

SETTLEMENT AGREEMENT AND RELEASE

This SETTLEMENT AGREEMENT AND RELEASE (hereinafter "Agreement") is entered into between the State of California Air Resources Board (hereinafter "ARB") with its principal office at 1001 I Street, Sacramento, California 95814, and Tesoro Refining and Marketing Company, Golden Eagle Refinery (hereinafter "TESORO"), with its principal place of business at 150 Solano Way, Martinez, CA 94952.

I. RECITALS

- (1) California Code of Regulations (hereinafter "CCR"), title 13, section 2265(a)(2) states, "...the producer shall notify the executive officer of...(B) the PM alternative specifications that will apply to the final blend ... and (C) the numerical values for percent change in emissions for oxides of nitrogen, hydrocarbons, and potency-weighted toxic air contaminants as determined in accordance with the applicable Predictive Model Procedures. The notification shall be received by the executive officer before the start of physical transfer of the gasoline from the production or import facility, and in no case less than 12 hours before the producer or importer either completes physical transfer or commingles the final blend."
- (2) CCR, title 13, section 2265(a)(3) states, "[o]nce a producer or importer has notified the executive officer ... that a final blend of California gasoline is being sold or supplied from a production or import facility as a PM alternative gasoline formulation, all final blends of California gasoline subsequently sold or supplied from that production or import facility shall be subject to the same PM alternative specifications until the producer or importer either (A) designates a final blend at that facility as a PM alternative gasoline formulation subject to different PM alternative specifications, (B) elects in accordance with section 2264.2 to have a final blend at that facility subject to flat limit compliance options and/or averaging compliance options, or (C) elects in accordance with section 2266(c) to sell a final blend at that facility as an alternative gasoline formulation."
- (3) CCR, title 13, section 2265(b)(1) states, "[n]o producer or importer shall sell, offer for sale, supply, or offer for supply from its production or import facility California gasoline which is reported pursuant to section 2265(a) as a PM alternative gasoline formulation subject to PM alternative specifications if any of the following occur: ... (C) The gasoline fails to conform with any PM flat limit in the identified PM alternative specifications..."
- (4) California Health and Safety Code (hereinafter "H&SC") section 43027(a) states, "[a]ny person who willfully and intentionally violates any provision of this part, or any rule, regulation, permit, variance, or order of the state board, pertaining to fuel requirements and standards, is liable for a civil penalty of not more than two hundred fifty thousand dollars (\$250,000), and the prosecuting agency shall include a claim for an additional penalty in the amount of any economic gain that

otherwise would not have been realized from the sale of the fuel determined to be in noncompliance.”

- (5) H&SC section 43027(b) states, “[a]ny person who negligently violates any provision of this part, or any rule, regulation, permit, variance, or order of the state board, pertaining to fuel requirements and standards, exclusive of the documentation requirements specified in subdivision (d), is liable for a civil penalty of not more than fifty thousand dollars (\$50,000).”
- (6) H&SC section 43027(c) states, “[a]ny person who violates any provision of this part, or any rule, regulation, permit, variance, or order of the state board, pertaining to fuel requirements and standards, exclusive of the documentation requirements specified in subdivision (d), is strictly liable for a civil penalty of not more than thirty-five thousand dollars (\$35,000).”
- (7) H&SC section 43027(d) states, “[a]ny person who enters false information in, or fails to keep, any document required to be kept pursuant to any provision of this part, or any rule, regulation, permit, variance, or order of the state board, pertaining to fuel requirements and standards, is strictly liable for a civil penalty of not more than twenty-five thousand dollars (\$25,000)....”
- (8) H&SC section 43029 requires the prosecuting agency to include a claim for an additional penalty designed to eliminate the economic benefits from noncompliance against any person who violates any provision of this part, or any rule, regulation, permit, variance, or order of the state board pertaining to fuel requirements or standards as follows: “(a) For violations of gasoline requirements, the amount of the penalty shall equal the product of the number of tons of incremental increased vehicular emissions resulting from the manufacture, distribution, and sale of the specified volume of noncompliant fuel and nine thousand one hundred dollars (\$9,100) per ton, which is the maximum calculated cost-effectiveness for California Phase 2 Reformulated Gasoline...”
- (9) H&SC section 43030(a) states, “for the penalties prescribed in Sections 43027...., each day during any portion of which a violation occurs is a separate offense.”
- (10) H&SC section 43031(b) states, “[i]n determining the amount assessed, ...the state board, in reaching any settlement, shall take into consideration all relevant circumstances, including, but not limited to, all of the following: (1) The extent of harm to public health, safety, and welfare caused by the violation. (2) The nature and persistence of the violation, including the magnitude of the excess emissions. (3) The compliance history of the defendant, including the frequency of past violations. (4) The preventive efforts taken by the defendant, including the record of maintenance and any program to ensure compliance. (5) The innovative nature and the magnitude of the effort required to comply, and the accuracy, reproducibility, and repeatability of the available test methods. (6) The efforts to attain, or provide for, compliance. (7) The cooperation of the defendant during the course of the investigation and any action taken by the defendant,

including the nature, extent, and time of response of any action taken to mitigate the violation. (8) For a person who owns a single retail service station, the size of the business.”

- (11) ARB alleges in Report of Violation **F04-10-2** the following: Between January 31, 2004 and April 2, 2004, TESORO sold and/or supplied eleven batches of regular grade California reformulated gasoline blendstock for oxygenate blending (CARBOB) with aromatic hydrocarbon contents exceeding their respective predictive model specifications.
- (12) TESORO produced batch numbers 04-53, 04-54, 04-83, 04-93, 04-125, 04-141, 04-156, 04-158, 04-160, 04-165, and 04-172 on January 31, 2004, February 1, 16, and 23, 2004, March 11, 19, 27, 28, 28, and 31, and April 2, 2004, respectively at its refinery located at 150 Solano Way, Martinez, California, using predictive models. ARB obtained and analyzed retained samples of each of these batches. ARB's laboratory alleges analyses of these samples revealed that the gasoline contained total aromatics in excess of the predictive model specification. At all relevant times, the foregoing batches of TESORO gasoline were subject to, or controlled, regulated, or otherwise governed by its predictive model specifications.
- (13) ARB alleges that the sale, offer for sale, supply, or offer for supply of gasoline from batch numbers 04-53, 04-54, 04-83, 04-93, 04-125, 04-141, 04-156, 04-158, 04-160, 04-165, and 04-172 was unlawful and in violation of CCR, title 13, section 2265(b)(1)(C).
- (14) ARB alleges that if the facts described in recital paragraphs 1 - 12 were proven, civil penalties could be imposed against TESORO as provided in Health and Safety Code sections 43027, 43029, 43030, and 43031.
- (15) TESORO admits the facts as alleged in recital paragraphs 1-12, but denies any liability arising out of those facts.
- (16) Upon discovery of the cause of the violations, TESORO immediately instituted quality control procedures such as improved statistical quality control charts to identify the decay of various aromatic components.
- (17) TESORO has provided full cooperation during the course of the investigation.
- (18) Seven of the eleven batches were subsequently determined to meet the criteria for approval in the predictive model, based on the correct total aromatic contents.
- (19) All violations referred to herein resulted in minimal excess emissions.
- (20) TESORO has voluntarily agreed to produce gasoline that will more than offset these excess emissions.

- (21) TESORO is entering into this Agreement solely for the purpose of settlement and resolution of this matter with ARB. Further, ARB accepts this Agreement in termination of this matter. Accordingly, the parties agree to resolve this matter completely by means of this Agreement, without the need for formal litigation.

II. TERMS AND RELEASE

In consideration of ARB not filing a legal action against TESORO for the violations referred to above, ARB and TESORO agree as follows:

- (1) Within 15-days of the execution of this Agreement, TESORO shall pay the total amount of \$325,000 dollars as follows. \$250,000 shall be payable to the California Air Pollution Control Fund. Payment shall be made by check payable to the California Air Pollution Control Fund and addressed to:

Kirk Oliver
Air Resources Board
1001 I Street
Sacramento, CA 95814

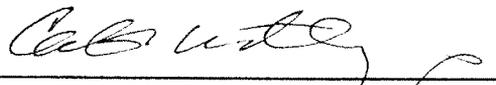
\$75,000 shall be payable to the California District Attorneys Association as follows. Payment shall be made by check payable to the CDA Environmental Circuit Prosecutor Project and addressed to the address appearing immediately above. Tesoro shall not seek to reduce any tax liability by virtue of paying the above amounts.

- (2) Tesoro shall produce gasoline at the Golden Eagle Refinery for use in the State of California during the time period from March 1 through October 31 of 2006 that results in a reduction of five tons of hydrocarbon emissions below the amount of hydrocarbon emissions Tesoro would be legally entitled to cause or would cause in its course of planned production, whichever is lower. Tesoro will provide a report to ARB that demonstrates that this reduction of five tons of hydrocarbon emissions is demonstrable, enforceable and verifiable.
- (3) This Agreement shall apply to and be binding upon TESORO and its principals, officers, directors, agents, receivers, trustees, employees, successors and assignees, subsidiary and parent corporations and upon ARB and any successor agency that may have responsibility for and jurisdiction over the subject matter of this Agreement.
- (4) Now therefore, in consideration of the payment of TESORO to the California Air Pollution Control Fund, ARB hereby releases TESORO and its principals, officers, directors, agents, employees, parents, subsidiaries, predecessors, and successors, and each of their officers, directors, agents, and employees from any and all claims that ARB may have based on the facts and allegations described

in recital paragraphs 1 - 14. The undersigned represent that they have the authority to enter this Agreement.

- (5) This Agreement constitutes the entire agreement and understanding between ARB and TESORO concerning the claims and settlement in this Agreement, and this Agreement fully supersedes and replaces any and all prior negotiations and agreement of any kind or nature, whether written or oral, between ARB and TESORO concerning these claims.
- (6) If any court of competent jurisdiction declares or determines any provision of this Agreement to be illegal, invalid, or unenforceable, the legality, validity, and enforceability of the remaining parts, terms, and provisions shall not be affected thereby, and said illegal, unenforceable, or invalid part, term, or provision will be deemed not to be part of this Agreement.
- (7) No agreement to modify, amend, extend, or supersede this Agreement, or any portion thereof, shall be valid or enforceable unless it is in writing and signed by all parties to this Agreement.
- (8) This Agreement shall be interpreted and enforced in accordance with the laws of the State of California, without regard to California's choice of law rules.
- (9) This Agreement will terminate upon completion of the penalty payment pursuant to paragraph (1) of this section and upon submittal of the report pursuant to paragraph (2) of this section.

CALIFORNIA AIR RESOURCES BOARD

By: 
Name: Catherine Witherspoon
Its: Executive Officer
Date: 1/27/06

TESORO REFINING AND MARKETING COMPANY

By: 
Name: WILLIAM M. BODNAR
Its: VICE PRESIDENT, CALIFORNIA
Date: 9 Feb 2006