17. (OIL AND GAS LEASE APPLICATION, SECTION 6871.3, PUBLIC RESOURCES CODE, SANTA BARBARA COUNTY - W. O. 2241.) Mr. Sam Grinsfelder of the Union Oil Company of California appeared personally and stated that he had previously appeared before the Commission to request what action had been taken toward classification of lands off the coast of Santa Barbara County, comprising some 62,000 acres, which had been nominated for leasing, in January of 1956, by the Union-Shell-Continental-Superior group. He asked for information regarding the progress being made in the classification of these lands toward offering them for lease.

The Executive Officer reported that the entire area was being studied by the staff's consultants, but that the staff's hopes for having a report for the current meeting had been dashed; he stated, however, that recommendations would be readied for presentation to the Commission at its October meeting.

18. (PUBLIC HEARING RE PROPOSITION NO. 4, "OIL AND GAS CONSERVATION ACT" - W. O. 2265.) The Chairman announced that the Commission was holding a public hearing at this meeting in connection with Proposition No. 4 on the November ballot, the "Oil and Gas Conservation Act", for the purpose of hearing arguments for and against this proposition regarding the effect it would have upon State lands and the development of oil and gas within those lands. He stated that a rather lengthy and detailed opinion, with many ramifications, Opinion No. 56/184, had been rendered by the Attorney General, but that as it had only been received a few days earlier, the members of the Commission had not had sufficient time to study it and determine its implications and what steps it might suggest. Copies of Opinion No. 56/184 were given to all those present, and this opinion is made a part of these minutes by reference to the files of the Commission.

Assistant Attorney General Wallace Howland, who participated in writing Opinion No. 56/184, was present and was called upon by the Chairman to comment, but indicated that he had no remarks to make.

Mr. Kirkwood questioned Mr. Howland as to what weight was given by the Attorney General to some of the arguments presented in the opinion, calling particular attention to doubts that had been expressed, and to points which it had been indicated could not be resolved without litigation, wanting to know if the arguments advanced should be given substantial weight or could be dismissed as more or less frivolous.

Mr. Howland stated that the only part about which any doubt was indicated was the first of the numbered conclusions (about whether the State will retain its present authority to insert and enforce lease provisions and regulations relating to the prevention of waste on State lands, including a reservation of authority to approve the maximum efficient rate of production for all wells operating under State leases), and it was the feeling that there was a substantial doubt as to the outcome of that question, but that it was not a matter of frivolity. He stressed the point that this was not the usual method of treating opinions, but that the matter was so important that they felt obligated to depart from their usual procedure, and to set forth the opinion in the manner in which it was given.

Mr. Kirkwood questioned the language at the top of page 10 of the opinion regarding Section 6829, asking whether this meant that provisions for prevention of waste on State lands could not be reinstated by subsequent legislation once the law (Proposition No. 4) became operable. Mr. Howland asked Mr. Kirkwood if he was suggesting the possibility that the provision of Section 6829 might subsequently be repealed. Thereupon Mr. Kirkwood queried whether, if the arguments were upheld those sections of leases now in force would be voided immediately. Mr. Howland replied in the affirmative.

Mr. Kirkwood then asked Mr. Howland if any consideration had been given to what the effect would be upon the Rincon lease, if the minority argument were to prevail. Mr. Howland indicated that he was not familiar with the provisions of the Rincon lease, and did not think that in the deliberations of the staff of the Attorney General the operations of the proposition, if adopted, were projected into that type of specific situation.

Next Mr. Kirkwood inquired if, under the act, the provisions of the Shell-Cunningham Act would be inoperative or limited regarding protection of residential or recreational use of the lands on shore, except as such protection might be written into leases entered into by the Commission. Mr. Howland said that two separate situations existed: First, where State land was under lease and the lease presumably had such restrictions written into it as are now contained in the Shell-Cunningham Act, and those lands were subsequently put under unit agreement with or without the consent of the State Lands Commission, the unit agreement would then, for all practical purposes, supersede the provisions in the lease; the other situation is where State lands are not leased, and the proposition would expressly authorize the Conservation Commission to direct the utilization of State lands.

Mr. Kirkwood then asked if there would be areas where the State would not have control and was informed that there would be cases where the State would have less than 25% interest. Assemblyman Joseph Shell interjected a question as to whether, if Proposition No. 4 passed, there was any question at all whether the Legislature could, at some future date, by statute, redefine waste. Mr. Howland stated that the answer would depend upon the specific bill which the Legislature had before it, and the definition that the Legislature had in mind; that only the general rule could be stated, that the Legislature would have no authority to pass any provision which would be in substantial conflict with the provisions of the initiative measure, but that, on the other hand, it could pass laws in furtherance of and in addition to the measure.

Appearances were made by the following, and copies of their presentations are attached hereto as Exhibits "A", "B", "C", and "D" respectively:

<u>Presenting Arguments in Favor of Proposition No. 4:</u>

Mr. Richard C. Bergen, of the law firm of O'Melveney & Myers, appearing on behalf of Charles F. Jones, President, and R. W. Ragland, Vice President, of the Richfield Oil Corporation, proponents of Proposition No. 4. (See Exhibit "A" attached.)

Mr. Turner H. McBaine, of the law firm of Pillsbury, Madison & Sutro in San Francisco, representing the Standard Oil Company of California. (See Exhibit "B" attached.)

Presenting Arguments Against Proposition No. 4:

Mr. Harry D. Aggers, Manager of Secondary Recovery for the Union Oil Company of California. (See Exhibit "C" attached.)

Assemblyman Joseph C. Shell. (See Exhibit "D" attached.)

Mr. Kirkwood personally questioned Mr. McBaine and Mr. Aggers regarding their presentations, in order to clarify in his mind some questionable points which he stated would affect his decision.

Following their presentations, those appearing were asked by the Chairman to send written copies of their statements to the Executive Officer of the State Lands Commission, for review and analysis by the staff. Thereafter the members of the Commission will consider that information, and will decide whether or not the Commission desires to express itself one way or the other concerning Proposition No. 4.

EXHIBIT "A"

STATEMENT BY RICHARD C. BERGEN, A PARTNER IN THE FIRM OF O'MELVENY & MYERS, ON BEHALF OF THE PROPONENTS OF PROPOSITION 4 BEFORE THE STATE LANDS COMMISSION IN LOS ANGELES, CALIFORNIA

September 27, 1956

I appreciate the opportunity of appearing before you on behalf of the proponents of Proposition 4 for the purpose of discussing the effect of Proposition 4 on State lands and clarifying any confusion on this issue that may have developed. As you know, Proposition 4 will create a new State agency--the Oil and Gas Conservation Commission--consisting of three full-time Commissioners who will take over the powers and the staff of the present State Division of Oil and Gas. The Proposition will give to this new Conservation Commission substantially increased powers over those presently given the Division of Oil and Gas to prevent waste and to increase the ultimate recovery of oil in the State of California on public as well as on private lands.

The interest of the State of California in oil and gas is two-fold: first, its interest in its proprietary capacity as the actual owner of lands in California capable of producing oil and gas; and second, its interest in its sovereign capacity as the protector of the public to make certain that this great natural resource is not wasted by bad practices on any California land, whether publicly or privately owned.

Proposition 4 deals primarily with the State's interest in oil and gas in its sovereign capacity, a matter which under existing law is the responsibility of the State Division of Oil and Gas rather than of the State Lands Commission, and accordingly under Proposition 4 this matter will become the responsibility of the Oil and Gas Conservation Commission. The rights and powers of the State Lands Commission to protect the proprietary interests of the State in its oil and gas lands will not only be protected by Proposition 4, but will be substantially enhanced. In formulating Proposition 4, we did not believe it would be right or proper to require you or your staff to assume the additional responsibility of protecting the sovereign interests of the State and thus acquire substantially greater burdens than you now have.

As you know, your jurisdiction has never extended to private lands in a pool, and, of course, adequate measures to prevent waste and to increase the recovery of oil by methods such as gas injection or water flooding must necessarily be conducted on a pool-wide basis in connection with all lands in a pool, whether public or private. Thus, there could be only one State agency to perform these functions and thereby protect the sovereign interests of the State, and Proposition 4 places this responsibility with the Oil and Gas Conservation Commission, which Commission will have paramount authority in connection with waste and unitization, whether in connection with public or private lands. We are sure that you, the members of the State Lands Commission, will welcome the assistance of this new State Commission which will have broadened and expanded powers over the present Division of Oil and Gas to prevent waste and facilitate unit operations on public as well as on private lands in all oil and gas pools in the State of California.

Proposition 4 will leave with you, however, the big job of protecting the proprietary interests of the State in its actual and potential oil and gas lands, and as you know, this is a tremendous responsibility which will take an ever-increasing amount of the time of you and your staff. In this connection, the proponents of Proposition 4 recognize that you are very properly concerned as to whether Proposition 4 would in any way impair your ability, as the authorized representatives of the State of California, to get for the people of California their fair share of revenues from oil and gas underlying lands actually owned by the State, whether from tidelands or uplands. We understand that once you have satisfied yourselves in this connection, you will feel no official obligation to pass on the merits or demerits of this Proposition, since the matter is one which, under our Constitution, must be decided by the people of the State of California in the exercise of their sovereign rights as electors. Accordingly, I will endeavor to limit my remarks to those which seem appropriate to demonstrate that Proposition 4 will not only not impair your ability to get for the people of California their fair share of the revenues from oil and gas lands owned by the State, but will actually increase your rights and powers and permit you to derive substantially more revenue for the people of California from State-owned oil and gas lands.

Proposition 4 does not amend or repeal any of the pertinent provisions of the Public Resources Code giving you, as the authorized representatives of the State of California, full rights and powers to protect the people's interests so far as State-owned oil and gas lands are concerned. You will continue to have full rights to make the best bargain you can with respect to State oil and gas lands, and your rights and powers will be as full and complete as that of any private individual or company owning actual or prospective oil and gas lands. There is no dispute on this point. The office of Legislative Counsel in its opinion regarding Proposition 4, bearing No. 2608 and dated June 14, 1956, said in this connection regarding the following provisions of the Public Resources Code:

> "Section 6827 contains requirements as to the royalties to be paid to the State and the term of an oil and gas lease of State lands. Section 6836 provides that the State Lands Commission shall award an oil and gas lease of State lands to the highest qualified bidder unless the commission rejects all the bids. These provisions would not be changed or superseded by the proposed initiative act. Assuming that the proposed initiative act becomes law, State lands would still be required to be leased to the highest qualified bidder pursuant to Section 6836 of the Public Resources Code. The royalty provisions and term of such leases would still have to meet the requirements of Section 6827 of the Public Resources Code. A pooling order or a unitization order of the Conservation Commission would not change the royalty provisions of a lease made by the State Lands Commission." (See p. 17.)

The whole contention of the opponents of Proposition 4 is based upon the proposed repeal of Section 6830 of the Public Resources Code by Proposition 4. They are desperately trying to read into the repeal of this section a devious intent to tie the hands of the State Lands Commission, whereas actually it is necessary, and in fact, is essential to free your hands by repealing said Section 6830 by the enactment of Proposition 4 if the interests of the State

in its oil and gas lands are to be properly protected. In fact, this Section should be repealed whether or not Proposition 4 passes as detrimental to the best interests of the State. Said Section 6830 deals with oil zones or separate underground sources of oil owned in whole or in part by the State, and the truly critical language in said Section reads as follows:

> "The commission . . . shall restrict the rate of production from any such zone or separate underground source of supply to that . . . agreed to by a majority of the total production from any such zone or separate underground source of supply."

This section means that under present law, the State Lands Commission is powerless to require its lessee to make any change in a rate of production from State Lands which has been agreed to by a majority of the total production from the particular pool. The State Lands Commission could not avoid this result no matter what it put in its lease or what it provided by its regulations, since the proviso in Section 6829-(e) of the Public Resources Code prevents a State lease from purporting to deprive if lessee of any right or benefit secured by said Section 6830. In other words, under present law, you are stuck with any production rate agreed to by a majority of the production in the pool.

The proponents of Proposition 4 did not believe that your Commission should have its hands tied to any such production rate agreed to by a majority of the total production from any pool. As a matter of fact, said Section 6830 probably means that the State Lands Commission would seldom have any say in determining production rates even in a wholly owned State pool since the State would, of course, have only a royalty interest in, and thus the State's very own lessee would have a majority of the total production from the particular pool. This fact is obliquely recognized in the very last paragraph of the Attorney General's opinion, which reads as follows on page 36:

> "One effect of the repeal of Section 6830 would thus be to eliminate the present possibility that a mere majority of the total production within a pool or zone might over-ride the discretion of the State Lands Commission in determining rates of production of wells operating under State leases."

In order to rectify this truly glaring deficiency in the present law, Proposition 4 proposes that Section 6830 be repealed. The theory of Proposition 4 is that the State Lands Commission should have full rights and powers to protect the proprietary interests of the State in State lands, irrespective of any agreement by a majority of the total production, or even by all of the production within a pool or zone.

It is a curious thing indeed, but typical of the tactics of confusion being indulged in by the opponents of Proposition 4, that they are trying to read into the repeal of Section 6830 some impairment of your right to require proper production rates under Proposition 4, whereas the facts are that the enactment of Proposition 4 and the repeal of said Section 6830 will restore to you full and complete powers to require your lessees to produce at proper production rates, subject only to the general overall authority of another

State agency--the Oil and Gas Conservation Commission--to prevent waste in all oil and gas lands in California, whether owned privately or publicly.

In view of the significance which the opponents of Proposition 4 have tried to attach to the repeal of said Section 6830, I would like to demonstrate that as a result of this repeal your Commission will no longer have a mere illusory power to require proper production rates, but will have the actual right and power to do so, either by way of enforcing appropriate lease provisions or enforcing your rules and regulations pertaining thereto. Such authority is found in Section 6829 of the Public Resources Code, which gives your Commission not only the power, but the duty to require proper production rates and protect the interests of the State, and in Section 6108 of said Code, which gives your Commission the power to make and enforce all reasonable and proper rules and regulations to carry out the provisions of Section 6829. The repeal of Section 6830 permits the provisions of the foregoing Sections to be truly effective, and a careful reading of the opinion of the Attorney General recognizes this fact. Thus, the Attorney General states in his opinion to you dated September 24, 1956:

> "It may be argued that the proposition in expressly repealing section 6830, would put an end to the authority of the State Lands Commission to reserve the power to control MER's and well spacing. However, we believe that continuing authority for such action could still be found in section 6829 . . . The point here is that repeal of section 6830 would not destroy the authority of the State Lands Commission to continue its present provisions and regulations." (See pp. 8-9.)

The opinion goes on to consider as to whether the proviso hereinabove referred to and contained in subdivision (e) of Public Resources Code Section 6829 might not allow a voluntary agreement of all the operators to prevent waste, as permitted by Section 4F(1) of Proposition 4, to supersede the authority of the State Lands Commission to require proper production rates the same as said proviso presently permits a simple majority to supersede your authority. However, after considering the argument that the opponents of Proposition 4 made in endeavoring to show that such proviso might permit such a voluntary agreement of all operators to nullify the right of your Commission to require proper production rates, the opinion unqualifiedly states as to these claims of the opponents of Proposition 4:

> "The foregoing argument will not prevail, in our opinion . . . We do not believe that this is either the intent or the effect of the proposition." (See p. 11.)

The opinion also unqualifiedly states that such a voluntary agreement by all the operators to prevent waste as authorized by Section 4F(1) of Proposition 4 could not affect such operators' obligations to comply with your rules and regulations and to abide by the provisions of their leases from the State. In this connection, the opinion states:

> ". . . there is nothing in the proposition to indicate an intention that a 4F(1) agreement should be effective to curtail or in any way to affect adversely the lawful rights of persons not

parties to the agreement. Neither does it indicate an intent to relieve any of the parties to the agreement of any obligation they may be under with respect to the property involved in their agreement. We feel that more explicit language would be required to accomplish such a far-reaching result . . . It follows from this analysis that Section 4F(1) does not authorize any agreement by working interest owners, but only such agreements as they are otherwise legally capable of making, after giving full force and effect to whatever obligations they may have as lessees to their respective lessors." (See pp. 12-13.)

The office of the Legislative Counsel had previously ruled to the same effect in their opinion above referred to of June 14, at which time they said in this connection:

". . . In our opinion, the State's lessee could not enter into such an agreement if it contained provisions conflicting with the terms of the lease. The rights and duties of a lessee are governed by the lease and the lessee is bound by any terms and conditions included therein. The proposed act does not purport to authorize the working interests to enter into an agreement for the prevention of waste notwithstanding the terms of their leases. As pointed out previously, the proposed act does not repeal Section 6829 of the Public Resources Code giving the State Lands Commission power to include in oil and gas leases of State lands terms and conditions as to prevention of waste." (See Office of Legislative Counsel No. 2608 dated June 14, 1956, at p.10.)

I believe the foregoing answers the critical question before you at this time, and proves beyond any doubt that the enactment of Proposition 4 will permit you not only to retain your present authority to require proper production practices on State leases, but by repealing Section 6830 of the Public Resources Code, actually removes a serious restriction on your present rights and powers in connection with State leases. However, before concluding, I would like to comment briefly on certain other features of Proposition 4 as it pertains to State lands.

The Attorney General's opinion discusses the possibility that unleased State lands might be a part of a productive pool, and in such an event, the opinion states that the Oil and Gas Conservation Commission could order such lands into a spacing unit under Section 5, or into a pool-wide unit under Section 6 of the proposed Act. I would like to observe that if your Commission has not leased the State's wholly-owned land which is a part of a productive pool, and thus no wells are producing oil therefrom, then the State's oil is being drained by the other operators in the pool, and I am sure you gentlemen would, as required by law under such circumstances, issue a lease forthwith with respect to such lands in order to protect the State's interests. If for any reason, however, the Oil and Gas Conservation Commission should order such land into a unit prior to the time it could be leased, the State of California would be entitled to the entire profits therefrom rather than simply its royalty share, and a substantial benefit to the State might result therefrom. In the event the Oil and Gas Conservation Commission ever ordered unleased

land into a unit, there can be no question but that such Commission would, as an authorized agency of the State, be equally diligent in protecting the State's interests in such land.

With respect to the points made in the Informative Report rendered by your staff and bearing their No. W. O. 2265, it seems to be unnecessary to treat specifically and in detail at this time with the various points raised in this report. I believe it is generally conceded that it was unfortunate this report was released prematurely and without the benefit of any advice from counsel. However, some of the points mentioned therein I have already answered in this statement, and with respect to the remaining matters mentioned therein, I believe it is a fair observation to state that the Attorney General's opinion indicates there is no substance to such points. If you wish me to go into more detail in answering any specific matter mentioned in this report, I will be glad to do so upon your request.

In conclusion, I would like to point out that the State of California has much to gain by the passage of Proposition 4. It is conservatively estimated by the proponents of this proposition that its passage will double the amount of oil which will be recoverable from California lands, including, of course, the lands owned by the State, and that the unitization of the Wilmington Field alone will add one-half billion dollars to the State's income from that field. From a legal standpoint, it is evident that Proposition 4 will substantially and materially increase the State of California's management powers over all oil and gas lands in California, and will enable the Oil and Gas Conservation Commission and the State Lands Commission, acting together, to fully protect both the sovereign and proprietary rights of the State.

RICHARD C. BERGEN

EXHIBIT "B"

STATEMENT OF TURNER H. McBAINE, OF THE FIRM OF PILLSBURY, MADISON & SUTRO, REPRESENTING STANDARD OIL COMPANY OF CALIFORNIA, BEFORE THE STATE LANDS COMMISSION SEPTEMBER 27, 1956.

I believe the State Lands Commission, representing the State of California as a landowner, should recommend the adoption of Proposition 4 because it will protect state oil and gas lands from waste, and encourage the recovery of the maximum economic quantity of oil and gas ultimately recoverable from those lands.

In the first place, our present conservation laws are not adequate to prevent underground waste in California. Mr. Reed Bush, Oil and Gas Supervisor of the State of California for thirty years and more recently consultant to Richfield Oil Corporation in conservation matters, says:

> "California's so-called Conservation laws are woefully inadequate. They simply don't do the job of protecting California's oil from waste and loss. A majority of the oil industry tries to bring about good conservation. But any fair-minded person can see that there is reckless waste by the few who disregard the public interest - and that such waste is absolutely uncontrollable under present laws. We need Proposition 4 - an up-to-date, comprehensive statute - to protect California's oil fields."

It may be argued that whatever the position of private landowners, the State Lands Commission can prevent wasteful production practices on State lands. True, but under our present laws neither it nor any other agency of the State can effectively prevent wasteful production practices on other lands which may have the effect of wasting oil and gas under State lands. This is because an oil field is a single pressure-connected "pool"; the State rarely owns all of the lands overlying a given pool; and the operator of a single parcel of private land overlying that pool can, by wasteful production, cause the underground loss of millions and millions of dollars worth of oil in State lands.

For example: the exploration and possible development of California's so-called tidelands are in prospect. If an important off-shore oil field should be discovered, and then ascertained to extend inland to an area cut up into town lots, another drilling and production race like that which occurred at Placerita might result in the loss of oil under State lands which would run into enormous figures.

There are those who say this oil is not lost, that it is still in the ground awaiting recovery by secondary recovery methods. As to this I will quote Mr. C. M. Moncrief, a petroleum engineer of many years experience with the Standard Oil Company of California. Mr. Moncrief says:

> "As an engineer I cannot say that the oil remaining in the ground will never be recovered. I can say that it cannot be economically recovered by any known method. I can also say that the science of

producing oil is fairly far advanced and I do not know of any new method on the horizon which offers promise of economic recovery of any substantial part of such remaining oil. Accordingly, I would say that it would be a long-shot gamble to assume that such remaining oil could ever be recovered."

I am sure the members of this State Lands Commission, as the guardians of State lands, will not wish to take this gamble with oil underlying the lands of the State of California.

Proposition 4 will prevent the possibility of any such disasterous damage to State lands.

First, it creates a State Conservation Commission - composed of three members appointed by the Governor and confirmed by the Senate and therefore a State agency as is the State Lands Commission - and authorizes it to issue any order necessary to prevent waste.

Second, it authorizes the State Conservation Commission to establish spacing patterns in newly discovered fields. This means that 2,000 wells need not be drilled if 1,000 will get the same oil efficiently. This is not merely to save the cost of the extra wells - though this in itself is a beneficial result which will help in keeping the price of gasoline down. The primary purpose is again to prevent the underground waste of oil. Every well drilled must be tested, and wastes some reservoir energy during testing. Further, every productive well will be allowed to produce enough oil to repay its costs, plus a reasonable profit, even though it causes some waste. This is true in every oil state in the Union. In Texas this principle is embodied in what they call their Marginal Well Statute. For these reasons the State Conservation Commission may, in effect, forbid unnecessary wells, for unnecessary wells all over California may well cause substantial underground waste in California's oil fields, including those containing State lands.

Lastly, it authorizes the State Conservation Commission to approve, after public hearing, any plan to operate a given oil field as a unit, and thus prevent wasteful practices in any part of the field, when such a plan is agreed to and proposed by the owners and operators of 75 per cent of the surface acreage in such a field, and meets certain standards set forth in the act. These standards are:

1. That the productive limits of the pool to be unitized have been reasonably outlined by actual drilling.

2. That unitized operation of the pool is reasonably necessary to increase the ultimate recovery of oil and gas from the pool.

3. That the value of the additional oil to be recovered will exceed the cost of getting it.

4. That under the plan production from the pool will be allocated among the different tracts in the pool on a fair, equitable and reasonable basis. The act provides:

"A separately-owned tract's fair, equitable and reasonable share of the unit production shall be measured by the value of each such tract for oil and gas purposes and its contributing value to the unit in relation to like values of other tracts in the unit, taking into account, among other things, the volume of productive oil and gas sand, permeability, porosity, connate water content, gravity of oil, composition of gas, gas-oil ratio, reservoir pressure, reservoir temperature, position on structure with respect to (a) gas-cap expansion, (b) gravity drainage, (c) edgewater encroachment, and (d) faulting, the degree of depletion, the contribution of each tract containing all or a part of a gas-cap to recovery of oil from the unit, acreage in any case where pertinent, or so many of said factors, and such other pertinent engineering, geological, economic or operating factors as may be reasonably susceptible of determination."

5. That under the plan rates of production will be determined in accordance with sound and efficient oil field engineering practices designed to result in the maximum economic quantity of oil and gas ultimately recoverable from the unit area.

(This, incidentally, is the standard agreed to by the United States Government for unit plans in California including federal lands. It protects the federal government; it will protect the state government.)

6. That the plan contains fair and reasonable provisions for voting on unit matters by unit members, allocating costs, etc.

This is majority-rule unitization. It will protect State lands from waste just as it will private lands.

Where State lands are leased, the State Lands Commission, representing the State as a landowner, may agree to the inclusion of State lands in such a plan. If it or any other landowner is doubtful of the feasibility or fairness of any such plan, the State Conservation Commission must hold a public hearing before it can approve the plan and make it binding on non-consentors. The State Lands Commission, representing the State as a landowner, may of course participate in such hearing. Any approval by the State Conservation Commission is subject to review in the State courts. It is hard to see how the State, through the inter-acting roles of these different State agencies, could have greater assurance that in obtaining protection from the waste of oil in State lands the position of the State will not be prejudiced in any way.

Where State lands are <u>not</u> leased, in theory the procedure is just the same, except that the State Lands Commission would act as both owner and operator of the State lands.

This means, of course, that the State would get <u>all</u> the production allocated to State lands, not just a royalty share. As a practical matter, it seems extremely unlikely that this could ever happen, particularly offshore. Before there can be a majority-rule unit plan, or indeed even a sensible voluntary

plan, the pool to be unitized must be outlined by actual drilling. State lands can be drilled only after they are leased. We are talking about a theoretical possibility here then, not a practical reality.

Now I have outlined the major things the proposed Conservation Act will do. Let me comment briefly on some of the things it will not do.

In the first place, it will not authorize anyone in any way to cut production from State - or private - oil lands to less than the maximum which can be produced without waste.

Section 4 F(4) of the act provides:

> "Nothing contained in this Act shall be construed to require, permit or authorize the Commission or any court to make, enter or enforce any order, rule, regulation or judgment requiring restriction of production of any pool to an amount less than the pool can produce without waste."

Faced with this unmistakably clear language, those who oppose Proposition 4 for their own good and sufficient reasons have, in the words of the San Francisco Chronicle, "tried to turn into a frightening bogey" the argument that entirely voluntary agreements under section 4 F(1) of the act, entered into by all the operators in a pool containing State lands, might result (1) in the State losing control over production rates and methods from its lands, and (2) in the curtailment of production from the pool to below the MER, or the maximum efficient rate at which the pool can be produced without waste.

The Attorney General's opinion concludes that neither of these results would follow from the act.

As to the second possibility, the opinion assumes or concedes, and does not even bother to mention, that the lessees of a given pool cannot, by getting together under a voluntary agreement under Section 4 F(1), cut the production from that pool to less than the maximum the pool can produce without waste. This is true whether the pool contains State lands or not. It is true for two reasons:

First, many leases have express provisions requiring the lessee to produce at the MER. Even where the lease has no such express provision, the courts will imply one. Thus Sullivan's "Handbook of Oil and Gas Law" says (at page 173):

> "In the absence of an express agreement in the lease, therefore, a covenant to diligently and properly operate the premises and market the product will be implied for the benefit of the lessor who otherwise would be subject to the unlimited discretion of the lessee."

Any lessee who produced at less than the MER without some very good reason would therefore be subject to suit by his lessor in the courts to enforce the lease provisions. As the Attorney General says in his opinion (page 12):

> "It is our opinion that section 4 F(1) cannot be validly construed to confer authority upon a lessee holding from a private owner to override or disregard his lease obligations."

Second, any group of operators who combined to cut production below the MER would be in trouble under the antitrust laws. In fact, this is precisely the issue in the Federal Government's antitrust case against the oil companies, pending in Los Angeles, so far as the production phase of that case is concerned.

So, returning to the first of the "bogey" possibilities raised under Section 4 F(1), the sole point discussed in Part I of the Attorney General's opinion is who determines the exact figure which is the MER - the State Lands Commission or the State courts. The opinion concludes that the State Lands Commission retains the power to issue regulations and leases requiring the MER's for State lands to be approved by the Division of State Lands.

The Attorney General says a contrary argument can be made, and that the courts will have to settle the question finally. Lawyers can make a contrary argument on any point, and of course under our system the Attorney General cannot issue a final and binding ruling - the courts must pass on our statutes, as they did when Proposition 4 was attacked as being unconstitutional for naming persons to office.

Incidentally, the contrary arguments the Attorney General mentions, the doubts he raises, are only as to whether the State Lands Commission can continue, in effect, to set MER's on State lands. I repeat, there is no doubt that nothing in Proposition 4 authorizes ~~any lessee~~ to cut production below the MER, with the MER to be determined by the courts if a dispute arises.

Further, even these contrary arguments could be removed by a simple act of the Legislature. The Attorney General says they rest on the proviso contained in Section 6829(e) of the Public Resources Code. This section can be amended by the Legislature at any time.

Also incidentally, those who fear voluntary agreements under Proposition 4 have never seemed to be afraid of Section 6830 of our Public Resources Code, in effect for the last fifteen years, which provides that the State Lands Commission

> "* * * shall restrict the rate of production from any * * * separate underground source of supply to that provided * * * by any reasonable conservation or curtailment plan ordered by the commission or agreed to by a majority of the total production from * * * such * * * separate underground source of supply."

In terms this covers not only conservation plans but curtailment plans, and requires approval not by all the operators in a field, but only a majority.

I suggest that it is drawing a very long bow to be concerned about arguments regarding Section 4 F(1), rejected by the Attorney General, when we have been living happily with Section 6830 without adverse results for the last fifteen years.

As Mr. Bergen has pointed out, Proposition 4 will repeal Section 6830, and in this regard give greater, not less, protection to State lands.

In the second place, Proposition 4 will not authorize or permit the restriction of production based on economic factors.

In this regard the act is totally unlike the Sharkey and Atkinson bills, with which the opponents of Proposition 4 have constantly sought to identify it.

I am not going to comment on this further; Part III of the Attorney General's opinion makes this crystal clear.

Thirdly, the act does not have the defects which apparently some members of the State Lands Commission staff felt, on first reading, it might have. Summarizing the staff's comments and the Attorney General's replies (in Part IV of his opinion):

A. The staff commented that the State Conservation Commission would have authority to include State lands in proposed units without regard to the State Lands Commission.

   The Attorney General pointed out that the Conservation Commission will not have authority to include any lands in a proposed unit, but that State as well as private lands will be subject to Section 6. This means that where the State owns 25 per cent or less of a pool, State lands might be unitized without the consent of the State Lands Commission, but the State Conservation Commission would have to find that the plan was fair and equitable to all, including the State.

B. The staff said that the State Conservation Commission could abrogate spacing provisions in State Land Commission leases.

   The Attorney General pointed out that this is true only as to newly discovered pools.

   The staff commented that a lien might be imposed on State revenues (i.e., the State's share of production) to pay the expenses of drilling a well on a spacing unit which includes State lands.

   The Attorney General pointed out that such a lien applies only to the working interests' shares of production. If State land is leased, therefore, no lien could be placed on the State's production. If the State's land is not leased, such a lien could attach to its share of production but, of course, in that case, the State's share would be 100 per cent of the production attributable to its land - not merely a royalty share. The production attributable to State lands would be determined by a State agency - the State Conservation Commission.

STANDARD B & P "NOEAR"

C. The staff expressed doubts that State tide and submerged lands would be counted in determining whether the necessary 75 per cent consent has been obtained to set up a unit plan, because of doubt as to whether the State owns "record" title to the tide and submerged lands.

In the Attorney General's opinion, all land within the pool must be counted and the State Lands Commission has the same rights as private owners in this regard.

D. The staff observed that where the State is a defendant in suits under the Act, it cannot cross complain against other parties in the same action.

The Attorney General pointed out that the same thing is true under existing statutes adopted in 1955.

E. The staff stated that a court could require the State Lands Commission to file a bond in certain lawsuits which it might commence under the Act.

The Attorney General's opinion is that a court could not require such a bond.

The staff stated that the Act would eliminate certain rules and regulations of the State Lands Commission.

The Attorney General stated that the Act has no bearing on the procedures of the State Lands Commission and could not eliminate any of its rules and regulations.

F. The staff objected that the State would have to pay a portion of the assessments imposed by the Conservation Commission, whereas under existing leases similar assessments must be borne by the State's lessee.

The Attorney General stated that there is nothing to prevent the Lands Commission from continuing to require its lessees to bear the State's share of such charges.

The staff observed that such assesaments might become a lien upon State lands.

The Attorney General pointed out that any such lien on State lands would be in favor of the State itself.

G. The staff commented that Sections 6830, 6832 and 6833 of the Public Resources Code would be repealed, saying these are the sections giving the State Lands Commission authority to regulate production and spacing of wells.

The Attorney General replied that in Part I of his opinion he had already concluded that the State Lands Commission would retain these powers under other sections of the Code.

> The Attorney General added that "one effect of the repeal of section 6830 would thus be to eliminate the present possibility that a mere majority of the total production within a pool or zone might override the discretion of the State Lands Commission in determining rates of production of wells operating under State leases," a point I have alluded to earlier.

We conclude, therefore, that Proposition 4 offers fair and effective protection to State lands against waste, that it is to the best interests of the State as a landowner as well as to the people of the State generally, that the objections to the act, from the State's point of view, have been proved to be illusory and mere "bogeys," and that the State Lands Commission should, therefore, endorse and recommend the adoption of Proposition 4.

Turner H. McBaine

EXHIBIT "C"

REMARKS MADE BEFORE STATE LANDS COMMISSION SEPTEMBER 27, 1956

Gentlemen, I am Harry Aggers, Manager of Secondary Recovery Operations for Union Oil Company of California. I am a petroleum engineer by profession, not an attorney.

The State Lands Commission has received opinions from the Legislative Counsel and from the Attorney General as to the effect of Proposition 4 on the State lands. These are both learned and eminent authorities and the Attorney General's opinion agreed with that of the Legislative Counsel's in most instances.

Where they were in agreement, their joint objections to the provisions of the proposed initiative measure were sufficient to warrant the defeat of this legislation. Where they were in disagreement, the element of doubt was substantial enough to indicate that litigation would be the only solution. This would be both time-consuming and expensive and would delay development of State lands.

Under the present law, the State Lands Commission has unquestioned control over State lands. Under the proposed act, such control would be definitely lost.

Let me present a brief comparison of the findings of the Attorney General and the recommendations of the State Lands Commission staff as to the effect of Proposition 4 on State lands.

In the final pages of his opinion, the Attorney General comments on the memorandum of the State Lands Commission staff which condemns Proposition 4. The State Lands Commission itself referred the Staff report to the Attorney General for his legal views.

The State Lands Commission staff contended that "in some circumstances the jurisdiction of the State Lands Commission over tide and submerged lands would be transferred and placed under the jurisdiction of the new commission."

This is the three-man commission set up in Proposition 4 which would be appointed by the Governor. Only one member would need any knowledge of the oil industry or any engineering background, and two members would constitute a quorum. Thus two politically-appointed non-experts would replace the technically-qualified staff of the State Lands Commission and the State Oil and Gas Division in making technical rulings over California's vast and complicated oil industry. The Division of Oil and Gas is abolished by Proposition 4, and power is taken away from the State Lands Commission.

The Attorney General agrees that Section 6 of Proposition 4 does "confer broad powers upon the Conservation Commission which would affect management and control of State, as well as private, lands."

The Attorney General also concurs in the opinion of the Legislative Counsel that:

STANDARD B & P "NOEAR"

"The proposed initiative act specifically provides that it is applicable to State lands (Sec. 4). Thus, State-owned oil and gas lands, including tide and submerged lands, would be subject to orders of the Conservation Commission in the same manner and to the same extent as privately owned lands. It follows then that compulsory orders of the Conservation Commission with respect to prevention of waste and including orders limiting production to prevent waste, and orders fixing maximum efficient rates of production, would supersede any conflicting provisions of oil and gas leases of State lands." (Legis. Couns. Op. No. 2608, dated June 14, 1956, par. B(2)(a).

The State Lands Commission staff also condemned Proposition 4 on the ground that Section 5 could cancel well spacing requirements set forth in existing State tidelands leases. The staff mentioned the Rincon Lease held by Richfield, which now requires that a well be drilled for every fifteen acres. It is to be noted that if the operator of a State lease wished to "get out from under" such drilling requirements, he could save thousands of dollars for every well not drilled. Proposition 4 could offer such an escape from the lease obligation.

The staff declared that Section 5 "would authorize the Oil and Gas Conservation Commission to abrogate well spacing in leases issued by the State Lands Commission", and the Attorney General comments that he concurs in this opinion.

The State Lands Commission staff also protested that the State would be required to pay its share of the cost of a unit operation over which it had no control, under Proposition 4. The Attorney General said:

"...If the property were unleased, the State would be the owner of the working interest and would have an obligation to pay its share of the costs."

The State Lands Commission staff also claimed that Section 15 of Proposition 4 "would prohibit the State Lands Commission, in case it is a defendant, to cross-complain against any other person involved in the same action." Comments the Attorney General:

"We agree with the staff that this restriction applies to the State Lands Commission as well as private defendants and intervenors."

Another point raised by the staff of the State Lands Commission in its criticism of Proposition 4 was that:

"The proposed act would impose upon the State the obligation to pay a portion of the assessments set up by the Oil and Gas Conservation Commission, based upon the State's royalty share of production. This would appear to be another appropriation of the State's money without proper budgetary procedure. Existing leases now require that such assessments shall be borne by the State's lessee."

The Attorney General comments on another objection raised by the staff of the State Lands Commission:

"The staff correctly points out that this section (17A) imposes an obligation upon the State on the same basis as private landowners, to pay a proportionate share of the expenses of administering this act."

The Attorney General also declares on still another point: "The staff is correct that Section 17J may be read literally so as to provide that the charges and assessments levied under Section 17 shall be a lien upon State oil and gas lands."

Another point to be considered by this group is that Proposition 4 will allow all of the working interests in a pool to set production rates by written agreement, provided such rates are below a wasteful rate. If these agreements are filed with the proposed Oil and Gas Conservation Commission, no action will be taken by the Commission unless there is clear and convincing evidence that waste is occurring.

Regardless of the statements by Mr. Bergen and Mr. McBaine, the Attorney General's opinion states, relative to this matter: "Concluding on this point, we repeat our admission that the question cannot be answered categorically and with certainty."

Almost all of the oil royalties now received by the State vary directly with the rate of production from the wells. Under Proposition 4, the regulation of producing rate could pass to the exclusive control of the operator and the corresponding royalty rates would be reduced substantially.

Richfield now holds 5200 acres of State submerged lands subject to this variable royalty rate, and Standard has an interest in 4230 acres of State submerged lands. This acreage constitutes over one-half of all State submerged lands currently under lease. Both companies favor Proposition 4, which would allow them to set production rates at levels which would offer the optimum royalty rate for them and which would reduce the income to the State.

The two legal opinions, plus the probability of reduced State income under the proposed Act, make it imperative that the State Lands Commission oppose the passage of Proposition 4.

EXHIBIT "D"

STATEMENT OF ASSEMBLYMAN JOSEPH C. SHELL BEFORE THE

STATE LANDS COMMISSION ON

SEPTEMBER 27, 1956

Mr. Chairman, members of the Commission. With the advent of the Attorney General's recent opinion concerning Proposition 4, I believe that the Lands Commission now has ample evidence to make a determination as to what affect this initiative, if passed, would have on the administration of state lands.

The Attorney General agrees basically with the conclusions of the Legislative Counsel Bureau which were developed in Opinion No. 1151. This opinion was termed reprehensible and ambiguous in a telegram to the Lands Commission from Mr. Charles Jones of the Richfield Oil Company. I would assume that with the basic agreement of these opinions that the same terms should apply to both.

Both opinions back up several months' work of your very competent staff as evidenced in the mailings of its findings and conclusions to Senator Regan and Assemblyman Lindsay on the 27th of June, 1956. Testimony of Col. Putnam before Mr. Kelley's committee indicated that the staff's opinion was still the same.

Some of the points of agreement to which I refer are: that state lands could be taken into a unit operation without the approval of the state; that state lands could be used for the production of oil and gas without the execution of a lease and without the consent of the State Lands Commission.

All three opinions indicate that there is a grave legal question that can only be settled in the courts as to whether 100% of the operators under Sec. 4F(1) could enter into an agreement setting their own MER's and well spacing. Certainly with the proper drafting and amendment this point could have been clearly stated.

All opinions referred to also clearly indicate that assessments of operational costs of any unit into which state land has been taken with or without consent of the state are assessible for a portion of the operating costs, and a resulting lien could accrue against state lands for these operating costs. Also the opinions concur that provisions of state leases on land within a unit area which are inconsistent with the terms of the unit agreement are superceded by the unit agreement.

The opinions also point out that there is a legal question, again probably determinable by court action only, whether the repeal of Sec. 6830 of the Public Resources Code ends the Lands Commission authority to controlling maximum efficient rates of production and well spacing or whether such authority is found in Sec. 6829 which is not repealed.

The mere fact that this was not expressed in a manner obviating any legal doubt is an indication that amendments are sorely needed.

There is no doubt that Proposition 4 abrogates a mandatory requesting of bids when state lands are put out for private operation. The bidding theory must be retained as a mandate in our public lands picture.

These questions and many more that have been brought up and analyzed by the Legislative Counsel Bureau, the Attorney General and the staff of the Lands Commission clearly indicate that the royalty revenues to the State of California from the state tidelands could be drastically curtailed by the operating oil companies if Proposition 4 passes.

No legislation of a major nature is perfection when introduced. A good example is the Cunningham-Shell Act of 1955. As originally introduced the bills were drafted by the attorneys of the Western Oil and Gas Association. In order to make those bills workable and acceptable more than 100 major amendments were necessary. The Attorney General's office, represented by Mr. Wallace Howland, the Legislative Counsel Bureau, the Lands Commission and its staff and all parties interested in tidelands drilling were consulted and heard before the final bill was passed.

I would like to quote the Attorney General's opinion: "Prior to the 1955 session of the Legislature, the State's laws dealing with the leasing and developments of its oil and gas lands was principally concerned with upland properties. There was no statute dealing comprehensively with the State's tide and submerged lands. After extensive hearings and full debate, the Legislature enacted the Cunningham-Shell Tidelands Acts of 1955. As amended by this enactment, the Public Resourses Code now confers broad authority upon the State Lands Commission designed to protect and further the overall public interest in the conservation and utilization of all of the State's oil and gas properties."

There is no avoidable waste on state lands under current law.

Further quoting the Attorney General: "If the law were one enacted by the Legislature, unforseen future developments could be dealt with and mistakes in judgement could be corrected by appropriate amendments at the next session of the Legislature.

"In evaluating the effect of an initiative measure, such as Proposition No. 4, which is submitted directly to the people, the hazards are much greater. Unlike a statute of its own enactment, the Legislature can only make such amendments and changes in an initiative as the initiative itself authorizes. By its express terms, section 20 of Proposition No. 4 does not permit the Legislature to amend any of the provisions with which we are concerned in this opinion."

Control of the states rich tidelands seems to be of prime importance to the proponents of Proposition 4.

The question arises as to why the proponents of Proposition 4 would not bring the measure to the Legislature and the answer has to be that they wanted no amendment.

The purpose of an initiative measure is to provide the people of the state with a lane of recourse if the Legislature refuses to act. The history has

been that whenever these same companies have come to the Legislature, as in 1931 and 1939 with the Sharkey and Atkinson bills, that the Legislature thoroughly debated these bills, amended them and put them out to the people for vote. Any statement that the Legislature has refused to act is unfounded. This measure certainly was never presented to the Legislature and refused.

I have been attacked personally and bitterly by the proponents and their paid publicists for requesting and presenting the Legislative Counsel opinions which I received during the last session of the Legislature. I undertook opposition to the measure on the basis of these opinions at that time and will continue to do so despite any pressures which might be exerted politically or otherwise. I believe with the Attorney General, the Legislative Counsel Bureau and the staff of the Lands Commission that Proposition 4 was improperly instituted, improperly drafted and indicates improper control of the state tidelands by private interests.

I have received and will receive no compensation for my position other than the satisfaction of seeing this unfortunate measure defeated.

I think this Commission should make the request of the proponents of Proposition 4 that they drop the promotion of its passage at this time and present it to the Legislature next January. There, all segments of the oil industry would be consulted and constant consultation would be held with the Attorney General's office, the Legislative Counsel Bureau, the Lands Commission and its staff, and all interested parties would be given full and equal opportunities to be heard.

If, after these full considerations, any measure is considered by the elected representatives to be in the best interests of the people of the State of California, it will be passed, but with the ability on the Legislature's part to eliminate those sections thought to be detrimental to California's interest.

This is our Representative Republic form of government.