TRANSCRIPT OF
MEETING
of
STATE LANDS COMMISSION

SACRAMENTO, CALIFORNIA
October 10, 1963

RE: DRILLING AND OPERATING CONTRACT (LONG BEACH
HARBOR DEPARTMENT TIDELANDS PARCEL) BOARD OF HARBOR
COMMISSIONERS, CITY OF LONG BEACH, WILMINGTON OIL
FIELD -- L.B.W.O. 10,190.
PARTICIPANTS:

THE COMMISSION:

Hon. Hale Champion, Director of Finance, Chairman

Hon. Alan Cranston, Controller

Hon. Glenn M. Anderson represented by Alan Sieroty, his Executive Secretary

Mr. F. J. Hortig, Executive Officer

OFFICE OF THE ATTORNEY GENERAL:

Mr. Howard S. Goldin, Assistant Attorney General

Mr. Jay L. Shavelson, Deputy Attorney General

CITY OF LONG BEACH:

Mr. John C. Spence, Assistant City Attorney

Mr. W. A. Smith, Jr., Assistant Chief Petroleum Engineer, Long Beach Harbor Department

Mr. H. E. Ridings, Jr., Commissioner
Port of Long Beach

INDUSTRY REPRESENTATIVES:

Mr. Durlan Clark, Shell Oil Company

Mr. D. B. Pinnell, General Manager, Natural Resources Division, Union Pacific Railroad Company

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MR. CHAMPION: The meeting will please come to order.

As you all know, this is a special meeting with, to my present knowledge, only one item on the agenda -- which is consideration from last week of the proposed drilling and operating contract to replace the present contract of the Long Beach Oil Development Company. I think we will begin with the staff report by Mr. Hortig on the present status of that proposal, what communications there have been, and if there are proposed alterations from the document we had before us last week.

Before I do that, I'd like to report that the City of Long Beach has responded to our invitation to discuss the terms of the Field Contractor Agreement for the new area, the new Wilmington Field, and have invited us to have a joint meeting with them at our mutual convenience; and we will proceed to set up a meeting for such a discussion as between their point of view and that of the State Lands Commission. As you know, they have offered us a form of contract, we have suggested a quite different form of contract, and the situation being somewhat at a stalemate we are going to have a discussion as to where to proceed from there.

Mr. Hortig, will you proceed with a statement of the present staff position on the proposed replacement contract for the B.B.O.D.?

MR. HORTIG: Mr. Chairman, as outlined on page 1 of the agenda item before you, pursuant to the directive of the Commission for deferment consideration of this matter to the meeting today and the suggestion to industry to submit any further proposals or raise any further questions, preferably in writing and prior to this meeting, written recommendations were received from Union Pacific Railroad Company on October 7, 1963 and from Pauley Petroleum Company on October 9, 1963. Copies
of those letters are attached to your agenda items as exhibits. Additionally, yesterday afternoon by special messenger a letter was received from Shell Oil Company, copies of which will be distributed to you gentlemen now.

The suggestions of Paulcy Petroleum relate primarily to the matter of price bases, which were reviewed on the calendar item (again attached to the agenda item you have before you) as it was presented on September 30, 1963. These questions raised and the bases and answers thereto were also reviewed in the legal review dated September 27, 1963 from the Office of the Attorney General, which is also attached to your agenda this morning as Exhibit B.

Secondarily, the Paulcy Petroleum letter suggests the highest price paid for oil by any stockholder which should be part of the contract. Staff feels again that such additional uncertainty of the price base, in view of the fact that the corporate entities cannot be forecast at any time in advance of calling for bids, would necessitate a discount in the net profits bid offer by any prospective contractor.

The Union Pacific Railroad Company has suggested that operations on the Long Beach Harbor Department tidelands parcel could be continued under existing unit agreements without the necessity of awarding a new drilling and operating contract with the Union Pacific Railroad Company and other upland operators as the unit operator i.e. all of the fault block areas that would be involved in the area as outlined on the attached map which it is proposed to be operated under the new contract.

The cost to the City, and necessarily to the State, through such method of operation and the lack of local control have resulted in the recommendation by the Long Beach Harbor Department against such an alternative operating procedure.
You have just received the letter from Shell Oil Company, which reviews also specifics with respect to bid procedure as well as relative to a recommendation that any price base that might be adopted should be adopted by the Commission in consideration of its applicability to other State leases and municipal leases and contracts in the future. This is a problem which it would be extremely difficult to forecast -- to determine for a specific set of circumstances such as we have before us -- where a new contract is required to continue operation -- that such price bases can necessarily be tailored to be so specific to assure the control necessary with the current contract and still be flexible enough to cover in the future any other circumstances -- economic, geographic, geologic, and so forth.

Under these circumstances, Mr. Chairman, I would recommend that the Commission order these three letters into the record in order that their contents be available to all, but without the necessity of reading them into the record at this point.

MR. CHAMPION: Is there any question with regard to that procedure? (No response) That, then, will be the order.*

MR. HORTIG: Now, additionally, at the meeting of September 30th, Richfield Oil Corporation requested that their company's name be included with those of the companies specifically mentioned in computing the average of posted prices, as outlined in Section 18.3 of the proposed drilling and operating contract; and the Office of the Attorney General suggested that approval by the Harbor Commission of termination of the contract, as provided in Section 4, be subject to approval by the State Lands Commission.

Those last two recommendations are concurred in by the staff and, therefore, represent the only modifications to the

* These letters are attached to end of transcript.
recommemations which were made to the Commission on September 30th, the recommended resolution today reading:

"It is recommended that the Commission approve:

1. The Drilling and operating contract (Long Beach Harbor Department Tidelands Parcel), including the specifications therein contained, with the following amendments:

A. Inclusion of Richfield Oil Corporation in the list of those companies specifically mentioned in computing the average of posted prices as set forth in Section 18.3 of the contract;

B. Addition of a last paragraph to Section 4 of the contract, reading as follows: 'Any termination of this agreement prior to February 26, 1939, shall require State Lands Commission approval.'

Also included in the resolution and recommended for approval are the notice inviting bids, the bid form, and the bidders' bond as submitted for approval by the City of Long Beach, referred to as Exhibits B, C, D, E, and F respectively and hereby made a part hereof by reference to the official files of the Commission."

MR. CHAMPION: Now, the situation is that after communications and comments that are all in, the staff recommendation is that we approve the contract as it was before us at the last meeting with the exception of these two amendments; and what we are really considering is the proposed contract with these two amendments, and this is the matter that is now before us for discussion -- whether there are other amendments to be considered, whether there are other proposals or comments or objections on the recommendation as it now stands -- the contract with these two amendments. Now I think we are prepared to hear from anyone who wishes to make further statement, comment or objection on the matter.

Is there anyone who wishes to testify in any way on this subject? Mr. Sieroty has some questions.

MR. SIEROTY: We have this letter from Union Pacific
which, from what I gather, proposes a rather different way of handling this. Now, first of all, I wonder whether Mr. Hortig would like to explain it because I really can't understand exactly their proposal; and then I'd like to know whether this was considered previously -- this form of operation was considered previously by the Long Beach Harbor Department.

MR. HORTIG: Mr. Chairman, in response to Mr. Sieroty's question, I think as background I should first report to the Commission that the election of the form of operation proposed for any particular tidelands grant area is at the option of the State's grantee, in this instance the City of Long Beach; and the options are not nominal with the Lands Commission to direct a different basic format for presentation without consideration for approval. Under existing State law we are limited to consideration for approval only of proposed contract forms, as they are presented by the State's grantee-trustee for consideration. Therefore, this matter has been discussed with Union Pacific Railroad, but the election to not proceed with presentation to the State Lands Commission of a proposal to proceed under the alternative as outlined by the Union Pacific Railroad was made by the Long Beach Harbor Department, who are the operating agency, who are operating the particular subject trust lands that are herein involved. Therefore, under those circumstances, I think it would be appropriate to call on a representative of the Long Beach Harbor Department and their legal counsel to give the details as to what went into the consideration and possibly why the alternative was not submitted to the Lands Commission.

MR. CHAMPION: I think that would be the best procedure. Would you step forward, please, and outline the proposal and the reasons for choosing in the alternative?

MR. SPENCE: Yes. For the record, my name is John
Spence, Assistant Attorney of Long Beach. The City of Long Reach
considered this proposal and it was not acceptable, principally,
for economic reasons and from an engineering standpoint. Now, I
don't propose to go into the engineering feature, but I do want
to point out to the members of the Commission that this proposal
would not take care of the portion of the tidelands not in the
unit, and I am speaking specifically of Fault Block V -- which,
when it is unitized, will only have the Ranger Zone. The re-
mainder of Fault Block V will not be in the unit, so that would
not solve our problem.

I would like to ask Mr. Smith to discuss the economic
features of this with the Commission.

MR. CHAMPION: Thank you.

MR. SIROTAY: May I ask Mr. Smith to generally explain
what the Union Pacific Railroad proposal is? How does it differ
from the one we are asked to approve?

MR. SMITH: My name is W. A. Smith, Assistant Petroleum
Engineer of the Long Beach Harbor Department. In answer to your
request, Mr. Sieroty, I am not sure I can explain the portion of
their proposal which deals with the oil purchased. They appar-
ently are making a recommendation that the oil purchased be
separated from operations, at least insofar as the unitized
areas are concerned. Their proposal for the sale of the oil
from these unitized areas is that we have recurrent bidding and
they seem to feel that this in some way will resolve the question
which has been raised as to the advantages of highest versus
posted or some other means; but they don't, to -- anyway, clearly
point out what their proposal is as far as pricing is concerned

MR. CHAMPION: Excuse me a moment. Is there a repre-
sentative of the Union Pacific here?

VOICE: Yes, two.
MR. CHAMPION: Could you speak to that question before Mr. Smith continues? (To Mr. Smith) I think perhaps since we have got this situation where Mr. Sieroty wants an explanation of the Union Pacific proposal, we might first take their comments and then you might comment.

MR. PINNELL: My name is D. B. Pinnell. I am General Manager of the Natural Resources Division of Union Pacific Railroad. Being present at the last meeting of this Commission, a great deal of the discussion seemed to center about the manner in which the State and City would receive a fair price or a value price for its oil. It appears that really the only way that that could be achieved -- although the other method that is proposed by the City of Long Beach, that of average posted price, has been widely used -- if this is a deep concern of the State, the only alternative method would be that of bidding. We didn't make any suggestion as to the periods that the bids would cover or the particular amount of oil or anything else. We thought that was up to the State and City. It is their oil. We do not propose to bid on it.

MR. SIEROTY: How would Union Pacific be compensated? I note in here it said something about "There is no fee payable to such operator."

MR. PINNELL: That's quite correct.

MR. SIEROTY: What does that mean?

MR. PINNELL: Well, Union Pacific would not be compensated through a fee, as an operator or as a contractor would, presumably. Most contractors are compensated for their work by a fee or a percentage of this or a percentage of that. The unit agreements provide that the only thing a unit operator receives for operating the unit is a six per cent overhead allowance, administrative expense allowance, on certain costs -- plus actual
costs, of course. The costs of operating the unit go to unit
expense and are, therefore, divided up among the participants on
the basis of their participation in the unit.

MR. SIROTY: Let me clarify that point. Is this six
per cent in this renewal proposal -- this six per cent overhead
allowance?

MR. HORTIG: As to the unit, to be paid wherever these
lands are included in units as they presently are for Fault Blocks
II, III and IV; but at the present time and until changed, the
City of Long Beach is the Unit Operator and is receiving this
overhead allowance.

MR. SIROTY: It doesn’t go to the contractor -- it goes
to the City?

MR. HORTIG: It goes to the unit operator; in this case
if the City continues as the unit operator, then the City con-
tinues to receive this overhead allowance under the unit agreement.

MR. SIROTY: Now, Union Pacific is suggesting that it
become the unit operator, is that correct?

MR. PINNELL: Yes, sir. Union Pacific is the unit
operator of a large portion of Fault Blocks II and III units;
the City is the unit operator of a small portion of Fault Block
II and III units and a larger portion of Fault Block IV, which
is also concerned here.

MR. SIROTY: And generally would operate on the six
per cent allowance and would put the oil out for bidding at
periodic times?

MR. PINNELL: Union Pacific would not. The oil from
the unit is distributed immediately to the owner, to the partici-
pant who is entitled to the oil. In this case, the State and City
gets a share of the oil from each of the fault blocks and this is
delivered immediately, and how the purchase is handled is up to
the owner of the oil.

MR. SIEROTY: Well, let me see what you are suggesting here regarding the sale of oil by the City and the State. In other words, the unit operator under your proposal would not be in the business of selling. You would turn the oil over, so to speak, to the City and State and there would be competitive bidding held by the City and State for this oil?

MR. PINNELL: Correct.

MR. SIEROTY: That is what you are suggesting. I have no further questions of Mr. Pinnell.

MR. CHAMPION: All right. Thank you, Mr. Pinnell.

MR. SMITH: In considering the Union Pacific's proposal, there were several things that occurred to us which appeared to make such proposal disadvantageous to both the City and the State. From a practical standpoint, the idea of having several operators operating adjacent fault blocks is unrealistic, because we have a large number of what we call general facilities, and these are facilities which are common to adjacent fault blocks and to adjacent or different groups of wells. It is difficult for me to see how different unit operators could operate these general facilities, which are common to all areas of the field.

In addition, of course, this proposal is not a total solution because it does not consider the City and State properties which are not unitized and which in all likelihood will never be unitized, so we would still be faced with the identical same problem we are faced with now in continuing the operation of those non-unitized areas.

Our major objection to the proposal is a matter of economics. We believe that this six percent overhead allowance—
and I want to be clear on this -- the six per cent of our cost in
operation of the unitized areas is currently coming to the City
and the State and if we were to relinquish our position as unit
operator, we would then not only lose our six per cent -- we would
be paying someone else the six per cent.

In addition to that, the majority of the City's Petroleum
Division payroll is reimbursed by the units. We have made a
quick calculation, which is based on our estimate of future
revenues, future costs, against this six per cent, and our future
payroll, the reimbursement of which we would lose if we were no
longer unit operator, and we estimate that such a proposal, if
accepted, would result in a loss to the City and State of ap-
proximately ten per cent of our future net profit from Fault
Blocks II, III and IV.

MR. CHAMPION: Have you estimated the general magnitude
of that in dollars?

MR. SMITH: The magnitude of it in dollars? Ten per
cent of it would be on the order of $25,000,000. For these rea-
sions we cannot concur in this proposal. Incidentally, there is
one subordinate reason here that you might be interested in and
that is, of course, the Harbor Department feels that it has a
responsibility in the matter of subsidence control. We feel we
have demonstrated we have the know-how and the capability and
desire to control subsidence, and we feel that the only way to
assure continued subsidence control in the tideland areas is for
us to have operation control.

MR. SIENOTY: How many unit operators are there at the
present time?

MR. SMITH: There are currently two companies that are
unit operators of what we call Segment 2 -- that is, the areas
north of Seaside Boulevard in four fault block units. Union
Pacific is operating in Fault Blocks II and III-- that is the northern portion thereof; and Socony Mobil is operating in Fault Block IV; and very soon will be operating in Fault Block V -- the Ranger Zone only, incidentally.

This is another problem that would arise if this proposal were accepted. It would be virtually impossible for Mobil to operate only the Ranger Zone of Fault Block V and have the City's other contractor, whoever it might be, operate zones both above and below the Ranger Zone, using common facilities.

MR. SIEROTY: You say the six per cent accrues to the City and State?

MR. SMITH: That is correct.

MR. SIEROTY: How does that work -- six per cent of the expense?

MR. SMITH: Six per cent of the majority of our unit costs are paid to us by the other working interest owners in the unit. This is our overhead allowance.

MR. SIEROTY: Why do you say the "City and the State"?

MR. SMITH: Because that goes into our oil revenues, in effect.

MR. SIEROTY: It does not go to the Long Beach City or Harbor Department?

MR. SMITH: It does not go to the City. It is a part of the revenue in the unit accounting.

MR. SIEROTY: So, in effect, you are saying the City and State receive a certain portion of this overhead allowance from lands which are owned by private interests?

MR. SMITH: That is correct -- all of the working interests. The way it works: There is a unit operator of Segment 1. That is the City of Long Beach in any of these units. There is a unit operator in Segment 2. In the case of Block II,
we will take, for example, that is Union Pacific Railroad. Union Pacific Railroad assembles all its costs for a given month and the City assembles all of its costs for a given month and each of them is entitled to reimbursement of that cost plus six per cent out of all of the working interests' income, and all of the working interest owners share in each of the unit operators' costs and each of the unit operators' six per cent overhead.

MR. SIROTY: Have you concluded that there would be a loss of $25,000,000 to the City and the State if the City did not remain as the unit operator?

MR. SMITH: That's correct. We would be deprived of approximately ten per cent of the future net and our expenses would go down very slightly -- because we feel, even though we were not unit operator, the size of our petroleum staff would remain about the same because we have such a large interest in the operation we cannot afford to ignore it.

MR. SIROTY: That's all.

MR. CHAMPION: Thank you very much, Mr. Smith. Mr. Hortig, do you have any comments on this proposal? Does the staff in general agree with the position taken by the Harbor Commission of Long Beach, or have you reached any conclusions on the subject?

MR. HORTIG: We did review the analyses and we did discuss with Union Pacific Railroad the applicability of this. In view of the fact that the Harbor Department has jurisdiction....

MR. CHAMPION: I am not harping on the jurisdiction matter. What is the opinion of the staff?

MR. HORTIG: We have no analysis contrary to that of the City of Long Beach.

MR. CHAMPION: Do you agree with them?

MR. HORTIG: To the extent that we have reviewed their analysis, yes.
MR. CHAMPION: Do you want to pursue another matter?

MR. SIEROTY: Shell Oil's letter here, which came in this morning, has a viewpoint I think ought to be considered. One point, which is in the third paragraph, has to do with the fact that under the contract proposed it specifies the companies whose postings we will take into consideration. Shell raises the point that maybe there are going to be other companies who are going to be posting in the next twenty-five years and maybe some of the existing companies may discontinue posting in the next twenty-five years; and perhaps this clause ought to be a little more open to take into consideration these changes.

I think it is a good suggestion and thought we might discuss that a minute. Maybe there was some reason why we picked only these companies and feel that is the only thing that ought to be in the contract, or maybe their suggestion is a worthy one.

MR. CHAMPION: We are now in this resolution proposing to have Richfield. Mr. Hortig, would you discuss that point?

MR. HORTIG: Yes, sir. In view of the fact that Section 18.3 with respect to pricing determination specifies alternatives....

MR. CHAMPION: 18.3 of what?

MR. HORTIG: The proposed contract -- ... specifies alternative pricing bases, of which the first and second alternatives are in turn dependent upon arithmetic comparisons made between posted prices, the companies who have and are posting in the broadest scope in the Los Angeles Basin oil fields, who have operated this way historically, were included in the list in order to give the broadest realistic base to this situation. In view of the fact that Richfield Oil reported in writing to the Commission it is intending to also become a poster, it was
the recommendation of the staff that they be added to the list.

We have the problem -- I believe I am correct and the Shell representative will straighten me out if I am not -- Shell is a purchaser at the present time in the Wilmington Oil Field, but I am not positive that they are posting prices.

MR. CHAMPION: May I ask: Is there any objection to a device whereby upon a certain volume of purchases over a certain period of time, such a company shall be automatically in the list; and falling below a certain level in a certain period of time, shall be eliminated from it? Would that eliminate the problem?

MR. HORTIG: This, of course, is covered in the contract in that there is a continuing purchaser with an average of one thousand barrels a day; but it does not provide for removal or addition -- although certainly your suggestion would be entirely acceptable because the intent of the program is to have the broadest base that it is possible to obtain with the only standards available -- a representation of the fair market value of the oil.

MR. CHAMPION: In order to meet this problem, why shouldn't we simply define "continuing purchaser," and make anyone who meets that definition eligible; and provide that any time for a period of time he no longer meets the definition he is no longer included. It seems to me this is a perfectly easy, self-executing way of handling it.

MR. HORTIG: This is a slight variation. I'd like to hear Deputy Shavelson's comment on the last provision, that absent any data to the contrary, as provided in the contract, any one is considered a continuing purchaser, I would think that either this section would be sufficiently flexible or would be the one that should be expanded.

MR. SHAPELSON: That language would not add any other
company to the list, and wouldn't fulfill that purpose. In other words, that language simply...

MR. CHAMPION: What language are you referring to -- what I suggested?

MR. SHAVELSON: No, the language that Frank just mentioned concerning the presumption in the definition of any continuing purchaser -- in the absence of evidence to the contrary he is presumed to be one; but still the price must be posted, under the present language, by one of the designated purchasers and, therefore, that language would not help.

MR. CHAMPION: We would have to expand the present language in order to make this self-executing.

MR. SHAVELSON: That is correct.

MR. CHAMPION: Do you see any legal problems in doing so?

MR. SHAVELSON: I don't.

MR. GOLDIN: No.

MR. CHAMPION: Mr. Smith, how would the Harbor Commission of the City of Long Beach feel about that?

MR. SMITH: We are certainly in accord with expanding the base of the pricing as much as possible. However, there are certain practical problems that we must not overlook and these, of course, were considered when we drafted this agreement as presently before you. The continuing purchaser definition, of course, applies only to Wilmington; and we feel, because of our interest in each of the major fault blocks in Wilmington and the fact that we get unit coordinator statements showing who has purchased the oil and how much, we will be able to pretty well pin down who the continuing purchasers are in Wilmington.

Now, the problem that will arise if we open up to this future group of companies, there is no way of knowing -- and this, of course, was discussed in the last meeting ten days ago -- there is no way of knowing whether or not they met this
MR. CHAMPION: I assume that if someone wished to be included, that if we set this up so that they would have to submit satisfactory figures that they did qualify as a continuing purchaser, your real problem is when you know that they fail to be a continuing purchaser.

MR. SMITH: In order to be considered, I suppose they would have to continually have to satisfy the Harbor Commission and the State Lands Commission.

MR. CHAMPION: I think they would have to be willing to agree to satisfy them on request, so the commitment is there to meet the request for information periodically.

MR. SIEROTY: Wait a minute. We are talking about this section referring not to Wilmington Field.....

MR. SMITH: That's correct.

MR. SIEROTY: ... but the general area -- the Signal, Hill, and Inglewood Fields. There is no requirement that any of these posting companies named in here buy any amount of oil; is that correct?

MR. SMITH: That is correct.

MR. SIEROTY: So I don't think you can impose upon other companies, it seems to me, a different standard.

MR. SMITH: Yes, I am afraid we would have to. We couldn't let the XYZ Oil Company come in and make a fictitious posting and completely upset our pricing arrangement either to the advantage or disadvantage of the City and State. It would have to be by posting.

MR. SIEROTY: All right. Why don't you just take the words "bona fide posting"?

MR. SMITH: There would have to be, in my opinion, a prescribed method for bona fide posting.
MR. CHAMPION: I don't see why we can't -- All we are doing is opening the door to them and they ought to be willing to provide the information to make that privilege open to them.

These people are all now posting and buying in the field.

MR. SHAVELSON: May I say this, Mr. Champion? As Mr. Smith pointed out, as far as the Wilmington Oil Field is concerned, we are open to any continuing purchaser whether or not it is one of these named companies. I just want to make sure that is clear to everyone; and it is only when we go to one of the other fields, where we deviate from this, so that as far as the Wilmington Field criteria is concerned, we do have that.

MR. CHAMPION: We are fully protected?

MR. SHAVELSON: Yes.

MR. CHAMPION: I am sorry -- I didn't understand that.

MR. SHAVELSON: I didn't make it clear.

MR. SIROTY: Now, may I ask -- Shell is the one who suggested this. I see representatives of Shell in the auditorium. I'd like to ask them whether they would like to answer the question: Why is it that they do not post in this area? Are they purchasing oil in the area, in any of these areas that are named?

MR. CLARK: Durlan Clark, Shell Oil Company. We post in some parts of the country but never have in California, and the time may come, however, in handling an average posted price, where this might be necessary for many companies to do. Richardson obviously saw this and I think they are quite correct.

We, in essence, are attempting to avoid the listing of a long group of companies -- merely saying that if one company actually buys and posts, they should be considered in this list. That's all I have to say to that.

MR. SIROTY: Why is it that you haven't been posting?
MR. CLARK: Just that we have never found it necessary.

MR. SIEROTY: How do you buy? What standard do you use to buy your oil?

MR. CLARK: Our leases provide that we meet posted prices in the field in which the oil is purchased and for many, many years we tied to specific company postings. Because of certain antitrust factors and consent decrees, this was eliminated -- so we do not buy to any particular company; we merely take what is posted there in a given field where we buy. Our own leases go further to provide that if there are no posted prices, then we make an offer and then the landowner has thirty days to accept the offer and store the oil in the meantime. If they do not choose to take the offer, they take in kind; if they accept the offer, we pay the offered price -- which is something in the nature of a private posting, an individual negotiation between landowner and purchaser.

MR. SIEROTY: On this specific point, Mr. Clark, do you have any language that we should include here to suggest? What we are trying to do is to provide that any bona fide posting be considered in this group of oil fields, so that we may have the average of all of these postings to consider as against the average of the Wilmington Field postings. Now, what language can we include? Do you have any idea, sir?

MR. CLARK: Oh, yes. I think the pricing clauses of most of the lease forms of major oil companies state this. The language would be a very simple matter. We did not furnish you with any of the language, but it might take all of thirty minutes to put together a clause that would do this.

We were merely picking up the point Mr. Champion made -- we feel this should be a continuing thing and certainly if the pricing standards here are expanded elsewhere, it might become a
critical thing in the future and there might be a request for
other companies to post.

MR. CHAMPION: The advantage of the oil company involved
is that it does participate in the pricing.

MR. CLARK: That's correct.

MR. CHAMPION: I am interested in this point. Do you
think, Mr. Smith and Mr. Hortig, that if the Commission were
without attempting to give you any language at this time -- were
simply to instruct you to try to work out some self-executing,
language on this which would also require the company who wanted
to come in to provide the kind of information needed in order to
verify their legitimate status -- Do you think that could be
done and we could simply enter that as an instruction in the
approval of the proposed contract?

MR. HORTIG: Yea, sir.

MR. CHAMPION: Do you see any problems with that?

MR. SMITH: No, I feel it could be accomplished.

MR. RIDINGS: I believe it could be, with a properly
worded procedure, included. We are certainly interested in
broadening the base as much as possible; but I do want to restate
that neither the City of Long Beach nor the Board of Harbor Com-
misioners have any right whatsoever to investigate into the
books and records of any company. Those companies mentioned here
are those who are known of record to be continuing purchasers and
we would be very much concerned if someone with a small refinery
came in with a low price and depressed the price of oil. So I
think there should be clearly set forth there must be a demonstra-
tion to the Board and the Commission here prior to their being
accepted -- that the lease be drawn in such way that such person
having demonstrated to the satisfaction of the Board and Commis-
sion are then to be included in the calculation.
MR. CHAMPION: I think that is included, Mr. Ridings, and I agree with you. I think our position is exactly the same. We want to make sure we don't accept a designation here for which we can't make an administrative finding; and I think the language will be clear -- if someone is interested, that they then voluntarily provide the information we need, because, as you say, we would otherwise have no right to investigate or ask. But in order for anyone to qualify, they would have to volunteer the information.

MR. SIEROTY: I would think this could be done on the motion of the City or State. In other words, if we feel that there is somebody posting who is a bona fide poster, we ought to be able to attempt to include him in this.

MR. CHAMPION: How can we do that if we are not in any position to require him to provide the necessary information?

MR. SIEROTY: Well, what information would we require?
If he is purchasing . . .

MR. CHAMPION: We would have to have evidence that he was a continuing purchaser.

MR. SIEROTY: He may give you evidence of this or we may be able to determine it independently. In other words, I think there ought to be a provision that it need not come from the oil company.

MR. CHAMPION: It is to the oil companies' interest to do this, which is the only reason to provide this in the contract, and I think it ought to be left to them.

MR. SIEROTY: Not necessarily.

MR. SHAVELSON: May I make one comment as to the present provision and how this might be expanded? Under the present provisions, there are two statements. One is that any person posting is presumed to be a continuing purchaser in the absence of
evidence to the contrary; and, secondly, there is a provision re-
quiring the contractor or any of the persons of whom the contrac-
tor may consist, any of the companies, to furnish to the City
upon request full information as to the quantity and prices of
any purchases that they might make. So, therefore, if we should
expand the definition of the determinative prices in the other
fields, by expanding it to include any continuing purchaser in
that field, then if our contractor should attempt to file an,
artificially low price, I think we would have some protection
against that. As a matter of fact, we would know whether or not
he was a continuing purchaser, so what it comes down to is
whether or not there would be any danger to the State of any third
person filing an artificially low price and, of course, if we
assumed that everyone posting was a continuing purchaser. We
could easily make that change, but I wanted to know whether that
would be satisfactory to the City if we did that.

MR. CHAMPION: Would you like to speak to that point,
Mr. Ridings or Mr. Smith?

MR. SMITH: I am not sure I completely understood Mr.
Shavelson's proposal but I think we have expressed in relation to
this problem what would be acceptable to us and that is that
other companies could be added to this named list -- which ap-
plied, as we have said, to these fields other than Wilmington
or this group of fields which does include Wilmington -- and
that these companies could only be added to this list if they
demonstrated that they are, in fact, posting and buying substan-
tial quantity of crude oil.

MR. CHAMPION: I think what we are dealing with here is
largely a technical problem. I don't think there is any funda-
mental problem on what we are trying to get at. What I would
suggest is that we continue with other matters and then have a
recess when we are through with that; and if there is a language
problem, you and the staff can work that out.

MR. SIEROTY: Let me make a few comments. First of all, there is no requirement in the contract that the named companies buy any oil?

MR. SMITH: That's correct.

MR. SIEROTY: So you are just assuming that these are pretty good sized companies and these are the companies you are going to look to.

MR. HORTIG: Might I expand on that point right there? Actually, during the period of time that the State Lands Commission has had responsibilities in connection with Long Beach Harbor Department tideland operations, in excess of one million barrels of oil were accounted for at posted prices, purchased and paid for by named companies; concurrently, during the same period of time, something approaching a hundred million barrels of oil from the Long Beach tidelands, and one hundred twenty-five million from other tide and submerged lands under State oil and gas leases throughout Southern California, again by these same companies. So, while there is not in theory any legal contemplation or requirement that these companies purchase, simply because they post, the fact remains that between 1956 and now they have done so to the tune of about two hundred twenty-five million barrels of oil -- which looks like fairly realistic support for the program.

MR. SIEROTY: Are there other companies which have been posting in these fields?

MR. HORTIG: Periodically, and for varying amounts of production. These have been the companies who have been the major purchasers and major continuing purchasers.

MR. GOLDIN: May the objective you are after be accomplished by the simple addition, after the names of the designated
five companies, of the terminology: "or any other person or
entity which can establish its qualifications as a continuing
purchaser."

MR. CHAMPION: "To the satisfaction of the Harbor
Commission and the Lands Commission. I think if you added
those words ..."

MR. SMITH: And for so long as they continue to
establish...

MR. SIEROTY: The only objection I have to that is
that it ought not be solely the duty of the company to establish
its qualifications. Let's assume Shell Oil Company started post-
ing and posted a higher price, say, in the Inglewood Field. It
would be to the advantage of the City and State to include Shell
Oil Company in this list, in order to increase the average. Now,
Shell for its own purposes may not want to be included. Shell
may not be the contractor who wins this bid and they may have no
interest; but it is to our interest. If we can see Shell is a
purchaser of substantial quantities and their posting is bona
fide, is there any reason why we shouldn't be able to include
them on our motion into the group?

MR. RIDINGS: Mr. Sieroty, in furtherance of your sug-
gestion, I wonder if the wording -- the demonstration would be
by our staff or your staff?

MR. CHAMPION: "Demonstrated to the satisfaction of..."
That would open it up either way. That would give us the ini-
tiative.

MR. RIDINGS: Conceivably, then, a third party oil
company could then come in as a demonstrator.

MR. CRANSTON: Mr. Chairman, moving on to another
area, the Senate Factfinding Committee, headed by Senator
O'Sullivan, rendered, I think, a very great service to this
Commission and the people of California in the exploration of
the contract that was earlier before the Lands Commission on
another field in Long Beach, the East Long Beach Field. We were
deeply interested in their recommendations and we have followed
some of them in our proposals to Long Beach in regard to that
field, and we are apparently now reaching the point where we will
have some direct negotiations between the Lands Commission and
the City of Long Beach in regard to that contract.

Senator O'Sullivan, who is Chairman of that committee,
sat with us at our last session and since then has raised certain
questions in regard to the contract which is now before us and I
think we should go into certain questions at this time before
approving the contract. I'd like to start out with what I think
is the most important area under examination here and that is
the issue of the highest versus average posted price. I have a
number of questions I'd like to ask on this subject and I'd like
to first direct them to either Frank Hortig or the representa-
tives of the Attorney General who are present.

MR. CHAMPION: Before we proceed with that, could we
just clean up this last matter before us? Are we in agreement
on this language and when we have a final action before us that
we will have that language? Would you read it again?

MR. GOLDIN: "Or any other person or entity whose
qualifications can be established to the satisfaction of the
Board and the State Lands Commission."

I don't particularly approve of those pearls of wisdom
but that's your thought in essence.

MR. CHAMPION: You can have a little more polishing
time before we finally act, but I think we are finally agreed
now. Has there any other thing here we needed to dispose of?

MR. SIEROTY: Well, I have other questions.
MR. CRANSTON: The first question I want to ask: Which of these two proposed types of prices, highest or average, are most easily subject to artificial manipulation by the contractor and/or by other oil companies?

MR. HORTIG: If I may essay an initial response, Mr. Cranston, which hopefully will be supplemented by the Attorney General's staff, the fact that there are periodically extreme variations in highest posted price, but for limited amounts of oil, indicates that if the highest posted price were to be elected as the criterion, this could more readily be adjusted by a single company without consultation with anyone else or without taking into account the competitive factors that go into the determination of an average price because nominally these high posted prices and extremes are specified in connection with a desire to accomplish a particular spot purchase of a limited amount of oil and, therefore, they do not truly reflect reasonable market value for the product and in the amount that it is available in a particular oil field when the base is broadened to include the economic determinations of all the major purchasers of oil.

We have to remember this is the background in California: Currently California can produce only approximately eight hundred thousand barrels a day of the roughly one million four hundred thousand barrels a day of demand that is needed. Therefore, there is a market and there will be a continued market for every drop of California-produced oil within the framework of the California economy. How this is affected in the future with respect to foreign imports, again does not relate at all to how prices are set competitively between the various California oil fields.

Patently, then, with an independent series of
different companies having to purchase oil in these various
fields and their own determinations of the fair market price
based on the primary consideration of supply and demand -- and
the demand is high and the supply is low -- the average is much
less susceptible of being capable of being manipulated than a
one-company determination for economic considerations which are
peculiar to its own organization to set either an artificially
high or an artificially low price for a product at a particular
location for a brief period of time.

This has been the difficulty that has been experienced
before in this type of artificial influence and extreme influence
by an independent producer, who set a high posted price for a
limited amount of oil and absolutely refused to take any other
oil at that same price. Patently, this is not a good criterion
against which to make any long-term estimates or against which
to calculate the net profits under which the City and State would
share under the proposed contract.

MR. CRANSTON: At our last session we discussed the
fact of uncertainty which would be involved in a highest posted
price in terms of the difficulties of ascertaining whether or
not actual oil was being bought and sold at that price; and I
think it was left that there would be consideration as to whether
there was any way of ascertaining whether or not it was, in fact,
a valid and actual price. Have you or the Attorney General made
any progress in figuring out a way to deal with that problem?

MR. HORTIG: Not a solution to it, sir. The resulting
review, which really constituted a re-review, that we have had
extensively with the staff of the Long Beach Harbor Department
on just this question, came back to the same conclusion that
inasmuch as there is no necessity for a public record repre-
sentation, there is no simple test as to the bona fide nature
of a highest posted price; that tests that have been devised
would all cost the City and State in terms of a discounted bid
on the contract. Under these circumstances, then, the conclusion
was again arrived at that the average posted price on the broad-
est base on which it can be computed will probably more nearly
reflect the reasonable market value of California crude in the
area, with all of the economic factors that impinge on that being
taken into consideration.

MR. CHAMPION: Do I understand from what you just said
that in your opinion if you went to the highest posted price,
that the difficulties and uncertainties involved in the estab-
lishment of that, would bring in your judgment a lesser net
profit bid on the contract and thereby lose more than might be
gained by going to the highest posted basis?

MR. HORTIG: Yes, sir.

MR. CRANSTON: Does the Attorney General's Office
concur that there has not yet been found a way to clearly estab-
lish that a highest posted price would be a valid and actual
price?

MR. GOLDIN: Mr. Cranston, to date, as a practical mat-
ter, we have been unable to formulate or ascertain a satisfactory
test of that which would constitute a bona fide highest posted
price.

MR. CRANSTON: Who might wish to manipulate the price
upwards -- a higher posted price? This goes into the realm of
speculation, but apparently there is fear someone might do so.
Under what circumstances would this be done?

MR. HORTIG: Well, circumstances are alleged to have
occurred, keeping personalities out of this, where it has become
known throughout the industry that a particular operator is re-
quired by earlier lease conditions, which did not foresee this
hazard, to pay his landowner's royalty as against the highest posted price in a particular field. It is obviously a simple matter for a competitor who might wish to create a problem for his competition, the lessor who holds this particular lease, to simply go in and post and never buy; and with no test provided for the bona fide nature of the purchase or even small purchases at the highest posted prices, immediately brings about the necessity for paying for large quantities of oil against what is really a fictitious or a rigged highest posted price, to the disadvantage of the particular lessor.

MR. CHAMPION: This could operate as a threat against, for instance, the contractor who might win the bid we are now discussing.

MR. HORTIG: Exactly; and in order to preclude such a possibility is why the basis has been developed as is here recommended.

MR. CRANSTON: Are there any conceivable safeguards to protest against artificial manipulation by inserting a highest artificial price that could be put in the contract or under present law?

MR. HORTIG: Yes, there are, Mr. Cranston; but these were evaluated and it was concluded that no safeguard could be included which did not carry with it a substantial price tag and a price tag which the City and State would pay for the benefit of specifying highest posted price and determining that it was highest posted price, and would cost more than the difference that would result . . . .

MR. CHAMPION: Wait a minute, Frank, you have me a little confused on what the price tag is on. Is the extra cost here the cost of making an adequate determination, or is the price tag the influence on the net profit bid?
MR. HORTIG: The price tag is the uncertainty of the bidder as to what he is going to have to face in the future; therefore, he has to take insurance against that eventuality in his bid to the City and State.

MR. CRANSTON: To turn to the other face of coin, who might want to manipulate the price downward?

MR. HORTIG: This, of course, goes to the heart of crude. I think a fairly effective definition of posted price is: that this is the lowest price at which a refiner can get his refinery supply of oil and this is the measure of the effect of supply and demand, and competition, again in any particular field for a particular quality of crude oil as it is needed for the refinery capacity of a particular operator. Every refiner would like to buy his oil for less money than he is paying for it today. This is just automatic, but if he can't get it for less money, why he pays the higher price and a higher price than that under which the major purchasers are purchasing and which reflects the reasonable market value, as shown on their schedule as the average posted price.

MR. CRANSTON: Would it presumably be the contractor who would have the most fundamental interest in seeking to bring about a lower average posted price?

MR. HORTIG: This would depend upon a series of interrelated factors that can't be precisely evaluated here, because if the contractor is not an integrated company he is in an entirely different position. If he winds up as being only an interested producer, he is interested in the highest price value because under this circumstance he will make the most net profits; if he is an integrated operator and can consider transferring some of the economic problem to his refinery operations, there could be an impact and a desire to have the lowest posted price.
for this particular operation.

MR. CHAMPION: He would be in the unique position of
benefit.

MR. HORTIG: He would be in the unique position of
benefit. However, I must stress the fact that this isn't the
one contract, the only one in California. These same people also
require oil over and above and beyond the amount of oil going to
be available under this contract and all of the major purchasers
in California will. If someone tried to artificially depress the
price for the production from this particular contract, they
would not get any other oil from any other producer at this
price; and in view of the favored nation clause, the thing re-
bounds right back to the highest price again.

The opportunity in practice for anyone manipulating
the price down is remote and, of course, we tied to an average;
and the competition is seeing to it that the average is going
down because they can't get the oil at the lower price either.

MR. CHAMPION: In your opinion, Mr. Goldin, does this
contract safeguard against a contractor artificially lowering
the price? I want to know whether you think there are others
needed?

MR. HORTIG: If I might respond first, I feel that the
provision for the average and the competitive forces throughout
the field and the fact that crude oil is in short supply in
California -- all of these work toward limiting the ability of
any contractor depressing the price for this one contract alone.

MR. CRANSTON: I'd like to hear from the Attorney
General on that one point alone.

MR. SHAVELSON: We thought very carefully. We realized
an average posted price provision does allow the contractor to
post a price and therefore affect a price at which he is account-
able to the City and State and therefore it is very important to
determine whether or not he can post an artificially low price.

Now, these are the protections in the contract:

First, he would have to be a continuing purchaser of oil insofar as the Wilmington Oil Field is concerned, which is the primary determination here; and if he posts an artificially low price, then presumably he could not sell an average of a thousand barrels per day each month for a twelve-month period at that artificially low price, unless there were some sort of collusive contract between our contractor and some third party seller and we think that any such collusive contract of that nature entered into for the purpose of depriving the City and State of revenue would be, if not a clear cut violation of Federal and State antitrust laws, would come so close to it that no company would dare try it and, furthermore, we think it very likely could be a violation of the California Penal Code involving theft by false representation -- so that is one protection.

Another protection is, as Mr. Hortig put it, they are going to presumably wish to buy other oil in the field and if this is an artificially low price, then they would presumably be compelled to pay a higher price to someone else, higher than what they post; and if they did that, we have the automatic escalator provision in 18.3 which would require them to account to the City and State at that higher price.

We also have the express contractual right to get from them complete information as to their other purchases. So it is a long answer to your question, but with those protections, we think the average price could not be effectively manipulated by our contractor.

MR. CRANSTON: You feel that we have protection in the contract in State law and in Federal law?

MR. SHAVELSON: Yes, sir.
MR. SIEROTY: On this point, the clause which provides that the contractor must give information regarding other purchases and must pay that price, in other words that price which would be established -- in what field does that relate, just to Wilmington Field or to all of them?

MR. SHAVELSON: The escalator provision is only applicable to purchases in the Wilmington Field. The information provision as to how much oil they are buying or selling applies to all fields. In other words, we would be supposed to know whether or not our contractor was in fact a continuing purchaser in any field, because we would have a contractual right to get from our contractor the necessary information. Whereas we would have to guess as to a third party, as to whether or not he was a continuing purchaser, we would know for a certainty whether or not our contractor was.

MR. SIEROTY: And does he reveal the price at which he is purchasing?

MR. SHAVELSON: Yes.

MR. SIEROTY: In all the fields specified here?

MR. SHAVELSON: Let me read the language to you, if I may; it is very brief: "The contractor, if so requested by the Board of Harbor Commissioners or its authorized representatives, shall promptly inform the Board of the prices used in valuing and the volume of all purchases and sales made by or to the contractor or by or to all persons or corporations comprising the contractor of oil in the Field or in the other fields above designated." In other words, it applies to the field, the Wilmington Field -- the other fields being the others specified.

MR. CRANSTON: Going to another matter, it has been suggested that the proposed contract will result in an oil price manipulation scheme run exclusively by a worldwide cartel. I'd
like to know if any such price-fixing has occurred under the
L.B.O.D. contract.

MR. HORTIG: Well, the State Lands' Division is not
aware thereof, despite having had supervising and audit responsi-
bility with respect to the operations under the contract since
July 5, 1956. Inasmuch as representatives of the operating
agency having direct operating responsibility are present, I
think a response would be in order from them also, Mr. Cranston.

MR. GOLDIN: The Attorney General's Office has no such
information.

MR. SPENCE: Well, I can say emphatically that the City
of Long Beach or the Board of Harbor Commissioners have never
entered into any conspiracy on any oil prices.

MR. CRANSTON: I don't think there was any suggestion
you had, but that oil companies might under the proposed contract.
But there has been no evidence of any such efforts and no evi-
dence of even unsuccessful efforts as far as you are aware?

MR. SPENCE: As far as I am aware.

MR. CRANSTON: Another question: Would there be any
greater opportunity for such things to occur under the proposed
contract than under the present contract?

MR. HORTIG: Well, Mr. Cranston, I believe this must
be an academic answer to a very academic question. There would
be less opportunity under the proposed contract because of the
broader base of more competitive entities under the program and,
therefore, the necessity in order to have any manipulation for
a joint collusive effort of more entities that are in direct
economic competition today; and every time you involve one more
competitor in an attempt to achieve a manipulation, it dilutes
the remaining profit to be distributed as a result of any suc-
cessful collusive effort and thereby makes it less desirable to
to even attempt such a course.
MR. CHAMPION: Well, such a collusive thing is really not a matter of this contract, is it, but of State law? If there is such a thing, State law already has adequate protections.

MR. HORTIG: I believe Mr. Shavelson has something in point here.

MR. SHAVELSON: I have here a copy of the decree against the major California oil companies entered in the United States District Court, and that decree prohibits the companies from fixing their prices in relation to the price of any particular other defendant in any field, but it goes on to say that this provision shall not prevent a defendant in the purchase of crude oil from offering or agreeing to pay for said crude oil a price which is referenced to or is expressed to be based upon the highest, lowest or average of the prices posted by any two or more persons—defendants or otherwise, who may be named.

So I believe that the Court is implying there that it does not regard the fixing of prices in relation to posted prices, whether highest, lowest or average, as inhibiting competition. Now, I am sure that there are some antitrust laws that might disagree with that decree, but I think it is a fair inference.

MR. CRANSTON: I ask if there is sufficient oil in this field to serve any sweeping price-fixing manipulation?

MR. HORTIG: I think probably the best measure, Mr. Cranston, is that the estimated......

MR. SMITH: ... remaining reserve is two hundred eighteen million barrels.

MR. HORTIG: Two hundred eighteen million barrels on a decline, this field having passed its peak, having been in operation for twenty-five years, peak production having been reached some time past; and with the possibility on reasonable estimates indicating that the economic limit and the last barrel
that can be afforded to be produced will probably be produced
between 1985 and 1990 — after which this particular field will
not be contributing a barrel of oil, and therefore no impetus or
ability to enter into any conspiracy or use as a lever in connec-
tion with price-fixing.

MR. CHAMPION: What will be the average production —
around forty thousand barrels a day?

MR. HORTIG: It is less than forty thousand now.

MR. CHAMPION: What is the total California production
per day?

MR. HORTIG: About eight hundred thousand barrels a
day.

MR. CHAMPION: And when Wilmington comes in, what will
it be?

MR. HORTIG: We estimate one hundred fifty to one
hundred sixty thousand barrels a day.

MR. CHAMPION: On top of the present eight hundred?

MR. HORTIG: Yes, sir.

MR. CHAMPION: So you will have about a million barrels
a day in California.

MR. HORTIG: By the time we get Wilmington in produc-
tion, California will be down, because over-all production is
decreasing.

MR. CHAMPION: We are talking here about forty — we
are talking about less than five per cent.

MR. CRANSTON: Who has called this field a "depleted"
field?

MR. HORTIG: I have seen that terminology in one press
report. I believe, however, staff comment and every staff analy-
sis in connection with the Lands Commission has been that it has
been in an area that has a declining production rate, but
apparently it is not a depleted field in the sense that a depleted field is used in the oil industry -- which means an exhausted field, when we have over a hundred million barrels reserve remaining to be produced.

MR. CRANSTON: To stick a bit more to the highest versus average price issue, obviously it is to the State’s interest and State’s policy to receive the highest price it can for the oil it possesses. It has been suggested that the Cunningham-Shell Act uses the term "highest price" as compared to this matter of highest posted price in relation to the average posted price. I’d like to ask the Attorney General’s comments on that point.

MR. SHAVERSON: Section 6827 of the Public Resources Code merely requires that the oil be based on the current market price plus any bonus or premium; although in our standard lease form it is tied to the highest price in the field, that is not a statutory requirement.

MR. HORTIG: Might I amplify on that, Mr. Cranston?

Of course, this also relates to oil and gas leases as are required to be issued by the State Lands Commission, with certain conditions which are provided by the statute as minimum, and in these oil and gas leases the return to the State is a percentage of the value of the product -- therefore, the higher the value of the product, the higher the return. On the other hand, if leases were offered for bid on an average posted price basis rather than the highest, it is patent that the high bidder, if there were any substantial difference -- which there isn't, between average and high -- a high bidder would offer an even higher percentage return to the State because of the ability to determine precisely, or more precisely, what his royalty payments and requirements are going to be because of the greater
stability and greater certainty with which an average price level can be determined, as against erratic fluctuations for amounts of oil by a spot purchase.

Contrasted with that, we have the contract before you for consideration, where the return to the State and City is not directly related to the value of the product as the basic criterion, but the return is going to be on the percentage of the net profits. True, any difference between highest and average will be considered in the percentage to be offered and would also result in a difference in the amount of net profit calculated for lower value of production; but it must be remembered that the actual experience from 1956, again since the State Lands Commission has monitored Long Beach operations, to date under the existing Long Beach Oil Development contract, has showed that because highest posted prices have applied to only minor purchases of oil there has only be 1\106 per cent difference between the highest and average posted price during that time.

MR. CRANSTON: The obvious mandate of the State of California to receive the highest price for its oil is not met legally or morally whether they receive highest or average posted price.

MR. HORTIG: May I make one correction? There is no mandate to receive highest price; it is to receive reasonable value.

MR. CRANSTON: Obviously, it is the State's responsibility to receive the highest price we can.

MR. HORTIG: True.

MR. CHAMPION: May I ask -- Alan, it isn't the highest price -- it is the highest profit to the State and City.

MR. HORTIG: Under the contract we have under consideration.

MR. CRANSTON: The contract which terminates next
March operates under average posted price, is that correct?

MR. HORTIG: That is correct, but determined on a narrower base than would be determined under the new contract.

MR. CRANSTON: Specifically, had we been operating under the highest posted price what would have been the difference in revenue to the State of California?

MR. HORTIG: We can't say there would be any difference in revenue.

MR. CRANSTON: Per barrel -- just stick to per barrel.

MR. HORTIG: It should have been on the order of a hundred thousand dollars, assuming the difference in specification as to how the value was to be calculated had not influenced the original bidder to change his bid according to the yardstick to be used.

MR. CRANSTON: What is the revenue over the life of this contract now? I just want to put this hundred thousand dollars figure in perspective.

MR. SMITH: About on the order of three hundred million.

MR. CRANSTON: Three hundred million and we are talking about one hundred thousand dollars.

Another matter, Frank, which comes up in your comments and your staff report on this matter, where you go into the matter of the one-tenth of a degree of A.P.I. gravity. Would you explain that and the relevance of that, as it relates to this in terms of revenue to the State?

MR. HORTIG: The normal pricing provisions and specifications by most of the oil companies purchasing oil have broken the prices stepwise by complete degrees of A.P.I. gravity. A.P.I. gravity is like a thermometer and it has bigger divisions on it -- 30° oil may bring five cents a barrel more than twenty-nine; and thirty-one, five cents more on top of that.
This is the way the matter is reflected in the offerings and in the crude oil price schedules I think I have here. As, for example, Mobil Price Schedule Number 91 effective January 22, 1962 lists for Wilmington 20 to 20.9 gravity, 2.35; 21 to 21.9 gravity, 2.41. In other words, suddenly, in going from 20.9 gravity scale to 21, there is an increase of six cents a barrel and there are two ways to try to get that additional six cents. That is, to go through elaborate blending procedures, and at a cost, on a tank farm to mix up lower gravity oil with higher gravity oil, in order to get just to the breakover point -- which you can't always do; or, as is proposed in this contract, that calculations be made by straightline interpolation for every degree of gravity, so this six cents differential will be divided into steps of 6/10 of a cent for each tenth of a degree of gravity, whatever the gravity measures when the oil is shipped.

The net result in applying this type of calculation, had it been applicable in past production to the L.B.O.D. contract it is apparent that approximately three cents a barrel will be realized out of future production for a given price schedule than had been achieved herefore -- because this step arrangement, rather than a smooth scale of prices over the entire gravity range.

MR. CRANSTON: That is three cents a barrel more due to this price against 17/100 of a cent.

MR. HORTIG: 17/100 of a per cent. While the two are not interrelated, more money will be received for the oil on an average posted price schedule with the tenth of a degree gravity schedule.

MR. CHAMPION: Without affecting the potential net profit.

MR. CRANSTON: Unless someone else has some questions.
on average versus highest posted price, I'd like to go into another matter. That matter is the additional acres which are being covered under this contract, which were not covered under the present contract. Can you explain why these have been added?

MR. HORTIG: Yes, Mr. Cranston. I apologize for the small map but you have it on your agenda. This is the tide and submerged lands under the jurisdiction of Long Beach Harbor Commission originally leased under the series of contracts, or awarded under the series of contracts to L.H.O.D. pursuant to competitive public bidding. As a result of development of the developed area, it was discovered that, contrary to the expectation that the seaward limit of production would be at this dashed line, the limit of the leased areas, developments culminating in data analysis on which field knowledge was only available four or five years ago demonstrated that the production structures actually extended some additional distance seaward of the area which had previously been leased.

It was about five years ago that we had conferences with the Long Beach Harbor Commission on the availability and desirability of seeking a lease for this additional adjoining area. I must point out this is the flank area on the seaward side of the presently leased Harbor Commission lands. This is not any of the area that has been considered by the Commission to be included in a future development program known as the Long Beach Unit. As a matter of fact, between the area discussed here as undeveloped area, and the Long Beach Unit, there is another city operating contract known as Richfield Parcel A.

When we evaluated the economics on the undeveloped area as to offering it for lease separately, it appeared marginal from the standpoint that a new operator coming in, having to operate in the deeper water area and from facilities outside
the developed area, which would conflict with the Long Beach Naval Shipyard operations; the additional costs of having to go, possibly, out to the seaward side and slant-drill back into the area; to provide duplicate facilities for handling the production, duplicate over those already in existence for the L.B.O.D. operation -- it was determined that probably the optimum return for the City and State could be achieved by including the marginal flank parcels in any new contract offer such as is being considered at the present time, where the efficiency of developing the entire area will result in a maximum of profit being secured by the City and State from developing the area in conjunction with the previously developed area rather than having sought to have it started earlier.

MR. CRANSTON: I take it your remarks a few minutes ago about the number of barrels in the field and their effect on California market conditions include that portion of the field as well as the present?

MR. HORTIG: That is true. As a matter of fact, as to the undeveloped area, the estimates range around an estimate of forty thousand barrels.

MR. CRANSTON: Would it be feasible to offer the field for bid and development under separate offerings by fault block?

MR. HORTIG: No, sir. If I may refer to a staff report for the short answer, considering division of undivided interests and offering these undivided interests with the division lines to be the fault blocks -- again if I may show you gentlemen a diagram, a cross section of the Wilmington Oil Field, indicating by these curved lines the approximate location of the subsurface fault zones -- you can see this renders a very complex subsurface picture. This complex subsurface picture, therefore, certainly does not lend itself to property description such that Area A
can be described for a particular lease and Area B for another lease. We reported previously that separate offerings by fault blocks would be complicated and disadvantageous, resulting in reduction of State-City revenues because of increased capital and operating expenses. Some of the principal factors contributing to the undesirability of separate offerings are:

(a) The faults separating the individual blocks are not definite lines, but are fault zones of variable width. Generally there are no visible surface indications of these faults, and their location and extent can be determined only from subsurface geologic data.

(b) Reservoir studies indicate that the faults separating the various blocks are not competent barriers to the migration of oil, gas, or water. This means that if the fault blocks were selected as units for separate leases and there were competing operators, the competing operators could find they did not have a fence between their property, but a sieve; and their own operating conditions would affect the other operator. They would be draining gas and pressure back and forth and this would probably be the most prolific source of litigation we have had on tidelands.

(c) The surface projections of the fault blocks overlap. Much of the surface area is directly underlain by two or three different fault blocks. In other words, if we put up these vertical fences, we find part of Operator A's property is within the fence, part of Operator B's property is also within the fence and extends next door, and part of Operator C's property starts at the easterly fence and goes over to the westerly fence and extends out an indeterminate distance to the west. Unfortunately, nature did not arrange these fault blocks in nice, compact individual units, where they could be described in such
a manner where they could be considered for offers in undivided
interests.

Next, duplication of equipment would result, inasmuch
as production facilities installed during the last twenty-five
years are common to all fault blocks. Extensive modification of
and additions to the following facilities would be required to
provide for use by separate contractors -- and all of these, of
course, at a cost to the City and State:

First, the oil gathering systems, which are common;
the electric power systems, the dry gas systems, waste water-
disposal systems, water-injection systems, the tank farms, the
shipping pumps and lines. Actually, currently there are tank
farms that are being used for multiple fault block operation,
one tank farm handling the production from as many as three of
the existing fault blocks. Therefore, if the fault blocks were
to be the lease unit or the contract unit, you would have three
contractors' production going into the same tank, with no abso-
late and assured criterion of how to divide the production; and
this, of course, can only result in interminable argument as to
who is entitled to which share.

Next, a substantial increase in number of operating
personnel would result for a multiple operation as against a
single operation. Supervisory and management personnel would
increase in direct proportion to the number of separate con-
tracts awarded; and this would carry with it the commitment for
more office space, equipment and automobiles for the contractors' 
personnel.

Finally, more than twenty multiblock wells produce oil
currently from more than one fault block. The producing inter-
vals of these wells actually are located on both sides of
specific faults, again making impossible the physical separation
and accounting, by fault blocks, of oil produced.
Therefore, in summary, few additional facilities will be required to develop the new area if the entire harbor tidelands oil operation is carried on under a single contract. Oil production in the presently developed parcel is decreasing, and surplus equipment and facilities therefore would become available for use in the new area -- at no additional cost to the City and State. It must be remembered that the total capital investment and operating costs for the I.H.O. operating contract have heretofore been advanced by the City of Long Beach from the state oil funds. In other words, this is a public operation and we do have the problem of protection by adequate continuity of the efficiency of the operation, achieving both the revivals return from the remaining production and also the protection of that public investment which has already been made in this area -- which, admittedly, was made initially at a time when the State Lands Commission had no statutory responsibility with respect to this operation.

MR. CRANSTON: Do you feel it would be feasible to divide up the field for bid purposes by resorting to the undivided interest route that we have advocated in regard to the East Wilmington Oil Field?

MR. HORTIG: Possibly an analogy would be, in effect, selling stock in a corporation to operate the entire fault block and the problem there is that the order of comparative magnitude between this operation and the Wilmington Unit that is under study by the State Lands Commission leads us to believe that the disadvantages and the discounts resulting from dividing this smaller area would not justify dividing the area -- whereas, we are considering the possibility of achieving minimization of anti-monopoly allegations by reason of dividing a major field, which the East Wilmington Field is going to be, as distinguished
from this smaller operation -- which, as we have already indi-
cated, will probably not be with us after 1990 in any event.

MR. CHAMPION: And will never be more than five per-
cent of the State's production.

MR. HORTIG: That is correct.

MR. CHAMPION: The difference being that in the East
Wilmington Field there is an opportunity, if there were not to
be divided interests, of establishing a dominant position in the
California market -- whereas in this situation there is no such
opportunity.

MR. HORTIG: Based on the East Wilmington Field, one
operator having control of a total of one-third of the State's
production.

MR. CRANSTON: Are there any ways in which the action
we take on this contract affect prospective action on the East
Wilmington contract? In other words, do we set any precedents
that tie us to any action we may wish to take in regard to the
other contract?

MR. HORTIG: My own opinion, Mr. Cranston, is no.
This will immediately produce an argument, I am sure, from some
industry representatives and, indeed, Shell has touched on the
point in their letter. If I may paraphrase it unless someone
can find me a copy -- I have it. Item 2 of the Shell letter
of October 7th suggests:

"Irrespective of whether the final decision is to utilize
a pricing basis of 'average posted price' or 'highest
posted price,' we urge that the Commission establish a
consistent pattern as between this and other tide and
submerged lands offerings so that in the future all offer-
ings of publicly owned lands (whether controlled by the
State or by a political subdivision thereof) will contain
identical crude-oil pricing terms."

With the feeling, and I believe the concurrence of the Attorney
General's Office, that by approval of this contract the State
Lands Commission is not establishing a precedent and committing
itself to use the identical terms in the other operations, this
then does not meet the test as suggested by the Shell Oil Company.

Through an intensive review of the operation, I believe that we
must conclude that it is not feasible to establish at any one
time in connection with a particular operation -- and certainly
not with respect to the Long Beach Harbor tidelands parcels -- a
set of criteria that will be so well controlled as to assure the
maximum of benefits and minimum of disadvantages in the operation
of this area, which criteria are in turn also at the same time
so flexible and so all-embracing as to fit all other leasing and
oil contract considerations that may come before the Commission
in future, irrespective of their variations in geography, geology and economics.

MR. CHAMPION: As a matter of fact, these contracts
are governed by a different law than governs the tidelands operated by the State Lands Commission -- these are two different
statutes.

MR. HORTIG: This is the practical fact.

MR. CHAMPION: So this isn't conceivable unless you re-
write those statutes.

MR. CRANSTON: Does the action we take on this contract
relate to any action which may be taken in the Legislature on
the matter of present division of revenues from Long Beach oil
wells?

MR. GOLDIN: No.

MR. CHAMPION: In other words, if there were to be a
change in the present fifty-fifty arrangement, that would auto-
matically apply regardless of this contract having been awarded.
The wording of the contract does not freeze any particular rela-
tionship. It is only the Statutes of 1957 that freeze that
relationship.
MR. GOLDEN: Yes, sir. What I was looking for was a specific provision that we had written into the contract to protect the State in the event of such a revision.

MR. CRANSTON: You do have such a provision in the contract?

MR. GOLDEN: Yes, if I can locate it. I believe that it is found in Section 40 of the contract relating to successors and assigns. We were cognizant of the possibility that this contingency might occur, so we inserted this provision for the State to act in the City's stead should the Legislature take such action.

MR. CHAMPION: That would be in terms of an entire revocation -- that the State would act in the City's stead; but if there were only a change by the Legislature in the allocation of the revenues from fifty-fifty, is there a provision on that?

I don't think there is any legal question.

MR. SHAVELSON: No. In other words, this being a proposed contract between the contractor and the City, it is none of the contractor's business as to how the revenues will be ultimately divided. However, it may be the contractor's business who has the specific authority. That's why this provision was put in; but nothing was put in regarding this division, because this doesn't concern him at all.

MR. CHAMPION: The State would operate the contract only on entire revocation?

MR. SHAVELSON: If there were substantial differences, there might be more participation by the State Lands Commission without complete revocation.

MR. CRANSTON: We have gone over many questions raised by this contract, but not all of them. I would now like to get into the matter that relates to our time schedule. In order to
have the contract ready to go and to have the field continue to
be developed as of the time this contract expires, what is the
necessary time schedule for approval, sending out notices,
awarding the contract?

MR. HORTIG: In terms of State statutory requirements
and the requirements of the Long Beach City Charter, there is
only one unalterable specification and this is a requirement in
connection with the award of contract by the City -- that after
bids are received there be a thirty-day waiting period before
the contract can become effective either in terms of having been
approved by the City Council, or not objected to by the City
Council, or, conversely, to be terminated by rejection by the
City Council; but that thirty-day period must run according to
the charter.

The balance of the scheduled time, then, relates
necessarily to what is most desirable and might be optimum in
terms of providing completely adequate time, if at all possible,
for all prospective bidders to evaluate the economics of the
contract offer which is being discussed here today -- which,
while it is a smaller operation, nevertheless relates to substan-
tial amounts of oil production and to existing plant and facili-
ties involving something in excess of six hundred operating oil
wells today. This, therefore, as a matter of any new operator
entering the area is going to require considerable study and
time is essential there.

MR. SIEROTY: Frank, could I stop you right there?
Has this economic information been made available to possible
bidders at yet?

MR. HORTIG: No, but may I plug that in at the point
in the time schedule I am about to tell you about? Secondly,
an equally important, of course, is the fact that if there is
to be a continuity of operations with the high degree of efficiency that has been achieved in the Long Beach Harbor Department tidelands, if there is to be a contractor at midnight March 20, 1964 who is not one who has previously operated in the area, if he should have such a contractor organization and should be the high bidder as against the present operator -- then in order to have staff training, indoctrination, even the necessary taking of inventories and even finding out where these six hundred wells are located on the ground and where their pipelines go, necessitates considerable indoctrination period if there is to be a smooth transition without a drop in efficiency at midnight on March 20th.

Therefore, it has been previously suggested as a desirable minimum for the contract effective March 20th, that the contract should be awarded and the contractor know he is going to have this obligation on March 20th by n" later than January 2, 1964. This would require a start of the thirty-day charter waiting period not later than December 2nd; and preceding the start of the charter waiting period, before award of a contract pursuant to a bid, there is required in the statutes, in the Public Resources Code, State Lands Commission approval of the bid before the contract can be awarded. This, therefore, to meet this starting date of December 2nd, would have to be before the Lands Commission at the meeting currently scheduled for November 31st.

MR. CHAMPION: Let me just ask: That means that if we should approve this and this progressed forward and the bidding did not develop as anticipated under the kind of discussion we have had today, that one or more of our speculations did not work out, that could at that time be turned down?

MR. HORTIG: Yes. Approval is required or no deal -- approval of the Lands Commission.
MR. CRANSTON: If it is turned down, to go off the schedule for a minute, we obviously are not going to have time to have a contractor by March 20th.

MR. HORTIG: We would not.

MR. CRANSTON: What happens if we don't have a contractor by March 20th?

MR. HORTIG: One of a series of alternatives have been suggested: Possibly reconsideration, with amendments in the light of those circumstances, of a unit operation of the type such as has been suggested by Union Pacific Railroad -- which, inasmuch as (and this is highly speculative) they are operating and they are there, and the Long Beach Harbor Department personnel are there, an emergency and stopgap type of operation could be put together by those groups much more rapidly than a new contractor could do it; or, conversely, even expansion of the Long Beach Harbor Department engineering and control staff could operate on, again, an interim basis, the field with which they are intimately familiar and in daily contact until a new form of offer could be developed.

MR. CHAMPION: As I understand it, however, this would be a sacrifice in the amount of money we would receive in terms of the present contract just so far as what we know about the present formula.

MR. HORTIG: As against reasonable expectations, I believe this would be the inefficient method and would come at a cost to the City and State to have such an interim operation.

MR. CRANSTON: Which would have to be weighed against other costs.

MR. HORTIG: That's correct. Now backing up one step further, if the Harbor Commission staff and State Lands Commission staff are going to have time to do an adequate job of
staff evaluation of the bids without being in our interminable
crash program and crisis schedule, it would be desirable if at
all possible -- it would have been, to have the bids received by
November first. That being the case, and again having in mind to
give the operator or prospective bidders an adequate opportunity
to determine what the bid should be in the light of the contract
here being considered, the City should have published notices
of intention to receive bids on September 2nd -- which we have
already passed. So we are behind schedule now by at least thirty
days; and these thirty days are going to have to be made up by
shorthing wherever we can to save time.

MR. CRANSTON: You do believe, however, that we can
compress this schedule and if we receive an appropriate bid which
we act upon still be able to meet the deadline of March 20th?

MR. HORTIG: Yes, sir.

MR. CRANSTON: What would be the effect of any further
compression of that time period if there was not action by the
State Lands Commission?

MR. HORTIG: This is speculative, again, upon who the
prospective bidders are going to be; but if there are any inter-
ested bidders, and I assume there would be under normal circum-
stances, who have not previously operated in the area -- as a
matter of fact, there has been some conjecture there might be
some who haven't even previously operated in California -- if
they had to start from scratch and they cannot be given time to
make an evaluation of what their bid will be, this will result
in taking increased insurance in case they get this responsi-
bility or in some cases result in no bid being submitted because
of inadequate time to become sufficiently knowledgeable in this
complex situation to proceed with an intelligent bid.

The ultimate argument on this, of course, is that you
could go to bid, have bids received up to thirty days before March 20th so that the waiting period could take place, and the contract become effective for the first time on March 20th. Under those circumstances, the only potential bidder in my estimation who would be in position to make an intelligent bid would be the present operator because he would be the only one who knows about the full scale of the operation.

MR. CRANSTON: Are you saying, then, that the delay plays to the advantage of the present operator -- a compression of the time necessary to consider the costs and methods necessary to get the field into development?

MR. HORTIG: Well, it puts other bidders at a greater disadvantage than the present operator.

MR. CHAMPION: If it puts other bidders at a disadvantage, don't you end up with an advantage?

MR. HORTIG: Right -- a matter of semantics. I didn't finish answering Mr. Sieroty's question, Mr. Chairman. It was the proposal, as reported at the last meeting of the Commission, of the Harbor Department to hold bidders' conferences and to present a bidders' package, representing the sum total of collected knowledge on the geology, economics, physical conditions, operating requirements, and so forth, for all prospective bidders, in order to give all previous non-operators in the area as broad a base of knowledge on which to base their bids.

Again, evaluation of this data is going to require time and, therefore, if this program is going to be followed it is essential that it be adopted as soon as possible.

MR. CRANSTON: Just for the record, who are the present operators?

MR. HORTIG: The Long Beach Oil Development Company, which is a stock corporation. Principal stockholders at the
present time are in the approximate percentages of Signal Oil and Gas Company, fifty per cent; Standard Oil Company of California, twenty-five per cent; and the remaining twenty-five per cent scattered, as reported at the last meeting on September 30th. The precise statistics are: Standard Oil of California, 28.5; Signal Oil and Gas Company, 57.0; Humble Oil and Refining Company, 8.5%; the Termo Company, 2%; Macrate (either oil company or as an individual, I am not certain) 2%; and one of the Continental group, 2%.

MR. CRANSTON: Mr. Chairman, it seems to me that in order to meet the deadlines that would seem to be the most desirable, we should seek to act today. The situation, when the contract bids are let and when they return to us, would still permit us at that time, although there would be vast complication involved, to reject the bids -- which we would, of course, do if they were unsatisfactory. Also, we would be able, if holes were punched in the contract form between now and then, to reject the bids if for that reason they were improper.

However, I regret to say I am not quite ready at this point to approve the contract, mainly because certain material was handed to me yesterday by the Attorney General's Office and the staff, and questions have been raised by Senator O'Sullivan and I have not had adequate time to digest this. However, I do not desire to delay any more than necessary and I'd like to ask if we can recess until three o'clock this afternoon and see if we would be prepared at that time.

MR. CHAMPION: All right, that is satisfactory to me. I'd like to have some idea of how much other material will need to come before us or whether there is other testimony.

MR. CRANSTON: Perhaps Alan has other questions.

MR. SIEROTY: I have some questions. Perhaps if I
can raise them now, we might be able to work on them between now and three o'clock.

Frank, you mentioned that economic information was available but hadn't yet been distributed to possible bidders. It would seem to me that whether we act today or not, that economic information could be made available to possible bidders. In fact, I can't see why it couldn't have been made available already. At least, possible bidders could be gathering their studies and making their evaluation, even if they didn't know the exact terms of the contract.

MR. HORTIG: Of course, the exact terms of the contract are such an essential part of the evaluation.

MR. SIEROTY: I know that.

MR. HORTIG: However, I think possibly the Long Beach Harbor Department should respond as to that schedule, inasmuch as it was their intent to carry out this program.

MR. SPENCE: Mr. Chairman, Mr. Smith will respond to Mr. Hortig's last question, but there is one point I think should be made clear. If we assume that the City of Long Beach could operate this field temporarily with the Long Beach Harbor tidelands parcel, we still have that big problem: What are we going to do with the oil? We can't dispose of the oil. We can't sell it except on a contract let pursuant to Chapter 29 under competitive bids, for which we have to receive prior approval of the State Lands Commission. So we can't solve it by doing the work ourselves, assuming we are able to do it.

MR. CHAMPION: Well, I think that's a question you won't have to face unless we pose it for you.

MR. SPENCE: I hope not.

MR. CHAMPION: If we end up by posing it for you, we will have to discuss what can be done about it; but I think that discussion might be academic at this time.
MR. SMITH: We are now in a position to distribute this package, which we feel does contain adequate information for potential bidders to evaluate our proposal. We have not distributed it yet, primarily because we were waiting for an approved form of contract. It is conceivable that a radically changed contract would require additional information, deletion of information, or modification of some of this information.

I can say that we have made the assumption that this contract form would be approved today and we would advertise for bids at the earliest possible time, which would be next week, and this would be made available at that time. If it appears there is going to be any delay in getting approval of this contract, the suggestion of putting this information out now might be worth considering.

MR. SIEROTY: How long a period of time will be given to possible bidders between the time of notice of the bid and the time that bids must be received?

MR. SMITH: We are proposing a sixty-day period of advertising this bid and I believe that sixty days is a fair minimum to digest this information and come up with an intelligent bid. We had hoped to be able to give them ninety days or perhaps even more if possible.

MR. SIEROTY: I have no information as to what time oil companies need to digest this. I think it is an extremely important point. You want to encourage bidders. If there is any possible bidder who would be cut off in his examination and study of this, I think it might be in the interest of the City and State to extend the period of time and perhaps if there is somebody here that would like to speak on that we could get that information. I notice we are thinking in terms of January 2nd to March 20th as a period of time in which the new contractor
can familiarize himself with the new operation. That seems to me perhaps a little longer than required, and I'd like to see any extra time given to study time.

MR. SMITH: That's right, Mr. Sieroty. If we have to compress any of our time schedule, it should be at the end, before the award and the taking over.

MR. CRANSTON: Is that not action time? If the contract is awarded on January 2nd, the winning group is going to require the time between then and March 20th to take the steps necessary to commence operations on March 20th. I assume most of his study on what he is going to do will have to be done before he bids on the contract.

MR. SMITH: That's correct. The sixty days we spoke of is for assimilation of the information in this package.

MR. CHAMPION: Let me ask you: Do you have any notion of how many bidders you are likely to have -- half a dozen?

MR. SMITH: It is difficult to say how many of the inquiries we have had are really valid inquiries. I don't have a list of those with me, but my recollection of those is that there may have been twenty separate companies or individuals who have asked for what information was available.

MR. CHAMPION: Are there any indications if we approve the contract as before us substantially in form that there will be substantial bidding -- that this will draw a number of rivals?

MR. SMITH: I really believe so.

MR. CHAMPION: And it really would be an unsatisfactory bidding procedure if that did not occur?

MR. SMITH: That is correct.

MR. CHAMPION: Thank you very much, Mr. Smith.

MR. SIEROTY: I have some other questions.

MR. CHAMPION: Well, we are approaching the hour of
twelve thirty. We will plan to meet by three o'clock. If there is anyone else who has questions they want to raise or who are going to want to speak on this thing, I'd appreciate if you would let Mr. Hortig or someone on the staff know, so we can apportion the time. We would like to conclude today and hopefully take action today; and with that expectation I'd like to have anyone who wants to speak to have an opportunity to do it, but I want to get cleaned up and take enough time to do so.

We will stand recessed until three o'clock.

(Recess 12:25-3:20 p.m.)

MR. CHAMPION: The meeting will please come to order. Mr. Hortig, I know Mr. Sieroty has some questions to raise. Did anyone else register anything further with you with reference to appearing or making statements?

MR. HORTIG: No, sir.

MR. CHAMPION: All right, Alan, do you want to proceed then?

MR. SIEROTY: Yes. I'd like to ask the Long Beach Harbor Commission -- We were talking at the end of the session about the availability of the economic report, information that you have compiled in that book, and you indicated that it was available. Is there any reason why that could not be made available to prospective bidders, let's say, as of tomorrow -- so they can get started in analyzing this information?

MR. SMITH: As I said before, Mr. Sieroty, if it were possible to put this package of information out with the proposed contract form, then we would be sure that we would be putting out the correct information they would need to make their analysis. It is available to be put out if the acceptance of the form of contract is going to be delayed for an appreciable
period and we would certainly consider putting it out.

MR. SIEROTY: Irrespective of whether the contract is approved, these are separate books, I suppose. I would think the economic information could be furnished to prospective leaders so they could be getting started on their analysis. Let's say the contract is approved in a week or two weeks. I am just concerned that the people who are bidding on this would not have time to analyze all the data.

MR. SMITH: Yes, I have that same concern, and I believe we can put it out within the next few days, make it available.

MR. SIEROTY: Well, would you state, then, to the Commission that you would make it available by Monday, no later than Monday, in any case?

MR. SMITH: Well, I would hesitate to say that because I don't know the status of the reproduction of it, to tell the truth. This copy I have is a preliminary copy. It is being reproduced now and I am not sure it is actually physically possible we would be able distribute it at this time; but certainly within a few days.

MR. SIEROTY: But you will make an attempt to get it out at the earliest time irrespective of what the Commission does on the contract?

MR. SMITH: Yes, I think we can do that.

MR. SIEROTY: All right.

MR. RIDINGS: Mr. Sieroty, if I might answer your last question, you said "irrespective of what the Commission does" -- A great deal of the information of this book has been tailored to fit the particular type of contract we are discussing here. If there is to be a substantial change in the type of contract, our time will have already been wasted and the time of anybody who has started study along those lines would also have been wasted.
MR. SIROTTY: I am not sure it will be wasted. I was assuming that there was economic information and petroleum studies, and so forth, that were somewhat different and not dependent on the form of contract.

MR. CHAMPION: May I make a suggestion on that? If we have a problem on that we can go into that at the end of the meeting. We will then know what the status of the contract is and this can be resolved. Did you have some other point?

MR. SIROTTY: Now, the contract provides for a termination clause in the event that the contract is not profitable and notice of that is how many days, Mr. Hortig, do you recall? How many days is it - one hundred eighty days notice?

MR. HORTIG: I believe it's one twenty.

MR. SPENCE: One hundred eighty days after the determination has been made.

MR. SIROTTY: In other words, one hundred eighty days after the City and the State are satisfied that the contract is unprofitable, the contract will be terminated?

MR. SPENCE: Yes.

MR. SIROTTY: My question is this: Is that enough time? Frankly, here we are and it's October and we have been working on this for some time and we are worried about March 20th - getting in there March 20th. Is one hundred eighty days enough time? Maybe you need nine months.

MR. SPENCE: Well, let me put it this way: If there is no delay in approving the contract and it's been processed just as this contract has been processed by the State Lands Commission staff and the Attorney General's Office, a hundred eighty days will be plenty of time; but if we have a lot of dilly dallying, it won't be long enough.

MR. SIROTTY: Well, we are thinking twenty-five years
in advance -- twenty years, or fifteen years.

MR. SPENCE: We have been through this one hundred eighty-day period with the staff of the Attorney General's Office. We are satisfied with it, provided there isn't any undue delay like we have had on this one.

MR. RIDINGS: May I answer further, Mr. Sieroty? If you will refer to the testimony at the previous hearing on September 30th, Mr. Spence explained that it is our plan to have, constantly on hand and prepared and currently up-to-date from time/time in meetings with the Lands Commission, a form of contract which would, in light of the circumstances of the years as they pass by, best suit the continuation. So there need not be the type of study preparatory to it that is needed here.

Further, this will not come at a time when the economics of the field are so great as they are now, but under a different set of circumstances when the magnitude of the field is substantially less and the problems likewise substantially less. It has been felt to hold a contractor in an unprofitable position for longer than six months may, as we have considered in so many other cases, require him to hedge in his bid; and these fractional percentages that he might hedge will amount to so many dollars in the earlier years. It is very important to get the highest return for the State and City.

MR. SIEROTY: Mr. Hortig, do you have any comment on the one hundred eighty days?

MR. HORTIG: No, I would concur in the comments you have had from the Long Beach Harbor Department; and, as Mr. Spence reported, this was reviewed as to its practicability before it was included as a specification in the contract.

MR. SIEROTY: Paragraph 4 in the Shell Oil Company letter asks about taxes -- a question about severance tax; and
I understand this has been informally discussed, and I think it ought to be answered in the record, answering the question raised in paragraph 4.

MR. SHAELSON: Mr. Chairman, if I may make a brief remark on that, it is the intention of the contract that the oil production license tax to be levied by the City will be paid by the contractor and will be reimbursable. We do not think that the language would be susceptible of any other meaning, since the tax is not measured by the reimbursable expenses in the contractor's share of the net profit. So, therefore, for purposes of the record I would like to state that this is the purpose of the contract -- to make such tax reimbursable. I understand that the representative of Long Beach will corroborate that in open meeting and as far as Shell Oil Company, that will satisfy them.

MR. SPENCE: The City of Long Beach concurs in that.

MR. SIEROTY: Mr. Scott's letter for Pauley Petroleum raises several questions that we should briefly answer. The first question has to do with the definition of continuing purchasers, and it is my understanding that the thousand barrels of oil per day that are referred to means that a purchaser need not purchase a thousand barrels every day, but that he purchase an average of one thousand barrels per day over a period of one month; is that correct?

MR. HORTIG: Over one year.

MR. SHAELSON: Yes -- During each of the preceding twelve calendar months; an average of a thousand barrels a day during each of the preceding twelve months. So if he purchased in any one month, say a thirty-day month, over thirty thousand barrels, even if on one particular day he purchased less than a thousand barrels, that would not disqualify him as a continuing
purchaser under the contract.

MR. SIEROTY: In effect, he does not have to purchase every day?

MR. SHAVELSON: That is correct.

MR. SIEROTY: Now, his question Number 4 here is very short: How will the contract treat tie bids? Let's take that part first. How will the contract treat tie bids? I guess he means how will the City and Commission treat tie bids, the procedure.

MR. HORTIG: Depending upon the nature of the tie bids received and any other conditions that might have been added to the bid form when it comes time for evaluation and determination as to which bids are qualified, which bids if any are tied in fact; and as to the manner of allocating an award as a result of a tie bid, it is felt it is strictly a legal question which will have to be faced if it is a problem as a result of bid submittals and will be faced during the bid evaluation procedure. It is not feasible during the time requirements to provide a complete set of specifications to cover all possible contingencies.

MR. SIEROTY: I wonder if the City has any information? Have you given any thought to the question of what you will do in the event of a tie bid?

MR. SPENCE: In the first place, we will wait until we get a situation where we have a tie bid. The City has had a number of tie bids and it has never posed any legal problem as far as we are concerned. The statutes provide that it must be awarded to the highest responsible bidder and at that time the Board of Harbor Commissioners will have to determine who is the highest responsible bidder.

MR. CHAMPION: The State often faces that problem.

MR. GOLDIN: Mr. Chairman, to minimize this possibility,
is it not practicable to ask that the bid factor be carried out, perhaps, to four decimal points? It will, therefore, minimize the possibility of the precise bid being submitted by multiple entities.

MR. CHAMPION: I assume that this is at the option of the bidder, if he would like to do it. I hardly think we can tell them to do it. Is there any objection to anybody submitting a bid in four decimal figures? (No response) I just don't see how we can issue a directive of that kind. That's like saying somebody wants to bid ninety-two per cent; they have to bid 92.111 or something.

MR. SIEROTY: Let me ask Mr. Hortig if he would care to comment on the last part of question 4 there?

MR. HORTIG: Would you read the question, Mr. Sieroty?

I don't have a copy of the letter before me.

MR. SIEROTY: "How will the contract treat tie bids or several bids that are 100% or better? Can there be more than 100% net profits? Will all bids 100% and over be treated as 100%?"

MR. HORTIG: I believe the answer is the same as previously -- if such bids are received pursuant to particular specifications in the bid offer, the first legal question is going to be that the bids received are responsive to the particular form of bid offer which is to be considered by the Lands Commission here today; and thereafter, the legal question of legal sufficiency of a bid in excess of 100% in the net profits. There is one tenable interpretation -- this is not necessarily legal -- that a bid over 100% could be viewed as an offer to pay; in effect, posted price plus a bonus for the oil.

MR. SIEROTY: Now, question Number 5 refers to page 32, lines 18 through 23, and this particular clause provides that if
the contractor, or one or more of the persons, firms or corpora-
tions comprising the contractor, purchases oil from others in the
field, the price for the oil taken by any such purchaser under
this agreement shall be the higher of either the price as cal-
culated above or the price paid by such purchaser to others.

Now, Mr. Scott is raising in this letter the question
of whether in a situation like L.B.O.D., where L.B.O.D. is a cor-
poration -- it is not a syndicate or partnership -- would a
stockholder such as Standard Oil -- would Standard Oil's pur-
chases be taken into consideration so as to cause L.B.O.D. to pay
a higher price in the event that Standard Oil would be buying oil
at a higher price in the field?

MR. HORTIG: Well, I believe, Mr. Sieroty, in the case
of your hypothetical example, if this were applicable to the
proposed contract or under the contract which the Commission is
now considering, that such a purchase would not invoke the most
favored nation clause as to the higher price in view of the
stock ownership by one of the participants in the corporation
that was the contractor. However, if on the order of magnitude
to constitute purchases of a continuing purchaser, entirely out-
side of its relationship to the contractor, this contract at
this higher price would be added in, particularly as a posted
price, in calculation of the average price which was to be
payable.

The other side of the coin, as reported on the agenda
item this morning with respect to this item, is that inasmuch as
there is obviously no certain method by which to forecast what
the corporate relationships and the stock relationships of the
potential bidders are going to be, and therefore some parties
to such an operating contract who might be the successful bidder
could conceivably be subject to other purchases by another party
on his own account in a manner so as to reflect on the basic con-
tract to such a degree of uncertainty and inability to evaluate
what the economic hazard of this would be in the future, we feel
again constitutes an uncertainty as to the applicable price base
and this would again necessitate a discount on the bid offer of any
prospective contractor.

MR. SIEROTY: Well, you have a situation where companies
get together as a partnership or syndicate. Their other purchases
are going to be considered in terms of getting the State the high-
et price, but in getting together as a corporation they will not
be considered. Is that not correct?

MR. HORTIG: It certainly will be considered in that
it qualifies in terms of establishing the average price for the
oil. It simply would not invoke the most favored nation clause.

MR. SIEROTY: That is what I mean. It would not serve
to give the City and the State the benefit of that higher price
that that company which is a member of this group, by virtue of
its stockholding, is paying in the same field.

MR. HORTIG: Only to the degree that this, again, would
be reflected in the calculated average price to be used, which
would be raised by inclusion of this price.

MR. SIEROTY: My suggestion is that we add in here
language which would insure that a contractor which may be a cor-
poration, whose ownership is by stockholders, whose ownership is
in oil companies -- maybe we have to have some percentage figure
there; I would suggest twenty per cent -- that then that com-
pany's purchases are going to be considered under this clause.

MR. HORTIG: Well, the hazard, of course, of the other
eighty per cent ownership being subject to the possibility of hav-
ing to pay a higher price because the favored nation clause
was triggered by someone holding twenty per cent of the stock,
would be such an uncertainty as to again discount the bidding
and require insurance and no matter what value we select —
if we select twenty per cent, I am almost certain whoever goes
out and buys at the higher price will only have nineteen per cent
so he doesn't trigger.

MR. SIEROTY: We are making quite a distinction as to
whether this is a corporation or whether it is a non-corporate
entity. I think we are just asking for any one of these groups
to become corporations, so as to negate this whole clause here
as to their buying and making other purchases in the field. Any
syndicate which becomes corporation would be under this clause.

MR. HORTIG: Only in the event that as a corporation
they did not buy other oil in the field at a higher price.

MR. SIEROTY: Right. I am assuming they are not going
to be making other purchases in the field.

Well, that's one question I raise, and I think it's a
very serious question.

MR. CHAMPION: It poses some real problems in terms of
what constitutes a corporation and who belongs to it and how to
handle it. Before I get into any amateur law, Jay, what is your
reaction to trying to deal with one corporation and another if
it happens to be made up of a number of oil companies?

MR. SHAVELSON: I think the point raised by Mr. Scott
and Mr. Sieroty is certainly a good one. I think perhaps with
a twenty per cent provision or something, we could draft some-
thing that would be workable.

MR. GOLDIN: I think Mr. Champion put his finger on
it. I mean, conceptionally, I can't take issue with the sugges-
tion; practically, to enforce it, I think is a horse of a
different color.

MR. SIEROTY: I don't think there is any question of
enforcing it. We will know the composition of the corporations
which bid.

MR. HORTIG: Again, of course, we would have the hazard,
as I said, whatever the standard, in view of the fact that this
hypothetical corporation is again an amalgamation of other cor-
porations, certainly stock ownerships could be adjusted so as to
meet any test that we prescribe now and avoid triggering the
most favored nation clause under these circumstances. That be-
ing the case, the penalty for a loss in the bid does not warrant
trying to include the addition of extremely difficult administra-
tive controls, as Mr. Champion has suggested would be necessary.

MR. CHAMPION: I'd like to ask whether the Long Beach
Harbor Commission has given any thought to this particular prob-
lem, has any view on it?

MR. SPENCE: Yes, we have; and we have considered this
draft of this particular section as being the best under the cir-
cumstances. Otherwise, as Mr. Hortig just said, you set a
figure of twenty per cent, so they come along and cut it to
nineteen per cent to get out of that provision. The corporation
can't be responsible for stock ownership. Many corporations,
most corporations, can't control their stock ownership to that
extent; so I think it's an idle act.

MR. SIROTY: I don't think it is an idle act at all.
If you want to reduce the percentage of ownership to ten per
cent, that's fine. The point is that these oil companies that
are going to be a part of the corporation, -- let's take L.B.O.D.-
we will know the composition of the corporation, I assume, and
then there is no administrative problem, as far as I see. At
that point, the corporations, the oil companies which own let's
way ten per cent or more of that corporation, would be obliged
to report their purchases in the field; and if their purchases
are at a higher price than what the State and City are going to be receiving, then the State and City would have the benefit of that higher price. That's the purpose of this suggestion. I don't see it is a problem mechanically or administratively.

MR. CHAMPION: What about ten per cent? You wouldn't have a substantial purchaser. What would there be wrong in setting it down at that lower level? How much administrative problem do you really cause?

MR. HORTIG: I don't think you actually reach the heart of the problem because the factors are not interrelated -- because the largest outside purchaser in the field could then be the one who has only nine per cent in this corporation, so he still couldn't trigger.

MR. SHAVELSON: I think we could add a simple sentence to the effect that where contractor is a corporation, persons comprising the contractor shall include any person buying oil in the field who owns ten per cent or more of the stock or said contractor I offhand can't see any reason why that wouldn't work.

MR. HORTIG: Mr. Chairman, may I ask an administrative question of Mr. Spence? Jack, would a modification of this magnitude, as just suggested, constitute a substantive change sufficient to require this contract to be resubmitted to the Harbor Commission and the City Council?

MR. SPENCE: No, sir.

MR. SHAVELSON: Do you have any objection to the provision?

MR. SPENCE: Where is that?

MR. SHAVELSON: On page 32, after line 26: "Where contractor is a corporation, persons, firms or corporations comprising the contractor shall include any person, firm or
corporation buying oil in the Field who owns ten per cent or more of the stock of said contractor."

MR. SPENCE: May I have just a moment, Mr. Chairman?

MR. CHAMPION: Yes. While this is under discussion, do you have anything further? Why don't you go ahead while they are considering this?

MR. SIEROTY: I have a related suggestion which will cover the same clause. Let me preface it by saying this: In the last hearing, we raised some question — there was feeling expressed here by Senator O'Sullivan and I expressed the same feeling — that posted prices in our opinion do not guarantee the fair market value to the City and State; and we have been working with this problem of whether highest posted price or average posted price or market value or what will give a fair price to the City and State.

Now, my feeling about this — and I am speaking for myself here, not for the other members of the Commission — but I think that the City and the State have a right to guarantee that they get a fair price for the oil.

MR. CHAMPION: You don't have to exclude the other Commissioners on that statement.

MR. SIEROTY: Now, the question of highest posted price or average posted price doesn't bother me as much as the use of the posted price as a test, because in practice the average posted price and highest posted price have been much the same; but I am concerned with using posted price as the sale gauge and we have had objections to other formulas, such as: "Well, we don't have any other information." All right.

Now, one suggestion I'd like to make is that in this paragraph 18.3 of page 32, in the same area we were just discussing, that we enlarge the language in line 20 which says "in the Field," to
include the other fields that we have been using here for the posted price -- Signal Hill, Inglewood, Huntington Beach. The effect of this would be that if a contractor or if oil companies which are a part of the contractor, whether it is a corporation or syndicate, buys oil at a higher price than, let's say, the average posted price, which is so far our test -- if one of those companies buys oil at a higher price not only in the Wilmington Field, but in the Huntington Beach, Signal Hill and Inglewood Field, then the State and the City would have the benefit of that higher price as the gauge for pricing out the oil under this contract.

Now that, I think, is a fair alternative -- because I think we have established that these fields are similar enough for consideration for use as posting prices, so I think they would be similar enough for the purpose of actual purchases, and here we have information available by the contractor or party of the contractor. So it is not a question of the information being available, and I think this will give a better pricing system to this field. It will tie it in to the other fields and we will get the best price that the contractor is paying in the whole area. So this is one suggestion that I would raise, Mr. Chairman.

MR. CHAMPION: Does the staff have any comment on this?
MR. HORTIG: Yes, Mr. Chairman. The fundamental problem with respect to additional controls in this proposed contract form is applicable to this suggestion in terms of providing a greater base against which to determine possibly a slight higher price on the average by, in effect, invoking the most favored nation clause as to all fields and not limiting it to simply the Wilmington Field and the contractor, as it is now stated, carries with it, of course, the problems and the economic ramifications of all operators operating in these other fields. Of necessity, therefore, not being able to forecast
what their economic requirements and purchase requirements are going to be, field by field, for the next twenty-five years, to insure themselves against, again, being penalized or forced to pay a bonus under this contract because of a higher price paid in another field, is another economic consideration.

MR. CHAMPION: You feel this would discount the bid?

MR. HORTIG: This will undoubtedly discount the bid.

MR. CHAMPION: May we have the comment of the Long Beach Harbor Commission on the subject?

MR. SMITH: Yes, Mr. Chairman. We concur in that view. We feel that the base for pricing as set forth in this contract is sufficiently broad to protect the State and insure that we get the fair market value for the oil.

MR. CHAMPION: Is there any further comment on this?

MR. SIROTY: Let me just ask this, because the basis of my objection here is to using posted prices as the sole gauge: I don't think that that ought to be the sole test. Here, we have an opportunity to tie it to actual prices paid in the area, to guarantee that we are going to get at least the best price that that particular contractor is paying for oil in the area, which must have been similar or else we wouldn't have the same fields for the purpose of testing the posted price.

MR. CHAMPION: Well, the difference is narrower than that, however. You do have a test against actual price in the field itself. You are asking that that be broadened. The principle of prices in the field is already recognized in the contract. You are asking that we go into other fields and test. There is an area of speculation there, whether you pick up more price there or by that uncertainty you cause a discount in the net bid. I gather the staff in Long Beach disagree with it.

MR. SMITH: Yes. You express my thoughts very well, Mr. Champion.
MR. SIEROTY: I have one more suggestion before I quit here and this, I think, is really a basic question again. I would like to see us be able to develop a test of the price of the oil in terms of the price generally prevailing and paid in the field. Now, we have this as a suggestion in the contract, in the event that there is no posting; and I would think that, even if there is posting, that this ought to be used as a test.

My suggestion is that in the event that the Harbor Commission or the State Lands Commission does not feel that the posted prices represent true reflection of the market value, they could use this test of the price equal to the market price generally prevailing and paid in the field. That's basically the idea we have. We have some language that we could submit, but that's basically the idea -- that we expand and go beyond posted price, where we feel that posted prices are not giving us a true reflection of the true market value.

MR. HURTIG: The problems in numerical order are, of course, number one, again a degree of uncertainty would be introduced, wherein the successful bidder would never be certain as to when an administrative agency might decide to undertake studies of prevailing market price and necessitate and study that they were at such extreme variance with the posted price base that they should become applicable. This again would take insurance in the bid and, frankly, there is no governmental agency in the United States today that is making studies of this type for application to calculation of either net profits or oil royalties under any existing contract. Establishment of such an agency, it would appear to me, would be necessary; and it certainly should be from an administrative standpoint, I would feel, an independent body -- because patently any determination by the Harbor Commission and/or the Lands Commission as the landlords
would invariably be subject to challenge in every instance that
the prevailing market price had been set too far up as a matter of
obvious economic advantage to the lessor.

MR. SIERTY: Well, as I see it, the problem really is
when you get down to it, who is going to set the price on the oil
I am not convinced that posted prices represent any kind of a
market and, therefore, it is a question, really, of whether we
are going to allow posted prices alone to determine this, or
whether the State will have the opportunity to find a market
value. Now, the Secretary of the Interior, I understand, has this
power in Federal oil leases. He can determine the price of oil.
He may not be using that power, and we may not use it, either, if
we feel that at the present time posted prices come pretty close
to what we consider market value; but the Secretary of Interior
at least has the power to make a separate determination and estab-
lish the price of oil, and apparently oil companies are willing
to lease from the Federal Government; and as I see this contract
running for many, many years, we don't know what is going to
happen to posted prices and I just feel it is a serious considera-
tion that we leave entirely or almost entirely the question of
the determination of the price that we are going to receive to
the oil companies, in determining their posted prices.

MR. CHAMPION: Well, I'd like to say what we really are
trying to arrive at here is the market; and the market as pre-
sented to us reflected the posted price was so close a variance
that we can hardly discern one from the other; and this is the
whole purpose of the posting of prices and posted prices really
don't have any influence except in relation to a market price.
This cannot be an arbitrary figure. This is the part that
bothers me. Posting has proved to be the most reliable method
that we can lay our hands on.
MR. HORTIG: And the only indicator existent.

MR. SIEROTY: I am not convinced it is a true indication of the market price. This is just a difference of opinion.

MR. CHAMPION: That's what makes horse races. Well, are there further points in connection with this that you'd like to raise?

MR. SIEROTY: No.

MR. CHAMPION: Is there anyone who wishes to comment?

MR. HORTIG: Mr. Chairman, I don't believe we had a response from Long Beach with respect to the possibility of an amendment reflecting stock ownership in the contractor.

MR. SPENCE: Could that be read one more time, please?

MR. SHAVELSON: Adding a new sentence after the word "contractor," on line 26 of page 32, reading as follows: "Where contractor is a corporation, persons, firms or corporations comprising the contractor shall include any person, firm or corporation buying oil in the Field who owns ten per cent or more of the stock of said contractor."

MR. SMITH: My only question is that there would be no question under this provision but that this higher price would apply to that oil taken by the ten per cent interest?

MR. SHAVELSON: That's right. In other words, it is simply substituting for the term "persons, firms or corporations comprising the contractor" on Lines 18 and 19, making sure that would include stockholders of the corporation, such as L.B.O.D.

MR. SIEROTY: I didn't hear Mr. Smith's question.

MR. SMITH: That this higher price which was being paid by a ten per cent interest would set a new higher price only for his ten per cent of the oil.

MR. SIEROTY: No.

MR. SHAVELSON: That's correct; in other words, the
oil taken by him, as if he were a joint bidder. The purpose of
this is simply to make the stockholder, put the stockholder in
the same position as if we had a joint bidding situation. I
think that's all we can accomplish.

MR. SIEROTY: Under the present system, let's say where
L.B.O.D. is the lessee or the contractor, is the oil taken in
kind by the stockholders -- in other words the Standard Oil Com-
pany owns twenty-eight per cent of L.B.O.D.; does Standard come
in and take twenty-eight per cent of the oil?

MR. SMITH: We have no knowledge of the disposition of
that oil.

MR. CRANSTON: I move the adoption of that amendment.

MR. CHAMPION: I'll second, and if there is no further
question that will stand adopted.

MR. HORTIG: There is another amendment, Mr. Chairman,
that should be adopted by the Commission. It was discussed, but
I don't believe it was the subject of a motion.

MR. CHAMPION: That is right.

MR. HORTIG: That is the one with reference to defini-
tion of the continuing purchaser to be broadened in the language
the Attorney General suggested. Would you read that amendment,
please, Jay?

MR. SHAVELSON: Line 21, page 31: Delete the word
"and" before Socony Mobil Oil Company and insert the words
after Socony Mobil Oil Company, Inc., "Richfield Oil Corporation,
and any qualified person or persons as herein below de-
finite," and that would simply be an insertion and the rest
of the provision would continue -- "... or their respective
successors, et cetera," the way it is presently worded.

MR. SPENCE: Except, Jay, on line 22....

MR. SHAVELSON: Right. On Line 22, after the word
"companies," insert the words, "Or persons," and then add a new sentence on line 26 after the word "pipelines" reading as follows: "A qualified person, for the purposes of the foregoing sentence shall mean and include any person, firm, corporation, or entity as can be demonstrated to the satisfaction of the Board and the State Lands Commission to have purchased in any of the aforementioned fields during each of the preceding twelve calendar months an average of at least one thousand (1,000) barrels of oil per day."

MR. CRANSTON: I move the adoption of those amendments.

MR. CHAMPION: Second. Any further comment? The amendment is adopted unanimously.

MR. CRANSTON: Mr. Chairman, there were two other amendments we agreed to: one, I believe, is to Richfield Oil.

MR. CHAMPION: That was included.

MR. CRANSTON: Likewise the termination.

MR. CHAMPION: No, the termination was not.

MR. HORTIG: That is in the form of the resolution before you, unamended.

MR. CRANSTON: Mr. Chairman, I'd like to say this: I wanted an opportunity to study the rather complex documents that I was handed only late yesterday afternoon relative to the questions raised by Senator O'Sullivan, before participating in any final action on this. I have studied those documents and I think the time has come to act. Before doing so, I want to call attention to the fact that while Alan Sieroty here, sitting for Governor Anderson, is not entirely satisfied with posted prices, he does now understand, and I want to understand that he agrees that there is no significance to the State in highest posted price as against average posted price; is that right?

MR. SIEROTY: Yes, I think the City and State would
probably receive in the long run less revenue as a result of the
highest posted price is probably true because of the fact that
the difference is so negligible in practice, whereas the fear
of the bidders, apparently, is rather substantial as to the-
chances of somebody coming in and trying to put in a phony high
price; that the bid would be substantially less and in the long
run the amount of money the City and State would receive would
probably be less.

MR. CRANSTON: Having examined that and other matters
as thoroughly as we were able to, I'd like to express that the
Lands Commission finds itself in this position at this point:
There is absolutely no legal means available to us to extend the
current L.B.O.D. contract which is about to expire. If that
field were to be shut down, it would result in great injury to
the field and to the financial interests of the State of Cali-
for\na in that field. Continuing operation of the field is in
the best interests of the State, and prompt action on our part
is best calculated to accomplish this.

I believe that the contract which is before us provides
the soundest vehicle available to us under prevailing circum-
stances for continuance of the operation of that field. Of
course, if we do not receive what we deem to be satisfactory bids
under the proposed contract, we will have no alternative but to,
reject them and we will then have to turn to the task of seeking
some alternative means of keeping the field going.

That being the position, I move that we adopt the con-
tract as submitted to us by the staff, with the appropriate
amendments.

MR. CHAMPION: I'll second that motion; and I would
like to add only that because we do feel the pressure of the
time situation does not mean, at least for me personally, that
I do not think that we have examined every single question that has been presented, looked at every piece of evidence or question that anybody has wanted to present to this Board. I am satisfied, not only that we ought to act now, but that we are acting on a proper instrument on which to act and I would not like to have the inference so far as our action that because we do point out this need for haste -- we do that out of deference to the fact that a number of legislators wanted more time to look at it -- we do not, at least I myself, do not believe that this Commission needs more time for judgment. We cannot defer to those who have asked for this delay because of the time situation; but as for me personally, I don't think any more time is required. We have made an adequate and exhaustive inquiry into all the points that have been made.

That was a second.

Is there any other comment or question before action is taken? (No response) I assume for purposes of this record we ought perhaps to take a formal vote.

MR. CRANSTON: Aye.


MR. SPENCE: Mr. Chairman, on behalf of the City of Long Beach, I want to thank the Commission for taking the action you have today. We are convinced you have approved a good contract. We want to thank you for your attention to it.

MR. CHAMPION: The meeting is adjourned.

ADJOURNED 4:15 P.M.
CERTIFICATE OF REPORTER

I, LOUISE H. LILlico, reporter for the Office of Administrative Procedure, hereby certify that the foregoing seventy-eight pages contain a full, true and correct transcript of the shorthand notes taken by in the meeting of the State Lands Commission held at Sacramento, California, on October 10, 1963.

Dated: Sacramento, California, October 12, 1963.

[Signature]

LOUISE H. LILlico
COPY OF LETTER FROM UNION PACIFIC RAILROAD COMPANY, addressed to Mr. Frank J. Hortig, Executive Officer, State Lands Commission, dated October 4, 1963:

Dear Sir:

At the meeting of the State Lands Commission on September 30, 1963, during which the proposed drilling and operating contract (Long Beach Harbor Department Tidelands parcels presently operated by LBOD in Fault Blocks II, II, IV and V) was discussed, the Chairman requested comments and suggestions by interested petroleum industry parties.

The portion of the proposed contract on which most of the discussion centered was the provision for establishing the price which would be paid to the city of Long Beach for the production in which the State shares, the principal objection being that the price paid (the average of several posted prices) was probably not representative of the value of the crude oil purchased. It is suggested that a way in which a value can be established with certainty and without recourse to the detailed records of all crude purchases in the Los Angeles Basin is that of awarding the purchase contract to the highest bidder. If purchase contracts were let periodically after competitive bidding for the crude oil produced by the City from these Tideland Parcels during a stated period, the governmental bodies could be certain that they were receiving the highest obtainable price.

If this arrangement for marketing production were adopted, there would be no need for tying the operation of the properties to the purchase contract because a large portion of the lands for which an operating contract is under consideration are or will be committed to the Wilmington Fault Block II, III, IV, and V Units. There would be no difficulty in operating the properties. One method of operating the Tideland parcels in these Units which would be the least costly to the City would be for the City to resign as Unit Operator of Segment I and permit the election of the present Upland Unit Operators by the Working Interest Owners as the Unit Operators of Segment I of the various Units. This procedure already is clearly established in the Agreements.

One advantage to the State and City under such an arrangement would be that the Tideland parcels in each Unit would be operated under the Unit Agreements by an existing operator thoroughly familiar with Wilmington Field, and with no fee payable to such operator. In addition, substantial savings in operating costs would be realized by combining in one operation the operations now separately conducted by two different operators in each Unit. Furthermore, there would be no need for any hasty consideration of an operating contract since the procedures are already established under the Agreements. It should be pointed out that the State and City will lose none of the control which they now have over the operations conducted on the subject parcels since the City's existing right as a Working Interest Owner to participate in decisions relating to operations, which is established in the Unit Agreements, would continue.

We consider the above arrangement to be the most advantageous possible to the State and City, both from the
standpoint of assuring the highest fair price for the oil and most competent and economical operation of the Tideland properties, and respectfully suggest that it be considered by the Commission.

Union Pacific is interested in the operation of each Unit by a single Operator, instead of two Operators, so that it can participate as a Working Interest Owner in the expected savings which will result from such a method of operation.

Very truly yours,

/s/ D. B. Pinnell
General Manager - Petroleum

cc Messrs. Vickers, Mangell and Desmond, City of Long Beach

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COPY OF LETTER FROM PAULEY PETROLEUM, INC. address to State Lands Commission, Attention Mr. F. J. Hortig, Executive Officer, dated October 7, 1963:

Gentlemen:

The State Lands Commission, at its last meeting on September 30, 1963, requested comments on the last draft submitted on captioned matter.

We received the revised draft on Wednesday, October 2, 1963, for which we wish to publicly acknowledge. We also received a copy of transcript of the September 30th meeting on Friday, October 4, 1963. We wish to make some comments on the contract.

1. We believe that there is an error in the definition defining "continuing purchasers." The definition used in the contract is as follows:

"(c) CONTINUING PURCHASERS shall mean purchasers who have, during each of the preceding twelve (12) calendar months, purchased an average of at least one thousand (1,000) barrels of oil per day in the Field. "In the absence of information to the contrary it shall be deemed that every purchaser posting prices in the Field is such a Continuing Purchaser."

In the transcript of the September 30th hearing, on page 5, lines 13 and 14, it states:

"(Parenthetically, 'continuing purchasers' have been defined as those continuously purchasing one thousand barrels oil per day)"

Mr. Hortig stated on page 15, line 11, the following:

"Identified as 'continuing purchasers' and in our definition and qualification they must be purchasing at least a thousand barrels of oil per day."

We wish to submit that the contract, as written, does not require a company to purchase "at least a thousand (1,000) barrels of oil per day." As written, a company could buy thirty thousand
(30,000) barrels of oil on April 30th, thirty-one thousand (31,000) barrels of oil on May 1st and thirty thousand (30,000) barrels on June 30th etc. and satisfy the definition in the contract, since they would have averaged at least one thousand (1,000) barrels of oil per day. If the contract is supposed to require the purchase of at least one thousand (1,000) barrels of oil per day, as assumed, then it should be made to so read. As it now stands, a company would have to buy three hundred and sixty-five thousand (365,000) barrels of oil over a yearly period. This could be done buying thirty or thirty-one thousand barrels of oil, one day each month. We do not think this is a proper definition.

We also wondered why it was necessary to make it an average of one thousand (1,000) barrels of oil per day when the September 30th transcript indicated that Richfield is buying, and has purchased in the past, large amounts of crude. I suppose it is because they do not go through the ritual of posting. Therefore, a twenty thousand (20,000) barrel of oil per day purchase is disqualified in helping determine the value of crude under this contract, unless and until they post. We recommend that the Commission determine how many other continuing purchasers there are in area that do not post prices.

We strongly urge that the last sentence in the definition of "continuing purchaser" be stricken, since we do not believe that any price merely offered should constitute a method to value oil at Long Beach. We believe that only purchases actually made should be used in computing the price of oil at Long Beach.

The sentence to be stricken reads as follows, which is line 10, through 13, page 5 of the draft of the contract:

"In the absence of information to the contrary, it shall be deemed that every purchaser posting prices in the Field is such a Continuing Purchaser."

We object to the use of "average posted price." We do not think it is in the best interest of the State and the industry. We strongly recommend that the State obtain the highest price actually paid for crude in the field by continuing purchasers, as defined in the contract.

Reference is made to the transcript of September 30th, where one company states that it has sought large quantities of oil in the past and is presently purchasing about twenty thousand (20,000) barrels a day. Since they do not POST their price could not be considered. How many other large purchasers in the field actually buy but do not post? The State can no longer permit its compensation to be determined by only those companies who go through the ritual of posting.

In 1955, after the Legislature passed the Tidelands Bill, the State Lands Commission adopted the policy of requiring the highest price for its oil. It is still following that policy on Tidelands leases. It must continue to have one price formula for all Tidelands oil or be a party to chilling bids and eliminating competition. The State must insist on the highest available price actually paid for crude under this contract since it is a "net profits" arrangement and since the State has no right to take its crude in kind if they do not like the price being paid.
3. It is recommended that the terms "unprofitable" be defined in Section 4, page 16, and 17 of the contract. The transcript of September 30th indicated that no one seems to know what it means. How can a bidder bid on a contract when the people who wrote the contract do not know what they meant when the term was put in the contract? This is a very serious problem, since some company may bid an extremely high "net profits" bid. It might be argued that it was "unprofitable" from its inception.

4. How will the contract treat tie bids or several bids that are 100% or better? Can there be more than 100% net profits? Will all bids 100% and over be treated as 100%?

5. Reference is made to lines 18 through 23, page 32, of the contract, which reads as follows:

"If the Contractor, or one or more of the persons, firms, or corporations comprising the Contractor, purchases oil from others in the field, the price for the oil taken by any such purchaser under this agreement shall be the higher of either the price as calculated above or the price paid by such purchaser to others for oil of like gravity in the field."

We believe this is a glaring oversight here. It should be modified to include any company or companies, or person owning stock in a corporation who is the Contractor. If it is not modified, it would permit persons or companies to insulate themselves from the pricing provision by forming a corporation to be the Contractor. In other words, if any company or person is the Contractor, or owns stock in the company acting as Contractor, and any one of them pays higher prices to others in the field for oil, then the State would be paid at the higher rate.

6. We have previously made ourselves abundantly clear on our objection to a pure net profits bid. In order to save time, I refer you to my statement on February 28, and the Staff Hearing held in April, on East Wilmington.

7. Reference is made to Section 18.2, page 30 and 31 of the contract, regarding the 12½% of oil the City may take in kind. In reading the transcript we gather that the City would be required to sell that oil at the highest price because of charter or ordinance provision. If this is the case, why doesn't the provision also apply the other 7½% of the oil? It is difficult for me to understand how an ordinance, charter or statutory provision applies only to the 12½% and not to the balance. Certainly the intent of the people is clear in requiring highest price for public property.

We assume it would follow that if the Harbor Department were to take over and operate the property after March 1964, that the Harbor Department would have to receive the highest available price for the crude. Is that assumption correct?

8. We strongly recommend that the State Lands Commission approve the award of the highest bid and signify same by executing the document. The document, as now written, does not provide for approval and execution by the State. Any prudent bidder would want the concurrence of the State Lands Commission in a trust setup like this.
There are many other points which we could raise concerning the documents. We will not take up your time with them until the major issues raised by this letter are dispensed with by the Commission and the documents rewritten.

Very truly yours,
/s/ L. E. Scott

Copies to Commissioners, Senator O'Sullivan, City Atty, Long Beach

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COPY OF LETTER FROM SHELL OIL COMPANY addressed to Hon. Hale Champion, Chairman State Lands Commission, dated October 7, 1963:

Dear Sir:

In connection with your pending consideration of the terms under which the subject parcel is being offered, we request that consideration be given to the following matters:

1. We suggest that prior to the time of the offering a system for resolving the bids be developed.

2. Irrespective of whether the final decision is to utilize a pricing basis of "average posted price" or "highest posted price," we urge that the Commission establish a consistent pattern as between this and other tide and submerged land offerings so that in the future all offerings of publicly owned lands (whether controlled by the State or by a political subdivision thereof) will contain identical crude-oil pricing terms.

Further, we suggest revision of the contract to take into account the postings of all companies now or hereafter posting prices in the Wilmington, Huntington Beach, Signal Hill and Inglewood fields. This would allow for the very real possibility that in future years not only may additional companies undertake to post prices, but also that one or more of the current posting companies may discontinue posting in the affected area.

3. We suggest that Sections 5.2 and 26 of the proposed contract be revised so as to protect the operator from liability for any act which it is compelled to perform against its better judgment pursuant to an order or directive of the Board of Harbor Commissioners. At present such protection is afforded only with respect to liability arising out of subsidence and/or sub-surface trespass resulting from repressuring operations.

4. Section 17 (Nonreimbursable Expenses) provides in part that no reimbursement will be allowed for income taxes or any other tax which the Contractor may pay upon the consideration (defined as including reimbursement for operating expenses) retained by Contractor under the contract. If it is intended to thereby impose non-reimbursable liability on the Contractor for such items as the City of Long Beach Severance Tax, then this should be made clear. Also it should be indicated whether such liability would attach to the gross production from the property or only the Contractor's net-profits interest therein.
5. We assume that the specifics of any collateral agreements between the City and/or Harbor Board and the State Lands Commission will be made known to all interested companies prior to the time the contract is formally offered for bidding.

Yours very truly,

SHELL OIL COMPANY

/\ D. E. Clark, Manager
Lands Department
Copies to F.J. Hortig, and M.D. Hughes, Long Beach Harbor Dept.