoro's sales of Petroleum Business products and services.

4. TERMINATION RIGHTS.

4.1 City Termination Rights. In addition to City's termination rights under Section 4.3, City shall have the right to terminate this Covenant if Required Operations are not conducted on the Site for a period of ninety (90) consecutive days.

4.2 Tesoro Termination Rights. If the lessor of the Site, without acting in concert with Tesoro, either terminates or fails or refuses to extend Tesoro's lease of the Site, or if the lease of the Site automatically terminates by operation of the terms of the lease, this Covenant shall terminate as of the date on which the Site lease terminates.

4.3 Mutual Termination Rights. City makes no representation or warranty to Tesoro as to the legality of the City Consideration payments or the City's authority to make such payments. In the event that a judgment is rendered against City invalidating its payment obligations set forth in this Covenant, either City or Tesoro may terminate this Covenant by delivery of written notice of termination to the other party.

5. GENERAL PROVISIONS.

5.1 Entire Agreement, and Amendments. This Covenant incorporates all of the terms and conditions mentioned herein, or incidental hereto, and supersedes all negotiations and previous agreements between the parties with respect to the subject matter hereof. Any amendment or modification to this Covenant must be in writing and executed by Tesoro and City.

5.2 Limitations on City's Liability. Tesoro acknowledges and agrees that:

5.2.1 the relationship between Tesoro and City pursuant to this Covenant is and shall remain solely that of contracting parties, and City neither undertakes nor assumes any responsibility pursuant to this Covenant to review, inspect, supervise, approve, or inform Tesoro of any matter in connection with this Covenant or the Required Operations;

5.2.2 City shall not be directly or indirectly liable or responsible for any loss or injury of any kind to any person or property (except to the extent proximately caused by City's active negligence or intentional misconduct), resulting or in any way arising from (a) any defect in any building, grading, landscaping, or other onsite or offsite improvement; (b) any act or omission of Tesoro or any of Tesoro's agents, employees, independent contractors, licensees, sublessees or invitees; or (c) any accident on the Site or any fire or other casualty or hazard thereon; and

5.2.3 by accepting or approving anything required to be performed or given to City under this Covenant, City shall not be deemed to have warranted or represented the sufficiency or legal effect of the same, and no such acceptance or approval shall constitute a warranty or representation by City to anyone.

5.3 Interpretation; Governing Law; Venue. This Covenant shall be construed according to its fair meaning and as if prepared by both parties hereto. This Covenant shall be construed in accordance with the laws of the State of California, without regard to conflict of law



perform under this Covenant; and (ii) all authorizations and approvals required to make this Covenant binding upon City have been duly obtained.

5.8 Litigation Expenses. If either of the parties institutes any legal action against the other in connection with any controversy related to, concerning or arising out of this Covenant, or any facts based upon or involving this Covenant, then the prevailing party, whether in court, through mediation, arbitration or by way of out-of-court settlement, shall be entitled to recover from the non-prevailing party such prevailing party's reasonable attorneys' fees, court costs, expert witness fees and other expenses relating to such controversy, including such fees, costs and expenses on appeal, if any, and the arbitrator(s), if any, is hereby authorized to make such an award to the prevailing party in arbitration.

5.9 Termination. In the event this Covenant terminates, no termination shall release any party in default and this Covenant shall survive for purposes of allowing a party to enforce its rights and remedies under this Covenant in the event of a default, including without limitation the provisions of Section 4.3. All indemnification provisions and any other provision that by its nature cannot be performed during the term of this Covenant shall survive the termination of this Covenant.

5.10 Joint Defense of Third Party Claims. In the event that a third party files litigation challenging the validity or enforceability of this Covenant, or any payment of the City Consideration by the City to Tesoro, the City and Tesoro may jointly defend the Covenant and/or City Consideration payment. If the litigation is filed only against the City, Tesoro may move to intervene as a defendant, respondent or real party in interest, based upon the nature and form of the litigation. The City and Tesoro may determine, in their discretion, to retain a single defense counsel and jointly share the costs of that defense.

5.11 Covenants to Run with the Leasehold Interest in the Land. All of the leasehold interest in the Site shall be held, sold, conveyed, hypothecated, encumbered, used, occupied, leased and improved subject to the covenants, conditions, and restrictions set forth herein which are hereby declared to be for the benefit of City. This Covenant is designed to create equitable servitudes and covenants running with the Site. The covenants, conditions, restrictions, reservations, equitable servitudes, liens and charges set forth herein shall be binding upon all persons having any right, title or interest in the Site, or any part thereof, their heirs, successive owners and assigns; shall inure to the benefit of City and its successors and assigns and successors, shall be binding upon Tesoro, its successors and assigns and successors in interest; and may be enforced by City. Tesoro hereby declares its understanding and intent that the burden of the covenants set forth herein touch and concern the land. In amplification and not in restriction of the provisions set forth hereinabove, it is intended and agreed that City shall be deemed a beneficiary of the agreements and covenants provided herein both for and in its own right and also for the purposes of protecting the interests of the community. All covenants without regard to technical classification or designation shall be binding for the benefit of City and such covenants shall run in favor of City for the entire period during which such covenants shall be in force and effect, without regard to whether City is or remains an owner of any land or interest therein to which such covenants relate.

5.12 Force Majeure. The obligations by either party hereunder shall not be deemed in default and times for performance hereunder shall be extended where delays are caused by fire/casualty losses; strikes; litigation; unusually severe weather; inability to secure necessary labor, materials or tools because of a shortage in the market; delays of any contractor, subcontractor or supplier; unjustified acts or failure to act by City in the processing or approval of plans or permits or inspection or approvals of improvements on the Site; acts of God, or other similar causes without the fault and beyond the reasonable control of the party, despite the party's diligent efforts (collectively, "force majeure"), if written notice is provided to the other party within a reasonable period following commencement of any such circumstances and, provided further, that the extension of time shall be only for the period of the force majeure delay. Adverse market conditions or the inability to obtain financing shall not constitute an event of force majeure.

5.13 Counterparts. This Covenant may be executed in two or more counterparts, each of which when so executed and delivered shall be deemed an original and all of which, when taken together, shall constitute one and the same instrument.

IN WITNESS WHEREOF, City and Tesoro have entered into this Covenant as of the date first written above.

**"CITY"**

CITY OF LA PALMA, a California municipal corporation

By: \_\_\_\_\_  
Steve Hwangbo  
Mayor

ATTEST:

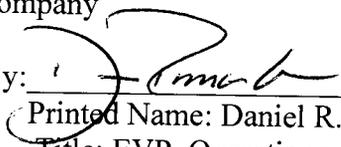
\_\_\_\_\_  
Laurie Murray, City Clerk

APPROVED AS TO FORM:  
RUTAN & TUCKER, LLP

\_\_\_\_\_  
Joel Kuperberg, City Attorney

**"TESORO"**

TESORO REFINING & MARKETING  
COMPANY LLC, a Delaware limited liability  
company

By:  \_\_\_\_\_  
Printed Name: Daniel R. Romasko  
Title: EVP, Operations

State of California )  
County of \_\_\_\_\_ )

On \_\_\_\_\_, before me, \_\_\_\_\_,  
(insert name and title of the officer)

Notary Public, personally appeared \_\_\_\_\_,  
who proved to me on the basis of satisfactory evidence to be the person(s) whose name(s) is/are  
subscribed to the within instrument and acknowledged to me that he/she/they executed the same  
in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument  
the person(s), or the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that  
the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature \_\_\_\_\_

(Seal)

State of Texas )  
County of Bexar )

On JANUARY 29, 2013, before me, ANDREA M. GARCIA,  
(insert name and title of the officer)

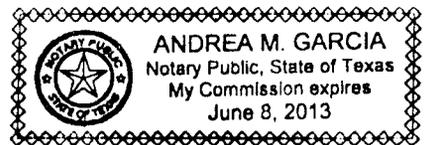
Notary Public, personally appeared Daniel R. Romasko, EVP, Operations, who proved to me on  
the basis of satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the  
within instrument and acknowledged to me that he/she/they executed the same in his/her/their  
authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or  
the entity upon behalf of which the person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that  
the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

Signature \_\_\_\_\_

(Seal)



**EXHIBIT "A"**

**LEGAL DESCRIPTION OF SITE**

All that certain property located in the City of La Palma, County of Orange, State of California, described as follows:

All or a portion of Parcel 1 and Parcel 2 of Parcel Map 84-1228 APN 276-081-61, commonly known as 6 Centerpointe Drive, La Palma, CA 90623