

This Calendar Item No. 90
 was approved as Minute Item
 No. 90 by the State Land
 Commission by a vote of 2
 to 1 at its 3/8/94
 meeting

MINUTE ITEM

90

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03/08/94
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 Frey
 Hager

RECONSIDERATION OF PROPOSAL BY CITY OF HERMOSA BEACH
 FOR LEASING FOR OIL AND GAS DEVELOPMENT ON
 GRANTED TIDE AND SUBMERGED LANDS, LOS ANGELES COUNTY

During consideration of Calendar Item 90, the Commission received testimony from both the opponents and proponents of the project. After this testimony, the Commission made the following findings concerning the leasing of the tide and submerged lands as being in the best interests of the State.

1. Additional domestic oil resources may be produced.
2. Drilling and production operations in Hermosa Beach will bring additional jobs and demand for services and materials that will help the economy of Southern California.
3. Tidelands oil can be developed from an inland drillsite several blocks from and out of view from the beach. This means that there will be no platforms in the ocean, no well locations and production facilities on the beach and no transportation of crude oil, whether by tanker or by pipeline, in the ocean off the California coast. Therefore, the serious risks of oil spills in the ocean usually attendant to tidelands oil production will not be present.
4. Drilling will occur from the City Maintenance Yard. The drilling rig, which will be present during less than one-seventh of the estimated thirty-five year life of the project, will be camouflaged by being encased in a tower. When the production phase begins, the rig and the tower will be removed, leaving no visual intrusion. During the production phase, the only impacts on the residents will be some traffic from trucks servicing the production facility. The electrically operated equipment will be soundproofed.
5. The development of the tidelands oil resources will provide money to the City to be used for improving and maintaining its granted public trust lands.

The Commission then took the following actions.

1. REAFFIRMED ITS FINDING THAT AN EIR WAS PREPARED AND CERTIFIED FOR THIS PROJECT BY THE CITY OF HERMOSA BEACH, ITS REVIEW AND CONSIDERATION OF THE INFORMATION IN THE EIR AND ~~ITS ADOPTION OF A~~

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STATEMENT OF OVERRIDING CONSIDERATIONS WHICH IS EXHIBIT "B" TO ITEM NO. C29 APPROVED ON APRIL 29, 1993.

2. PURSUANT TO SECTION 6872 OF THE PUBLIC RESOURCES CODE, MADE THE FOLLOWING DETERMINATIONS REGARDING LEASING IN THE SANTA MONICA BAY SANCTUARY:

A. BASED UPON THE ENTIRE RECORD IN THIS MATTER, INCLUDING BUT NOT LIMITED TO THE EVIDENCE RECEIVED BY THE COMMISSION AT THE HEARING ON JUNE 30, 1992 AND THE REPORT OF MESSRS. BROCK AND WRIGHT, DETERMINED THAT OIL AND GAS DEPOSITS ARE BELIEVED TO BE CONTAINED IN THE HERMOSA BEACH TIDE AND SUBMERGED LANDS.

B. BASED UPON THE ENTIRE RECORD IN THIS MATTER, INCLUDING BUT NOT LIMITED TO THE EVIDENCE RECEIVED BY THE COMMISSION AT THE HEARING ON JUNE 30, 1992 AND THE REPORT OF MESSRS. BROCK AND WRIGHT, DETERMINED THAT THESE OIL AND GAS DEPOSITS ARE BEING DRAINED BY MEANS OF WELLS ON ADJACENT LANDS.

C. BASED ON THE FINDINGS SET FORTH ABOVE, DETERMINED THAT LEASING OF THE HERMOSA BEACH TIDE AND SUBMERGED LANDS FOR THE PRODUCTION OF OIL AND GAS WILL BE IN THE BEST INTERESTS OF THE STATE.

3. DETERMINED UNDER SECTION 7057 OF THE PUBLIC RESOURCES CODE THAT LEASING BY THE CITY FOR OIL AND GAS EXPLORATION AND PRODUCTION OF ITS TIDE AND SUBMERGED LANDS, ALL OF WHICH ARE WITHIN THE SANTA MONICA BAY SANCTUARY, IS PERMITTED BECAUSE THE REQUIREMENTS OF SECTION 6872 OF THE PUBLIC RESOURCES CODE HAVE BEEN MET.

4. ACTING PURSUANT TO SECTION 7054.5 OF THE PUBLIC RESOURCES CODE, APPROVED THE PROPOSAL OF THE CITY TO LEASE TO WINDWARD ASSOCIATES AND GLG ENERGY FOR PURPOSES OF OIL AND GAS EXPLORATION AND PRODUCTION THE TIDE AND SUBMERGED LANDS THAT HAVE BEEN GRANTED IN TRUST TO THE CITY.

The Commission voted 2-1 to take the action set forth above.

Attachment: Calendar Item 90.

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RECONSIDERATION OF PROPOSAL BY CITY OF HERMOSA BEACH
FOR LEASING FOR OIL AND GAS DEVELOPMENT ON
GRANTED TIDE AND SUBMERGED LANDS, LOS ANGELES COUNTY

INTRODUCTION:

The proposal of the City of Hermosa Beach (City) to lease its granted tide and submerged lands for oil and gas development again is before the Commission. This time the matter comes to the Commission pursuant to a writ of administrative mandate issued by the Los Angeles County Superior Court in Hermosa Beach Stop Oil Coalition, et al. v. State Lands Commission, etc., No. BS024656. This case was brought against the Commission by several environmental organizations to challenge the Commission's finding that drainage of the Hermosa Beach tidelands is presently occurring by means of wells on adjacent lands and the Commission's approval of the proposed lease. The court found that the Commission proceeded correctly except for its failure upon approving the lease to make adequate findings that the leasing of the lands would be in the best interests of the State. The writ requires the Commission to review the matter again. The Commission may allow the City to lease its tide and submerged lands for oil development, provided that it makes adequate findings that the leasing is in the best interests of the State, or it may reconsider its prior decision and disapprove the leasing. If this latter course is taken, the Commission must find either that there is no drainage or that in spite of the existence of drainage, leasing would not be in the best interests of the State.

BACKGROUND INFORMATION:

For at least the past decade, the City has been pursuing a proposal to lease its granted tide and submerged lands for oil and gas development in conjunction with the leasing of City owned uplands. If tidelands contain economically recoverable amounts of oil, their development could produce additional revenue for the City which, under the terms of its statutory tidelands grant, must be used for purposes connected with the establishment, improvement and operation of a harbor.

The tidelands are part of an oil and gas drilling sanctuary in Santa Monica Bay and can be leased only under certain conditions which are set forth in section 6872 of the P.R.C. (section 6872).

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Under this statute, leasing can occur only if the Commission determines that (1) oil or gas deposits are believed to be contained in the sanctuary lands, (2) these deposits are being drained by means of wells on adjacent lands and (3) the leasing of the sanctuary lands for the production of oil and gas will be in the best interests of the State.

The overriding issue throughout the history of the City's attempt to lease its tidelands has been that of drainage from wells on adjacent lands. For many years, wells drilled into the adjacent Redondo Beach tidelands from an onshore drill site in Redondo Beach produced substantial amounts of oil. The City claimed and still claims that these wells are the cause of drainage of oil deposits from its tidelands. When the City's leasing proposal was first before the Commission in 1985, the staff concluded that the Hermosa Beach tidelands were being drained by wells on the adjacent Redondo Beach tidelands. However, the Commission was unable at that time to determine whether leasing would be in the best interests of the State because no adequate environmental review under the CEQA had been made. Therefore, the Commission deferred action on the City's leasing proposal pending the environmental review.

Several years passed while the environmental review was made. During this time, the operator halted production from the Redondo Beach wells because the high water cut (ratio of water to oil expressed as a percentage) made further production uneconomic. By 1991, the operator had plugged and abandoned all the wells that had been drilled into the Redondo Beach tidelands. After the wells were plugged and abandoned, the staff took the position that a finding of drainage under Section 6872 could not be made because Section 6872 requires drainage from actively producing wells. This was the basis for the staff recommendation for the Commission's determination of drainage at its meeting on June 30, 1992.

At that meeting, the Commission did not accept the staff's interpretation of the drainage requirement in Section 6872. Instead, it accepted the interpretation espoused by the City and its proposed lessees, which is that Section 6872 permits a finding of drainage where that drainage is a result of past production from wells that currently are plugged and abandoned. The Commission based its finding of drainage on a report by petroleum engineering consultants retained by the City and its proposed lessees. The report concluded that oil was draining from the Hermosa Beach tidelands to the Redondo Beach tidelands as a result of a reservoir pressure differential created by past production from the Redondo Beach wells. The superior court held that the Commission's interpretation of Section 6872 is correct

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and that substantial evidence supports its finding that oil deposits are being drained from the Hermosa Beach tidelands by means of wells on adjacent lands.

The hearing before the Commission on June 30, 1992, dealt only with the question of drainage because there were at that time other unresolved matters. The staff believed that there were deficiencies in the Environmental Impact Report (EIR) that had been prepared for the oil development project, including a failure to address adequately the mitigation of adverse impacts. The City and the staff were able to resolve these environmental concerns through a memorandum of understanding in which the City agreed to additional mitigation in its conditional use permit process. They also were able to resolve the question of the division of royalties. Part would be compensation for use of the upland drill site and go to the City's general fund. The remainder would be payment for the City's share of the oil produced from the tidelands and would have to be used exclusively for harbor improvement projects.

On April 28, 1993, the proposed lease by the City to Windward Associates and GLG Energy came before the Commission to be approved as required by Section 7054.5 of the P.R.C.. In view of the Commission's previous interpretation of the statutory drainage requirement and its acceptance of the conclusion of the City's engineering consultants that drainage was occurring as a product of a reservoir pressure differential caused by past production from the Redondo Beach wells and the staff's ability to resolve the outstanding environmental concerns, the staff recommended that the lease be approved. Section 7057 of the P.R.C. requires that the Commission, when approving an oil and gas lease for granted tidelands in Los Angeles County, insure that the requirements of Section 6872 of the P.R.C. have been met. Therefore, at its April 28, 1993 meeting, the Commission approved the lease and determined that the requirements of Section 6872 had been met. However, the calendar item that the Commission adopted did not set forth the reasons why it determined that the leasing of the Hermosa Beach tidelands for the production of oil and gas would be in the best interests of the State. This omission was the reason the court issued the writ of mandate requiring the Commission to reconsider the matter.

OPTIONS AVAILABLE TO THE COMMISSION:

The Commission has several options available to it. The Commission may make the necessary findings to support its prior determination that leasing of the Hermosa Beach tidelands is in the best interests of the State. The record before the

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Commission will support these findings. Making these findings will correct the error found by the court and permit the City to lease its tidelands to Windward Associates and GLG Energy. The City and its proposed lessees are advocating this course of action.

The environmental groups are advocating rejection of the leasing proposal. They believe that Section 6872, properly interpreted, permits leasing only if there is drainage from actively producing wells on adjacent lands. This narrow interpretation of Section 6872 was rejected by the court in favor of the broader interpretation advanced by the City and its proposed lessees that drainage can occur from a pressure differential resulting from past production from presently plugged and abandoned wells. Although the narrow interpretation was previously advanced by the staff, the staff believes that in view of the court's ruling, the Commission should not adopt it as the basis for a rejection of the City's leasing proposal. If the Commission wishes now to reject the City's leasing proposal, other means are available.

The Commission simply could find that leasing of the Hermosa Beach tidelands for oil and gas development is not in the best interests of the State. The record could support this finding just as it could support the opposite finding. Beyond this, the Commission could examine the report of the City's petroleum engineering consultants to determine whether there is credible evidence of current drainage of oil from the Hermosa Beach tidelands to the adjacent Redondo Beach tidelands caused by a pressure differential formed by past production from the old Redondo Beach wells. The staff recommends that the Commission reject the leasing proposal of the City on both grounds, that there is no credible evidence of any current drainage, and that even if there were credible evidence of current drainage, leasing is not in the best interests of the State.

THERE IS NO CREDIBLE EVIDENCE OF CURRENT DRAINAGE

The contention of the City and its proposed lessees that the Hermosa Beach tidelands currently are being drained is based on a report dated February 5, 1992, by M. E. Wright and L. W. Brock, two consulting petroleum engineers retained by the City. In that report, Wright and Brock conclude that 680 B/D of fluid is migrating from Hermosa Beach to Redondo Beach, most of which is occurring offshore.

The staff has studied the report and questions the data upon which it is based and the assumptions that it makes. In order for migration of fluids within an underground reservoir to occur, there must be a pressure gradient from one area to another.

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Wright and Brock postulate this pressure gradient from pressure data from the Redondo Beach wells and from two wells (the Stinnett wells) drilled long ago into the uplands area of Hermosa Beach, one of which is idle and the other recently plugged and abandoned. Wright and Brock extrapolate the pressures from the Stinnett wells to the offshore area of Hermosa Beach. The extrapolation is over a great distance and into an unknown area of the reservoir. There are no available data showing whether the structure of the reservoir in the offshore area is the same as the structure in the onshore area because there are no wells in the offshore area from which to obtain such data. Without knowing whether there is any structural similarity, there is no basis for an extrapolation of the onshore well pressure data to the offshore area. Therefore, the high pressures that Wright and Brock postulate for the offshore area of Hermosa Beach are conjecture, and the pressure gradient between the Hermosa Beach tidelands and the Redondo Beach tidelands is built upon this conjecture.

Assuming that there may be some fluid migration, even the 680 B/D estimated by Wright and Brock, there is no basis for concluding that a significant part of this fluid is oil. It is far more likely that the fluid is predominantly water. As Brock and Wright state, there are no faults or permeability barriers between the Hermosa Beach and Redondo Beach offshore areas. Therefore, depletion drainage (fluid migration) likely has occurred throughout the years when the Redondo Beach wells were producing. Since water pushes oil ahead of it and the Redondo Beach wells had an exceedingly high water cut when they were abandoned, there is good reason to conclude that some of the fluid that was being produced from these wells was water that had drained from Hermosa Beach.

The hypothesis of Wright and Brock is that past production from the Redondo Beach wells created a pressure differential in a reservoir common to Redondo Beach and Hermosa Beach causing drainage from Hermosa to Redondo that is continuing today. These wells had such a high water cut that they were plugged and abandoned as uneconomic. High water cuts would be expected throughout a homogeneous reservoir. However, if the reservoir is not homogeneous, but faulted and fractured, there likely would be isolated areas with high oil saturations. But then, there would not be significant fluid migration in a faulted and fractured reservoir. In other words, the presence of large amounts of commercially recoverable oil and significant drainage by high water cut wells in the same reservoir appear to be mutually exclusive.

LEASING IS NOT IN THE BEST INTERESTS OF THE STATE

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The staff believes that the potential benefits of the proposed oil development project are meager and are outweighed by the adverse environmental impacts of the project. The City's and its proposed lessees' projections of oil recovery and prior expectations of profit notwithstanding, the staff believes the prospect for commercial oil production from the Hermosa Beach tidelands is slight. Coupled with the adverse environmental impacts the project would have on the community, to go forward with it would not be in the best interests of the State.

As stated above, there are no well data indicating any significant quantities of commercially recoverable oil in the Hermosa Beach tidelands. Furthermore, drilling and development costs for an urban oil operation are very high. Add to this the low price of oil, and the economic outlook for the project looks very bleak. Oil prices are low, about \$10.50 per barrel for 20 degree API gravity oil from the Torrance field, and there is no prospect for a significant increase. In 1987 and 1988, when this project was first being proposed, oil prices were in the range of \$12 to \$15 per barrel and expected to rise. The expectations the City and its lessees may once have had for this project cannot be their expectations today. If there is no expectation of profit, there will be no project.

Assuming that the proponents of the project reasonably can expect some favorable return on their investment, the environmental impacts militate against the project. The tidelands would be developed from an onshore drill site that currently is the City Maintenance Yard. The City Yard is about 2,000 feet from the beach. It is separated from the beach area by a hill so that the drilling and production operations should have no significant effect on the users of the beach. However, the operations will have a significant impact on the residents of the area. The City Yard is located within a mixed commercial and residential area. It is slightly to the west of the center or bottom of a little hollow or depression. It is immediately adjacent to small commercial and light industrial establishments, except on the east side where there is a greenbelt (a former railroad right of way) that traverses the base of the hollow. Beyond these buildings and the greenbelt on the hills or rises overlooking the hollow and the City Yard are houses and apartments built very close together on small lots. Some of the houses and apartments are within 300 feet of the City Yard. Because of the geographical and developmental configuration of the area, the City Yard is a focal point. During the drilling phase of the proposed project, there will be a large tower camouflaging the drilling rig. This tower will be a high profile visual intrusion. The tower will come down at the end of the drilling phase and remain down during the far longer production phase.

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Throughout the life of the project, there will be noise, albeit minimized by soundproofing, from electrically operated equipment. In addition, there will be traffic from trucks servicing the wells and removing the produced oil.

Assuming that the project proves to be economic and produces commercial quantities of oil for a number of years, the project will not be an economic panacea for the City. Because the revenues are from oil produced from lands held in trust by the City, those revenues are impressed with the terms of the trust. This means that the revenues, like the tidelands, must be used only for purposes connected with the establishment, improvement and operation of a harbor. (See Chapter 479, Statutes of 1919.) At the request of the City, the Commission previously agreed to a formula for splitting the City's royalty revenue between compensation for use of the upland drill site and compensation for production of tidelands oil. The formula provides a 7% royalty as compensation for the drill site and an 11 1/2% royalty as compensation for tidelands oil. The former goes to the City's general fund to be used exclusively the acquisition of parks and open space; the latter, of course, is restricted to trust uses. While in an era of economic hardship for local government, any increase in revenues, however slight, is helpful, this project will not be a source of revenue to help offset the cost of essential municipal services like police and fire.

ENVIRONMENTAL REVIEW:

An EIR was prepared for the City for the proposed oil exploration and production project. The staff has reviewed the EIR and the mitigation measures proposed for the project.

IT IS RECOMMENDED THAT THE COMMISSION:

1. FIND THAT AN EIR WAS PREPARED AND CERTIFIED FOR THIS PROJECT BY THE CITY OF HERMOSA BEACH AND THAT THE COMMISSION HAS REVIEWED AND CONSIDERED THE INFORMATION IN IT.
2. PURSUANT TO SECTION 6872 OF THE P.R.C., MAKE THE FOLLOWING DETERMINATIONS REGARDING LEASING IN THE SANTA MONICA BAY SANCTUARY:
 - a. BASED UPON THE DISCUSSION ABOVE, OIL AND GAS DEPOSITS ARE BELIEVED TO BE CONTAINED IN THE HERMOSA BEACH TIDELANDS.
 - b. THESE OIL AND GAS DEPOSITS ARE NOT BEING DRAINED BY MEANS OF WELLS ON ADJACENT LANDS BECAUSE, AS DISCUSSED ABOVE, THERE IS NO CREDIBLE EVIDENCE THAT COMMERCIAL

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QUANTITIES OF OIL AND GAS ARE MIGRATING FROM THE HERMOSA BEACH TIDELANDS TO THE ADJACENT REDONDO BEACH TIDELANDS OR TO ANY OTHER ADJACENT LANDS.

- c. FOR THE REASONS DISCUSSED ABOVE, LEASING OF THE HERMOSA EACH TIDELANDS FOR THE PRODUCTION OF OIL AND GAS WOULD NOT BE IN THE BEST INTERESTS OF THE STATE.
3. DETERMINE UNDER SECTION 7057 OF THE P.R.C., THAT LEASING BY THE CITY FOR OIL AND GAS EXPLORATION AND PRODUCTION OF ITS TIDE AND SUBMERGED LANDS, ALL OF WHICH ARE WITHIN THE SANTA MONICA BAY SANCTUARY, IS NOT PERMITTED BECAUSE THE REQUIREMENTS OF SECTION 6872 OF THE P.R.C. HAVE NOT BEEN MET.
4. ACTING PURSUANT TO SECTION 7054.5 OF THE P.R.C., DISAPPROVE THE PROPOSAL OF THE CITY TO LEASE TO WINDWARD ASSOCIATES AND GLG ENERGY FOR PURPOSES OF OIL AND GAS EXPLORATION AND PRODUCTION THE TIDE AND SUBMERGED LANDS THAT HAVE BEEN GRANTED IN TRUST TO THE CITY.