

MEMORANDUM

July 7, 2016

TO: MEMBERS, PORT COMMISSION
Hon. Willie Adams, President
Hon. Kimberly Brandon, Vice President
Hon. Leslie Katz
Hon. Eleni Kounalakis
Hon. Doreen Woo Ho

FROM: Elaine Forbes
Interim Executive Director

SUBJECT: Request approval of an Operations Agreement with Chevron U.S.A. Inc. ("Chevron") allowing continued operation of its Richmond, California refinery as a Foreign Trade Zone No. 3 subzone site for a term of five years, with three options for five years each

DIRECTOR'S RECOMMENDATION: Approve Attached Resolution

Summary

The U.S. Congress established foreign trade zones (FTZ) in 1934 (Act) to stimulate economic development in communities by providing businesses with economic advantages to conduct international trade activities in the United States. In 1948, the Port of San Francisco received an FTZ Board Grant of Authority to establish, operate and maintain foreign trade zones. In the San Francisco Bay Area there are three Foreign Trade Zones: Port of San Francisco Zone No. 3, City of Oakland Zone No. 56 and City of San Jose Zone No.18. Richmond California, location of Chevron U.S.A. Inc. (Chevron) facility, does not operate a Foreign Zone. Given this situation Chevron has selected to utilize the Port of San Francisco Zone No. 3 with its long maritime history and orientation rather than The City of Oakland or San Jose where the FTZ activity is dominated by non-maritime related businesses. The Port, aside from administrative staff time, is not exposed to any capital or operational costs nor has exposure to liabilities resulting from granting a business the use of the FTZ Program.

Chevron has operated their Richmond refinery as sub-zone of the Port of San Francisco's Foreign Trade Zone No. 3 for the past 18 years. The most recent agreement between the Port and Chevron had an expiration date of July 31, 2015. At the July 14, 2015 Port

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Commission meeting, Port staff requested approval of an operations agreement with Chevron granting renewed authority to operate its refinery site in Richmond, California as a Foreign Trade Zone No. 3 subzone for a term of five years, with three options for five years each. At this meeting, community members and a Richmond City Councilmember raised concerns regarding this extension and Port Commissioners asked staff for clarifications regarding the scale and scope of the Foreign Trade Zone program and requested further community outreach. The Port Commission approved a six-month extension of the then Chevron operating agreement which had an expiration date of January 27, 2016.

With this extension, Port staff expanded public outreach. Specifically the Port of San Francisco, grantee of Foreign Trade Zone No. 3, together with the City of Oakland, grantee of Foreign Trade Zone No. 56, jointly held a free half-day regional forum for parties interested in learning about the benefits of the Foreign Trade Zones program. Over 65 attendees from regional and municipal economic development departments, as well as companies looking to learn more about the FTZ benefits were present. Representatives from the City of Richmond, where the Chevron refinery is located, participated. Representatives from organized labor were also invited.

On October 13, 2015 Port staff made an informational presentation to the Port Commission to provide an update on progress on community outreach, outline the overall scope and mechanics of the federal FTZ program and answer questions regarding its geographic scope, economic benefits as well as the “uniform treatment provision” of federal FTZ law. A discussion ensued regarding the Port Commission’s ability to make sure that companies taking advantage of the FTZ program are “good corporate citizens”.

At the Port Commission’s December 8, 2015 meeting, Port staff asked for an additional six-month extension of the FTZ Operating Agreement through July 26, 2016. The additional six-month extension allowed the Port to explore with the Foreign Trade Zone Board the concept of how good corporate citizenship can be woven into the operating agreements with Chevron as well as all future FTZ operating agreements brought before the Port Commission. At this meeting, members of organized labor and both the Richmond and San Francisco communities voiced support for the Port’s FTZ agreement with Chevron.

At the Port Commission’s request, staff has crafted “good corporate citizenship” language now included in the proposed FTZ operating agreement with Chevron. Port staff requests that the Port Commission approve this revised Operating Agreement to ensure that Chevron’s Richmond, CA refinery can continue to use the Federal FTZ program, keeping this operation competitive with other local refinery operations (Valero and Phillips 66) both of whom currently use FTZ No. 3’s authority.

Background

The Foreign Trade Zone Board and the United States Customs service have federal oversight as to applications that grantees, such as the Port of San Francisco, submit for approval. In terms of local discretionally approval, the FTZ Act (Section 14 (19 U.S.C. 81n) mandates that each zone “be operated as a public utility ...and the grantee shall afford to all who may apply for the use of the zone...uniform treatment under like conditions.” Federal law mandates that FTZ grantees, such as the Port of San Francisco, must provide

access to zone benefits to businesses and manufacturers on a nondiscriminatory basis unless it has a compelling case not to. Failure to do so could result in the grantee being fined by the Foreign Trade Zone Board up to \$1,000 per day.

In the case of Chevron USA's request for approval of an agreement with the Port, it should be noted that the Port Commission has granted subzone status to two other Bay Area oil refineries, Valero in 2012 and Phillips 66 in 2014. Foreign Trade Zone Board requirements stipulate that different treatment between similar users requires justification.

Chevron established a Foreign Trade Zone subzone site at its Richmond, California refinery facility in August 1998 under an Operations Agreement with Foreign Trade Zone Services, Inc. then acting as Port's designee to operate Port's Foreign Trade Zone No. 3 ("FTZ No. 3"). The original agreement, which had a term of 17 years, would have expired July 31, 2015 but the Port Commission approved two six-month extensions that now expire July 27, 2016. Chevron refines, blends, stores and distributes finished petroleum products at its Richmond refinery. FTZ status at the Richmond refinery puts Chevron in a better position to retain jobs and compete with imports of finished petroleum products and with other refineries in the region, two of which also are operating under FTZ procedures.

If approved, Chevron will operate the subzone site pursuant to the terms of the revised operations agreement, a copy of which is on file with the Secretary of the Port Commission. Within the anti-discriminatory bounds of Federal law, the Port Commission has sole discretion to grant approval of this operating agreement based on Chevron's performance of the agreements terms, and can evaluate Chevron's performance as required by the terms of the agreement when deciding whether or not to enter into the agreement.

The Port's current Agreement contains standard Port terms for subzone operating agreements, including that Chevron will: (i) assume responsibility under the Agreement for operation and management of the subzone site in conformance with all FTZ Board and U.S. Customs and Border Protection ("CBP") regulations and guidelines and all other local, state and federal laws; (ii) allow for Port and regulatory agency oversight of compliance with FTZ rules; (iii) agree to pay fees (as adjusted); (iv) indemnify Port for claims resulting from the Agreement; and (v) provide adequate insurance coverage. Any operating costs or capital improvements associated with the extension of the operating agreement will be Chevron's responsibility.

Discussion

In granting such a designation, the Act allows for the establishment of special-purpose subzone sites, such as petroleum refineries. In 1998 the Port established the subzone site for the Chevron petroleum refinery facility in Richmond and in 2011 established another such subzone site at the Valero Refining Company refinery facility in Benicia, California. A third such subzone site was established for the Phillips 66 Rodeo, California refinery site in February 2014.

FTZ status at the Richmond refinery allows Chevron to improve its cash flow at that refinery and puts Chevron in a better position to retain jobs and compete with imports of finished petroleum products. The refinery complex currently employs 3,119 workers.

Renewal of Chevron's FTZ status allows the Richmond refinery to better compete with the two other refineries in the area already operating as FTZ subzones. As the U.S. becomes more efficient in its own consumption of petroleum products and as developing countries increase their demand, U.S. refiners, including Chevron, could be poised to increase exports to those countries. FTZ status will promote continued exports from the Richmond refinery, which currently include jet fuels, motor gasolines, diesel fuels and fuel oils. Approximately ten percent of products originating in the subzone were exported in 2015.

Chevron supplies jet fuel to San Francisco International Airport's airline customers, and the petroleum used to produce jet fuel for international flights is duty-exempt because the fuel is considered an export when consumed outside of U.S. borders.

The Foreign-Trade Zones Act provides for "...the establishment...of foreign-trade zones in ports of entry of the United States, to expedite and encourage foreign commerce, and for other purposes," and authorizes the FTZ Board to grant to qualified corporations the privilege of establishing FTZ subzone sites in or adjacent to CBP ports of entry. The FTZ Board's regulations (15 CFR Part 400) provide for the establishment of special-purpose subzones when existing zone facilities cannot serve the specific use involved, and when the activity results in a significant public benefit and is in the public interest.

Article VII of the Transfer Agreement and Charter Section B3.581(o) authorizes the Port of San Francisco "to operate foreign trade zones within the Port area or auxiliary to the Port area, or such zones or subzones as have been operated by the San Francisco Port Authority." The proposed subzone is auxiliary to the Port area because Chevron imports crude oil to its refinery in Richmond on vessels that regularly anchor at San Francisco Bay anchorages, and use tug and tow and other marine services that are predominantly located at the Port of San Francisco to support these vessels. The more ships Chevron continues to bring into the Bay, the more need Chevron will have for Port of San Francisco harbor services which translates to greater maritime commerce and income to the Port.

Foreign trade zone benefits Chevron utilizes at the subzone site include: (i) deferring U.S. Customs entries of petroleum imports until finished products are ready to leave the subzone, thereby deferring payment of Customs duties; (ii) processing Customs entries weekly rather than on a per-shipment basis and thereby reducing administrative costs; (iii) reducing Customs duty rates on certain imported inputs to the refining process; and (iv) eliminating payment of Customs duties on imported refinery inputs for finished products that are later re-exported.

FTZ subzone status does not exempt Chevron from paying any local or state taxes or fees and does not take away any local governmental tax or regulatory control.

Port staff has worked diligently to promote our role as FTZ No. 3 grantee to companies in the region. Staff has made numerous presentations to local trade groups, municipalities and other governmental organizations extolling the benefits that the FTZ program can offer as an economic development tool. A "Good Corporate Citizen" provision has been added to the Operating Agreement at the request of the Port Commission. . After review of this request and working within the regulations of the FTZ Board, Port staff have crafted a "Good Corporate Citizen" provision we believe honors the spirit of the Port Commission

concerns. Given this provision embodies Federal, State and Local laws and regulations that all businesses conducting commerce similar to Chevron must adhere to, it does not create an unfair or unequitable regimen of compliance. Chevron has agreed with this new provision. The new provision reads as follows:

During the Term of this Agreement, Operator shall continue to act as a good corporate citizen with respect to its activities within the FTZ by complying with all relevant standards of commercial integrity and business ethics embodied in all applicable federal, state and local laws and Regulations, including but not limited to all such requirements pertaining to equal employment opportunity, the environment, labor, occupational safety and health, securities, antitrust, banking and public integrity, as a condition of Operator's right to receive the FTZ benefits under this Agreement in accordance with the grant of authority issued by the FTZ Board.

Strategic Plan

This use of Foreign Trade Zone program meets the Port's Strategic Plan goals by improving Economic *Vitality* by benefiting our harbor service companies and Northern California's economic competitiveness.

Recommendation

Port staff recommends that the Port Commission approve the attached resolution authorizing execution of an Operations Agreement with Chevron allowing continued operation of its Richmond, California refinery as a Foreign Trade Zone No. 3 subzone site for a term of five years, with three options for five years each. As a maritime agreement, this Agreement is subject only to approval of the Port Commission and not subject to Board of Supervisors' approval.

Prepared by: Peter Dailey
Deputy Director, Maritime

**PORT COMMISSION
CITY AND COUNTY OF SAN FRANCISCO**

RESOLUTION NO. 16-18

- WHEREAS, The grant of authority for Foreign Trade Zone No. 3 ("FTZ No. 3" or the "Zone") was issued to the San Francisco Port Authority, the State of California's predecessor port agency prior to its transfer to the City and County of San Francisco, by the Foreign-Trade Zones Board ("FTZ Board") on March 10, 1948 under Board Order No. 16; and
- WHEREAS, Article VII of the Transfer Agreement and Charter Section B3.581(o) authorizes the Port of San Francisco "to operate foreign trade zones within the Port area or auxiliary to the Port area, or such zones or subzones as have been operated by the San Francisco Port Authority;" and
- WHEREAS, The FTZ Act mandates that the each zone "be operated as a public utility ...and the grantee shall afford to all who may apply for the use of the zone...uniform treatment under like conditions"; and
- WHEREAS, As grantee of the FTZ No. 3, the San Francisco Port Commission ("Zone Grantee") has certain responsibilities to establish and maintain the FTZ No. 3 as stated in the FTZ Board regulations; and
- WHEREAS, The Foreign-Trade Zones Act provides for "...the establishment...of foreign-trade zones in ports of entry of the United States, to expedite and encourage foreign commerce, and for other purposes," and authorizes the FTZ Board to grant to qualified corporations the privilege of establishing foreign-trade zone sites in or adjacent to U.S. Customs and Border Protection ports of entry; and
- WHEREAS, The FTZ Board's regulations (15 CFR Part 400) provide for the establishment of special-purpose subzones when existing zone facilities cannot serve the specific use involved, and when the activity results in a significant public benefit and is in the public interest; and
- WHEREAS, Chevron U.S.A. Inc. ("Chevron") desires to continue making use of foreign trade zone status at its Richmond, California refinery site described in its application to the FTZ Board; and
- WHEREAS, The proposed subzone is auxiliary to the Port area because Chevron imports crude oil to its refinery in Richmond on vessels that regularly anchor at San Francisco Bay anchorages, and use tug and tow and other marine services that are predominantly located at the Port of San Francisco to support these vessels; the more ships Chevron continues to bring into the Bay, the more need Chevron will have for Port of San Francisco harbor services which translates to greater maritime commerce and income to the Port; and
- WHEREAS, The Port, as Zone Grantee, deems it practicable to limit its participation in the everyday operations of the subzone site; and
- WHEREAS, Chevron, as subzone operator, continues to be the owner of the subzone and wishes to continue undertaking the operational management of foreign trade zone subzone activities, on its own behalf, pursuant to the authority extended by the

Port, as Zone Grantee, and subject to all applicable federal, state and local regulations, statutes and ordinances; and

WHEREAS, Subzone activities that Chevron conducts at the subzone site include: (i) deferring U.S. Customs entries of petroleum imports until finished products are ready to leave the subzone, thereby deferring payment of Customs duties; (ii) processing Customs entries weekly rather than on a per-shipment basis; (iii) reducing duty rates on certain imported inputs to the refining process; and (iv) eliminating payment of Customs duties on imported refinery inputs for finished products that are later re-exported; no local or state tax payments are exempted; and

WHEREAS, The Port and Chevron as subzone site operator have negotiated an operating agreement, a copy of which is on file with the Secretary of the Port Commission (the "Agreement"), granting subzone site operator exclusive authority to operate the subzone, and outlining conditions for the operation of the subzone site; and

WHEREAS, Under the Agreement, Chevron as subzone site operator agrees to pay the Port as Zone Grantee a prorated \$20,000 annual fee that will cover Zone Grantee expenses for oversight of the subzone site and submission of the Annual Report summarizing FTZ No. 3 annual activities to the FTZ Board; now, therefore, be it

RESOLVED, That the Port Commission hereby approves an updated Operations Agreement with Chevron U.S.A. Inc. for a term of five years with three five year options commencing July 28, 2016, such extension to include the "good corporate citizen" provision, annual fee and other applicable rates and charges and authorizes the Executive Director to execute the Agreement; and be it further

RESOLVED, That the Port Commission authorizes the Executive Director to enter into any additions, amendments or other modifications to the Agreement that the Executive Director, in consultation with the City Attorney, determines are in the best interest of the Port, do not materially increase the obligations or liabilities of the Port or City or materially decrease the public benefits accruing to the Port, and are necessary and advisable to complete the transaction and effectuate the purpose and intent of this Resolution, such determination to be conclusively evidenced by the execution and delivery by the Executive Director of any such documents.

I hereby certify the foregoing resolution was adopted by the Port Commission at its meeting of July 12, 2016.

Secretary