

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

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

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

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

24 MR. HORTIG: Mr. Chairman, as outlined on page 1 of
25 the agenda item before you, pursuant to the directive of the
26 Commission for deferment consideration of this matter to the
27 meeting today and the suggestion to industry to submit any
28 further proposals or raise any further questions, preferably in
29 writing and prior to this meeting, written recommendations were
30 received from Union Pacific Railroad Company on October 7, 1963
31 and from Pauley Petroleum Company on October 9, 1963. Copies

1 of those letters are attached to your agenda items as exhibits.
2 Additionally, yesterday afternoon by special messenger a letter
3 was received from Shell Oil Company, copies of which will be
4 distributed to you gentlemen now.

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

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

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

28 The cost to the City, and necessarily to the State,
29 through such method of operation and the lack of local control
30 have resulted in the recommendation by the Long Beach Harbor
31 Department against such an alternative operating procedure.

1 You have just received the letter from Shell Oil Com-
2 pany, which reviews also specifics with respect to bid procedure
3 as well as relative to a recommendation that any price base that
4 might be adopted should be adopted by the Commission in considera-
5 tion of its applicability to other State leases and municipal
6 leases and contracts in the future. This is a problem which it
7 would be extremely difficult to forecast -- to determine for a
8 specific set of circumstances such as we have before us -- where
9 a new contract is required to continue operation -- that such
10 price bases can necessarily be tailored to be so specific to as-
11 sure the control necessary with the current contract and still be
12 flexible enough to cover in the future any other circumstances -
13 economic, geographic, geologic, and so forth.

14 Under these circumstances, Mr. Chairman, I would recom-
15 mend that the Commission order these three letters into the
16 record in order that their contents be available to all, but
17 without the necessity of reading them into the record at this
18 point.

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

21 MR. HORTIG: Now, additionally, at the meeting of
22 September 30th, Richfield Oil Corporation requested that their
23 company's name be included with those of the companies specific-
24 ally mentioned in computing the average of posted prices, as out-
25 lined in Section 18.3 of the proposed drilling and operating con-
26 tract; and the Office of the Attorney General suggested that
27 approval by the Harbor Commission of termination of the contract,
28 as provided in Section 4, be subject to approval by the State
29 Lands Commission.

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

* These letters are attached to end of transcript.

1 recommendations which were made to the Commission on September
2 30th, the recommended resolution today reading:

3 "It is recommended that the Commission approve:

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

7 A. Inclusion of Richfield Oil Corporation in the list
8 of those companies specifically mentioned in computing
9 the average of posted prices as set forth in Section
10 18.3 of the contract;

11 B. Addition of a last paragraph to Section 4 of the
12 contract, reading as follows: 'Any termination of this
13 agreement prior to February 28, 1959, shall require
14 State Lands Commission approval.'

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

21 MR. CHAMPION: Now, the situation is that after communi-
22 cations and comments that are all in, the staff recommendation is
23 that we approve the contract as it was before us at the last
24 meeting with the exception of these two amendments; and what we
25 are really considering is the proposed contract with these two
26 amendments, and this is the matter that is now before us for dis-
27 cussion -- whether there are other amendments to be considered,
28 whether there are other proposals or comments or objections on
29 the recommendation as it now stands -- the contract with these
30 two amendments. Now I think we are prepared to hear from anyone
31 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

1 which, from what I gather, proposes a rather different way of
2 handling this. Now, first of all, I wonder whether Mr. Hortig
3 would like to explain it because I really can't understand
4 exactly their proposal; and then I'd like to know whether this
5 was considered previously -- this form of operation was consid-
6 ered previously by the Long Beach Harbor Department.

7 MR. HORTIG: Mr. Chairman, in response to Mr. Sieroty's
8 question, I think as background I should first report to the
9 Commission that the election of the form of operation proposed
10 for any particular tidelands grant area is at the option of the
11 State's grantee, in this instance the City of Long Beach; and
12 the options are not nominal with the Lands Commission to direct
13 a different basic format for presentation without consideration
14 for approval. Under existing State law we are limited to con-
15 sideration for approval only of proposed contract forms, as they
16 are presented by the State's grantee-trustee for consideration.

17 Therefore, this matter has been discussed with Union
18 Pacific Railroad, but the election to not proceed with presenta-
19 tion to the State Lands Commission of a proposal to proceed under
20 the alternative as outlined by the Union Pacific Railroad was
21 made by the Long Beach Harbor Department, who are the operating
22 agency, who are operating the particular subject trust lands
23 that are herein involved. Therefore, under those circumstances,
24 I think it would be appropriate to call on a representative of
25 the Long Beach Harbor Department and their legal counsel to give
26 the details as to what went into the consideration and possibly
27 why the alternative was not submitted to the Lands Commission.

28 MR. CHAMPION: I think that would be the best proceed-
29 ure. Would you step forward, please, and outline the proposal
30 and the reasons for choosing in the alternative?

31 MR. SPENCE: Yes. For the record, my name is John

1 Spence, Assistant Attorney of Long Beach. The City of Long Beach
2 considered this proposal and it was not acceptable, principally,
3 for economic reasons and from an engineering standpoint. Now, I
4 don't propose to go into the engineering feature, but I do want
5 to point out to the members of the Commission that this proposal
6 would not take care of the portion of the tidelands not in the
7 unit, and I am speaking specifically of Fault Block V -- which,
8 when it is unitized, will only have the Ranger Zone. The re-
9 mainder of Fault Block V will not be in the unit, so that would
10 not solve our problem.

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

13 MR. CHAMPION: Thank you.

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

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

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

31 VOICE: Yes, two.

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

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

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

23 MR. PINNELL: That's quite correct.

24 MR. SIEROTY: What does that mean?

25 MR. PINNELL: Well, Union Pacific would not be compen-
26 sated through a fee, as an operator or as a contractor would,
27 presumably. Most contractors are compensated for their work by
28 a fee or a percentage of this or a percentage of that. The unit
29 agreements provide that the only thing a unit operator receives
30 for operating the unit is a six per cent overhead allowance,
31 administrative expense allowance, on certain costs -- plus actual

1 costs, of course. The costs of operating the unit go to unit
2 expense and are, therefore, divided up among the participants on
3 the basis of their participation in the unit.

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

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

12 MR. SIEROTY: It doesn't go to the contractor -- it goes
13 to the City?

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

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

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

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

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

1 the owner of the oil.

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

8 MR. PINNELL: Correct.

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

11 MR. CHANZON: All right. Thank you, Mr. Pinnell.
12 Sorry to interrupt you, Mr. Smith, but this provides a better
13 basis for us to proceed.

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

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

30 Our major objection to the proposal is a matter of
31 economics. We believe that this six per cent overhead allowance--

1 and I want to be clear on this -- the six per cent of our cost in
2 operation of the unitized areas is currently coming to the City
3 and the State and if we were to relinquish our position as unit
4 operator, we would then not only lose our six per cent -- we would
5 be paying someone else the six per cent.

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

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

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

27 MR. SIEROZY: How many unit operators are there at the
28 present time?

29 MR. SMITH: There are currently two companies that are
30 unit operators of what we call Segment 2 -- that is, the areas
31 north of Seaside Boulevard in four fault block units. Union

1 Pacific is operating in Fault Blocks II and III-- that is the
2 northern portion thereof; and Socony Mobil is operating in Fault
3 Block IV; and very soon will be operating in Fault Block V -- the
4 Ranger Zone only, incidentally.

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

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

12 MR. SMITH: That is correct.

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

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

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

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

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

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

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

28 MR. SMITH: That is correct -- all of the working
29 interests. The way it works: There is a unit operator of
30 Segment 1. That is the City of Long Beach in any of these units.
31 There is a unit operator in Segment 2. In the case of Block II,

1 we will take, for example, that is Union Pacific Railroad. Union
2 Pacific Railroad assembles all its costs for a given month and the
3 City assembles all of its costs for a given month and each of them
4 is entitled to reimbursement of that cost plus six per cent out
5 of all of the working interests' income, and all of the working
6 interest owners share in each of the unit operators' costs and
7 each of the unit operators' six per cent overhead.

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

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

17 MR. SIEROTY: That's all.

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

23 MR. HORTIG: We did review the analyses and we did dis-
24 cuss with Union Pacific Railroad the applicability of this. In
25 view of the fact that the Harbor Department has jurisdiction....

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

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

30 MR. CHAMPION: Do you agree with them?

31 MR. HORTIG: To the extent that we have reviewed their
analysis, yes.

1 MR. CHAMPION: Do you want to pursue another matter?

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

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

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

19 MR. HORTIG: Yes, sir. In view of the fact that Sec-
20 tion 18.3 with respect to pricing determination specifies alter-
21 natives.....

22 MR. CHAMPION: 18.3 of what?

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

1 the recommendation of the staff that they be added to the list.
2 We have the problem -- I believe I am correct and the Shell repre-
3 sentative will straighten me out if I am not -- Shell is a pur-
4 chaser at the present time in the Wilmington Oil Field, but I am
5 not positive that they are posting prices.

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

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

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

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

31 MR. SHAVELSON: That language would not add any other

1 company to the list, and wouldn't fulfill that purpose. In other
2 words, that language simply

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

5 MR. SHAVELSON: No, the language that Frank just men-
6 tioned concerning the presumption in the definition of any con-
7 tinuing purchaser -- in the absence of evidence to the contrary
8 he is presumed to be one; but still the price must be posted,
9 under the present language, by one of the designated purchasers
10 and, therefore, that language would not help.

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

13 MR. SHAVELSON: That is correct.

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

16 MR. SHAVELSON: I don't.

17 MR. GOLDIN: No.

18 MR. CHAMPION: Mr. Smith, how would the Harbor Commis-
19 sion of the City of Long Beach feel about that?

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

30 Now, the problem that will arise if we open up to
31 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

1 criteria; or whether they then, after meeting it, failed to meet it.

2 MR. CHAMPION: I assume that if someone wished to be
3 included, that if we set this up so that they would have to sub-
4 mit satisfactory figures that they did qualify as a continuing
5 purchaser, your real problem is when you know that they fail to
6 be a continuing purchaser.

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

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

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

15 MR. SMITH: That's correct.

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

20 MR. SMITH: That is correct.

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

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

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

30 MR. SMITH: There would have to be, in my opinion, a
31 prescribed method for bona fide posting.

1 MR. CHAMPION: I don't see why we can't -- All we are
2 doing is opening the door to them and they ought to be willing to
3 provide the information to make that privilege open to them.
4 These people are all now posting and buying in the field.

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

12 MR. CHAMPION: We are fully protected?

13 MR. SHAVELSON: Yes

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

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

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

22 MR. CLARK: Durlan Clark, Shell Oil Company. We post
23 in some parts of the country but never have in California, and
24 the time may come, however, in handling an average posted price,
25 where this might be necessary for many companies to do. Rich-
26 field, obviously, saw this and I think they are quite correct.
27 We, in essence, are attempting to avoid the listing of a long
28 group of companies -- merely saying that if one company actually
29 buys and posts, they should be considered in this list. That's
30 all I have to say to that.

31 MR. SIEROTZ: Why is it that you haven't been posting?

1 MR. CLARK: Just that we have never found it necessary.

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

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

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

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

29 We were merely picking up the point Mr. Champion made --
30 We feel this should be a continuing thing and certainly if the
31 pricing standards here are expanded elsewhere, it might become a

1 critical thing in the future and there might be a request for
2 other companies to post.

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

5 MR. CLARK: That's correct.

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

15 MR. HORTIG: Yes, sir.

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

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

18 MR. RIDINGS: I believe it could be, with a properly
19 worded procedure, included. We are certainly interested in
20 broadening the base as much as possible; but I do want to restate
21 that neither the City of Long Beach nor the Board of Harbor Com-
22 missioners have any right whatsoever to investigate into the
23 books and records of any company. Those companies mentioned here
24 are those who are known of record to be continuing purchasers and
25 we would be very much concerned if someone with a small refinery
26 came in with a low price and depressed the price of oil. So I
27 think there should be clearly set forth there must be a demonstra-
28 tion to the Board and the Commission here prior to their being
29 accepted -- that the lease be drawn in such way that such person
30 having demonstrated to the satisfaction of the Board and Commis-
31 sion are then to be included in the calculation.

1 MR. CHAMPION: I think that is included, Mr. Ridings,
2 and I agree with you. I think our position is exactly the same.
3 We want to make sure we don't accept a designation here for which
4 we can't make an administrative finding; and I think the language
5 will be clear -- if someone is interested, that they then volun-
6 tarily provide the information we need, because, as you say, we
7 would otherwise have no right to investigate or ask. But in
8 order for anyone to qualify, they would have to volunteer the
9 information.

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

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

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

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

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

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

27 MR. SIEROTY: Not necessarily.

28 MR. SHAVELSON: May I make one comment as to the present
29 provision and how this might be expanded? Under the present pro-
30 visions, there are two statements. One is that any person post-
31 ing is presumed to be a continuing purchaser in the absence of

1 evidence to the contrary; and, secondly, there is a provision re-
2 quiring the contractor or any of the persons of whom the contrac-
3 tor may consist, any of the companies, to furnish to the City
4 upon request full information as to the quantity and prices of
5 any purchases that they might make. So, therefore, if we should
6 expand the definition of the determinative prices in the other
7 fields, by expanding it to include any continuing purchaser in
8 that field, then if our contractor should attempt to file an
9 artificially low price, I think we would have some protection
10 against that. As a matter of fact, we would know whether or not
11 he was a continuing purchaser, so what it comes down to is
12 whether or not there would be any danger to the State of any third
13 person filing an artificially low price and, of course, if we
14 assumed that everyone posting was a continuing purchaser. We
15 could easily make that change, but I wanted to know whether that
16 would be satisfactory to the City if we did that.

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

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

28 MR. CHAMPION: I think what we are dealing with here is
29 largely a technical problem. I don't think there is any funda-
30 mental problem on what we are trying to get at. What I would
31 suggest is that we continue with other matters and then have a

1 recess when we are through with that; and if there is a language
2 problem, you and the staff can work that out.

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

6 MR. SMITH: That's correct.

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

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

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

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

30 MR. GOLDIN: May the objective you are after be accom-
31 plished by the simple addition, after the names of the designated

1 five companies, of the terminology: "or any other person or
2 entity which can establish its qualifications as a continuing
3 purchaser."

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

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

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

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

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

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

29 MR. CRANSTON: Mr. Chairman, moving on to another
30 area, the Senate Factfinding Committee, headed by Senator
31 O'Sullivan, rendered, I think, a very great service to this

1 Commission and the people of California in the exploration of
2 the contract that was earlier before the Lands Commission on
3 another field in Long Beach, the East Long Beach Field. We were
4 deeply interested in their recommendations and we have followed
5 some of them in our proposals to Long Beach in regard to that
6 field, and we are apparently now reaching the point where we will
7 have some direct negotiations between the Lands Commission and
8 the City of Long Beach in regard to that contract.

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

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

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

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

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

31 MR. SIERTY: Well, I have other questions.

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

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

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

31 Patently, then, with an independent series of

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

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

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

26 MR. HORTIG: Not a solution to it, sir. The resulting
27 review, which really constituted a re-review, that we have had
28 extensively with the staff of the Long Beach Harbor Department
29 on just this question, came back to the same conclusion that
30 inasmuch as there is no necessity for a public record repre-
31 sentation, there is no simple test as to the bona fide nature

1 of a highest posted price; that tests that have been devised
2 would all cost the City and State in terms of a discounted bid
3 on the contract. Under these circumstances, then, the conclusion
4 was again arrived at that the average posted price on the broad-
5 est base on which it can be computed will probably more nearly
6 reflect the reasonable market value of California crude in the
7 area, with all of the economic factors that impinge on that being
8 taken into consideration.

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

15 MR. HORTIG: Yes, sir.

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

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

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

28 MR. HORTIG: Well, circumstances are alleged to have
29 occurred, keeping personalities out of this, where it has become
30 known throughout the industry that a particular operator is re-
31 quired by earlier lease conditions, which did not foresee this

1 hazard, to pay his landowner's royalty as against the highest
2 posted price in a particular field. It is obviously a simple
3 matter for a competitor who might wish to create a problem for
4 his competition, the lessee who holds this particular lease, to
5 simply go in and post and never buy; and with no test provided
6 for the bona fide nature of the purchase or even small purchases
7 at the highest posted prices, immediately brings about the necess-
8 ity for paying for large quantities of oil against what is really
9 a fictitious or a rigged highest posted price, to the disadvan-
10 tage of the particular lessee.

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

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

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

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

28 MR. CHAMPION: Wait a minute, Frank, you have me a
29 little confused on what the price tag is on. Is the extra cost
30 here the cost of making an adequate determination, or is the
31 price tag the influence on the net profit bid?

1 MR. HORTIG: The price tag is the uncertainty of the
2 bidder as to what he is going to have to face in the future;
3 therefore, he has to take insurance against that eventuality in
4 his bid to the City and State.

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

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

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

23 MR. HORTIG: This would depend upon a series of inter-
24 related factors that can't be precisely evaluated here, because
25 if the contractor is not an integrated company he is in an en-
26 tirely different position. If he winds up as being only an inter-
27 ested producer, he is interested in the highest price value be-
28 cause under this circumstance he will make the most net profits;
29 if he is an integrated operator and can consider transferring
30 some of the economic problem to his refinery operations, there
31 could be an impact and a desire to have the lowest posted price

1 for this particular operation.

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

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

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

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

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

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

29 MR. SHAVELSON: We thought very carefully. We realized
30 an average posted price provision does allow the contractor to
31 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

1 determine whether or not he can post an artificially low price.

2 Now, these are the protections in the contract:

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

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

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

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

31 MR. SHAVELSON: Yes, sir.

1 MR. SIEROTY: On this point, the clause which provides
2 that the contractor must give information regarding other pur-
3 chases and must pay that price, in other words that price which
4 would be established -- in what field does that relate, just to
5 Wilmington Field or to all of them?

6 MR. SHAVELSON: The escalator provision is only appli-
7 cable to purchases in the Wilmington Field. The information pro-
8 vision as to how much oil they are buying or selling applies to
9 all fields. In other words, we would be supposed to know whether
10 or not our contractor was in fact a continuing purchaser in any
11 field, because we would have a contractual right to get from our
12 contractor the necessary information. Whereas we would have to
13 guess as to a third party, as to whether or not he was a continu-
14 ing purchaser, we would know for a certainty whether or not our
15 contractor was.

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

18 MR. SHAVELSON: Yes.

19 MR. SIEROTY: In all the fields specified here?

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

29 MR. CRANSTON: Going to another matter, it has been
30 suggested that the proposed contract will result in an oil price
31 manipulation scheme run exclusively by a worldwide cartel. I'd

1 like to know if any such price-fixing has occurred under the
2 L.B.O.D. contract.

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

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

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

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

18 MR. SPENCE: As far as I am aware.

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

22 MR. HORTIG: Well, Mr. Cranston, I believe this must
23 be an academic answer to a very academic question. There would
24 be less opportunity under the proposed contract because of the
25 broader base of more competitive entities under the program and,
26 therefore, the necessity in order to have any manipulation for
27 a joint collusive effort of more entities that are in direct
28 economic competition today; and every time you involve one more
29 competitor in an attempt to achieve a manipulation, it dilutes
30 the remaining profit to be distributed as a result of any suc-
31 cessful collusive effort and thereby makes it less desirable to
to even attempt such a course.

1 MR. CHAMPION: Well, such a collusive thing is really
2 not a matter of this contract, is it, but of State law? If there
3 is such a thing, State law already has adequate protections.

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

6 MR. SHAVELSON: I have here a copy of the decree against
7 the major California oil companies entered in the United States
8 District Court, and that decree prohibits the companies from fix-
9 ing their prices in relation to the price of any particular other
10 defendant in any field, but it goes on to say that this provision
11 shall not prevent a defendant in the purchase of crude oil from
12 offering or agreeing to pay for said crude oil a price which is
13 referenced to or is expressed to be based upon the highest, low-
14 est or average of the prices posted by any two or more persons --
15 defendants or of firms, who may be named.

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

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

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

26 MR. SMITH: ... remaining reserve is two hundred eight-
27 een million barrels.

28 MR. HORTIG: Two hundred eighteen million barrels on
29 a decline, this field having passed its peak, having been in
30 operation for twenty-five years, peak production having been
31 reached some time past; and with the possibility on reasonable
estimates indicating that the economic limit and the last barrel

1 that can be afforded to be produced will probably be produced
2 between 1985 and 1990 -- after which this particular field will
3 not be contributing a barrel of oil, and therefore no impetus or
4 ability to enter into any conspiracy or use as a lever in connec-
5 tion with price-fixing.

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

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

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

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

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

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

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

18 MR. HORTIG: Yes, sir.

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

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

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

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

28 MR. HORTIG: I have seen that terminology in one press
29 report. I believe, however, staff comment and every staff analy-
30 sis in connection with the Lands Commission has been that it has
31 been in an area that has a declining production rate, but

1 apparently it is not a depleted field in the sense that a deplet-
2 ed field is used in the oil industry -- which means an exhausted
3 field, when we have over a hundred million barrels reserve remain-
4 ing to be produced.

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

13 MR. SHAVELSON: Section 5827 of the Public Resources
14 Code merely requires that the oil be based on the current market
15 price plus any bonus or premium; although in our standard lease
16 form it is tied to the highest price in the field, that is not
17 a statutory requirement.

18 MR. HORTIG: Might I amplify on that, Mr. Cranston?
19 Of course, this also relates to oil and gas leases as are re-
20 quired to be issued by the State Lands Commission, with certain
21 conditions which are provided by the statute as minimum, and in
22 these oil and gas leases the return to the State is a percentage
23 of the value of the product -- therefore, the higher the value
24 of the product, the higher the return. On the other hand, if
25 leases were offered for bid on an average posted price basis
26 rather than the highest, it is patent that the high bidder, if
27 there were any substantial difference -- which there isn't,
28 between average and high -- a high bidder would offer an even
29 higher percentage return to the State because of the ability to
30 determine precisely, or more precisely, what his royalty payments
31 and requirements are going to be because of the greater

1 stability and greater certainty with which an average price level
2 can be determined, as against erratic fluctuations for amounts of
3 oil by a spot purchase.

4 Contrasted with that, we have the contract before you
5 for consideration, where the return to the State and City is not
6 directly related to the value of the product as the basic cri-
7 terion, but the return is going to be on the percentage of the
8 net profits. True, any difference between highest and average
9 will be considered in the percentage to be offered and would also
10 result in a difference in the amount of net profit calculated for
11 lower value of production; but it must be remembered that the
12 actual experience from 1956, again since the State Lands Commis-
13 sion has monitored Long Beach operations, to date under the exist-
14 ing Long Beach Oil Development contract, has showed that because
15 highest posted prices have applied to only minor purchases of oil
16 there has only be 14/100 per cent difference between the highest
17 and average posted price during that time.

18 MR. CRANSTON: The obvious mandate of the State of Cali-
19 fornia to receive the highest price for its oil is not met legally
20 or morally whether they receive highest or average posted price.

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

24 MR. CRANSTON: Obviously, it is the State's responsi-
25 bility to receive the highest price we can.

26 MR. HORTIG: True.

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

29 MR. HORTIG: Under the contract we have under con-
30 sideration.

31 MR. CRANSTON: The contract which terminates next

1 March operates under average posted price, is that correct?

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

4 MR. CRANSTON: Specifically, had we been operating
5 under the highest posted price what would have been the differ-
6 ence in revenue to the State of California?

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

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

10 MR. HORTIG: It would have been on the order of a
11 hundred thousand dollars, assuming the difference in specifica-
12 tion as to how the value was to be calculated had not influenced
13 the original bidder to change his bid according to the yardstick
14 to be used.

15 MR. CRANSTON: What is the revenue over the life of
16 this contract now? I just want to put this hundred thousand dol-
17 lars figure in perspective.

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

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

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

26 MR. HORTIG: The normal pricing provisions and specifi-
27 cations by most of the oil companies purchasing oil have broken
28 the prices stepwise by complete degrees of A.P.I. gravity.
29 A.P.I. gravity is like a thermometer and it has bigger divisions
30 on it -- 30° oil may bring five cents a barrel more than twenty-
31 nine; and thirty-one, five cents more on top of that.

1 This is the way the matter is reflected in the offerings and in
2 the crude oil price schedules I think I have here. - -
3 As for example, Mobil Price Schedule Number 91 effective
4 January 22, 1962 lists for Wilmington 20 to 20.9 gravity, 2.35;
5 21 to 21.9 gravity, 2.41. In other words, suddenly, in going
6 from 20.9 gravity scale to 21, there is an increase of six cents
7 a barrel and there are two ways to try to get that additional
8 six cents. That is, to go through elaborate blending procedures,
9 and at a cost, on a tank farm to mix up lower gravity oil with
10 higher gravity oil, in order to get just to the breakover point --
11 which you can't always do; or, as is proposed in this contract,
12 that calculations be made by straightline interpolation for
13 every degree of gravity, so this six cents differential will be
14 divided into steps of 6/10 of a cent for each tenth of a degree
15 of gravity, whatever the gravity measures when the oil is shipped.

16 The net result in applying this type of calculation,
17 had it been applicable in past production to the L.B.O.D. con-
18 tract it is apparent that approximately three cents a barrel
19 will be realized out of future production for a given price
20 schedule than has been achieved here^{of} before -- because this step
21 arrangement, rather than a smooth scale of prices over the
22 entire gravity range.

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

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

29 MR. CHAMPION: Without affecting the potential net
30 profit.

31 MR. CRANSTON: Unless someone else has some questions

1 on average versus highest posted price, I'd like to go into
2 another matter. That matter is the additional acres which are
3 being covered under this contract, which were not covered under
4 the present contract. Can you explain why these have been added?

5 MR. HORTIG: Yes, Mr. Cranston. I apologize for the
6 small map but you have it on your agenda. This is the tide and
7 submerged lands under the jurisdiction of Long Beach Harbor Com-
8 mission originally leased under the series of contracts, or
9 awarded under the series of contracts to L.B.O.D. pursuant to
10 competitive public bidding. As a result of development of the
11 developed area, it was discovered that, contrary to the expecta-
12 tions that the seaward limit of production would be at this
13 dashed line, the limit of the leased areas, developments culmin-
14 ating in data analysis on which field knowledge was only avail-
15 able four or five years ago demonstrated that the production
16 structures actually extended some additional distance seaward of
17 the area which had previously been leased.

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

28 When we evaluated the economics on the undeveloped
29 area as to offering it for lease separately, it appeared mar-
30 ginal from the standpoint that a new operator coming in, having
31 to operate in the deeper water area and from facilities outside

1 the developed area, which would conflict with the Long Beach Naval
2 Shipyard operations; the additional costs of having to go, pos-
3 sibly, out to the seaward side and slant-drill back into the
4 area; to provide duplicate facilities for handling the production,
5 duplicate over those already in existence for the L.B.O.D. opera-
6 tion -- it was determined that probably the optimum return for
7 the City and State could be achieved by including the marginal
8 flank parcels in any new contract offer such as is being consid-
9 ered at the present time, where the efficiency of developing the
10 entire area will result in a maximum of profit being secured by
11 the City and State from developing the area in conjunction with
12 the previously developed area rather than having sought to have
13 it started earlier.

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

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

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

23 MR. HORTIG: No, sir. If I may refer to a staff report
24 for the short answer, considering division of undivided interests
25 and offering these undivided interests with the division lines to
26 be the fault blocks -- again if I may show you gentlemen a dia-
27 gram, a cross section of the Wilmington Oil Field, indicating by
28 these curved lines the approximate location of the subsurface
29 fault zones -- you can see this renders a very complex subsurface
30 picture. This complex subsurface picture, therefore, certainly
31 does not lend itself to property description such that Area A

1 can be described for a particular lease and Area B for another
2 lease. We reported previously that separate offerings by fault
3 blocks would be complicated and disadvantageous, resulting in
4 reduction of State-City revenues because of increased capital and
5 operating expenses. Some of the principal factors contributing
6 to the undesirability of separate offerings are:

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

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

22 (c) The surface projections of the fault blocks over-
23 lap. Much of the surface area is directly underlain by two or
24 three different fault blocks. In other words, if we put up
25 these vertical fences, we find part of Operator A's property is
26 within the fence, part of Operator B's property is also within
27 the fence and extends next door, and part of Operator C's
28 property starts at the easterly fence and goes over to the west-
29 erly fence and extends out an indeterminate distance to the west.
30 Unfortunately, nature did not arrange these fault blocks in nice,
31 compact individual units, where they could be described in such

1 a manner where they could be considered for offers in undivided
2 interests.

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

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

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

28 Finally, more than twenty multiblock wells produce oil
29 currently from more than one fault block. The producing inter-
30 vals of these wells actually are located on both sides of
31 specific faults, again making impossible the physical separation
and accounting, by fault blocks, of oil produced.

1 Therefore, in summary, few additional facilities will
2 be required to develop the new area if the entire harbor tidelands
3 oil operation is carried on under a single contract. Oil produc-
4 tion in the presently developed parcel is decreasing, and surplus
5 equipment and facilities therefor would become available for use
6 in the new area -- at no additional cost to the City and State.

7 It must be remembered that the total capital investment
8 and operating costs for the I.N.O.D. operating contract have
9 heretofore been advanced by the City of Long Beach from tidelands
10 oil funds. In other words, this is a publicly-owned operation,
11 and we do have the problem of protection, by adequate control,
12 of the efficiency of the operation, achieving both the maximum
13 return from the remaining production and also the protection of
14 that public investment which has already been made in this area --
15 which, admittedly, was made initially at a time when the State
16 Lands Commission had no statutory responsibility with respect to
17 this operation.

18 MR. CRANSTON: Do you feel it would be feasible to di-
19 vide up the field for bid purposes by resorting to the undivided
20 interest route that we have advocated in regard to the East Wil-
21 mington Oil Field?

22 MR. HORTIG: Possibly an analogy would be, in effect,
23 selling stock in a corporation to operate the entire fault block
24 and the problem there is that the order of comparative magnitude
25 between this operation and the Wilmington Unit that is under
26 study by the State Lands Commission leads us to believe that the
27 disadvantages and the discounts resulting from dividing this
28 smaller area would not justify dividing the area -- whereas, we
29 are considering the possibility of achieving minimization of
30 anti-monopoly allegations by reason of dividing a major field,
31 which the East Wilmington Field is going to be, as distinguished

1 from this smaller operation -- which, as we have already indi-
2 cated, will probably not be with us after 1990 in any event.

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

5 MR. HORTIG: That is correct.

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

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

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

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

25 "Irrespective of whether the final decision is to utilize
26 a pricing basis of 'average posted price' or 'highest
27 posted price,' we urge that the Commission establish a
28 consistent pattern as between this and other tide and
29 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."

30 With the feeling, and I believe the concurrence of the Attorney
31 General's Office, that by approval of this contract the State
Lands Commission is not establishing a precedent and committing

1 itself to use the identical terms in the other operations, this
2 then does not meet the test as suggested by the Shell Oil Company.
3 Through an intensive review of the operation, I believe that we
4 must conclude that it is not feasible to establish at any one
5 time in connection with a particular operation -- and certainly
6 not with respect to the Long Beach Harbor tidelands parcels -- a
7 set of criteria that will be so well controlled as to assure the
8 maximum of benefits and minimum of disadvantages in the operation
9 of this area, which criteria are in turn also at the same time
10 so flexible and so all-embracing as to fit all other leasing and
11 oil contract considerations that may come before the Commission
12 in future, irrespective of their variations in geography, geo-
13 logy and economics.

14 MR. CHAMPION: As a matter of fact, these contracts
15 are governed by a different law than governs the tidelands oper-
16 ated by the State Lands Commission -- these are two different
17 statutes.

18 MR. HORTIG: This is the practical fact.

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

21 MR. CRANSTON: Does the action we take on this contract
22 relate to any action which may be taken in the legislature on
23 the matter of present division of revenues from Long Beach oil
24 fields?

25 MR. GOLDIN: No.

26 MR. CHAMPION: In other words, if there were to be a
27 change in the present fifty-fifty arrangement, that would auto-
28 matically apply regardless of this contract having been awarded.
29 The wording of the contract does not freeze any particular rela-
30 tionship. It is only the Statutes of 1957 that freeze that
31 relationship.

1 MR. GOLDEN: Yes, sir. What I was looking for was a
2 specific provision that we had written into the contract to
3 protect the State in the event of such a revision.

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

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

12 MR. CHAMPION: That would be in terms of an entire
13 revocation -- that the State would act in the City's stead; but
14 if there were only a change by the Legislature in the allocation
15 of the revenues from fifty-fifty, is there a provision on that?
16 I don't think there is any legal question.

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

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

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

29 MR. CRANSTON: We have gone over many questions raised
30 by this contract, but not all of them. I would now like to get
31 into the matter that relates to our time schedule. In order to

1 have the contract ready to go and to have the field continue to
2 be developed as of the time this contract expires, what is the
3 necessary time schedule for approval, sending out notices,
4 awarding the contract?

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

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

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

29 MR. HORTIG: No, but may I plug that in at the point
30 in the time schedule I am about to tell you about? Secondly,
31 and equally important, of course, is the fact that if there is

1 to be a continuity of operations with the high degree of effi-
2 ciency that has been achieved in the Long Beach Harbor Department
3 tidelands, if there is to be a contractor at midnight March 20,
4 1964 who is not one who has previously operated in the area, if
5 he should have such a contractor organization and should be the
6 high bidder as against the present operator -- then in order to
7 have staff training, indoctrination, even the necessary taking of
8 inventories and even finding out where these six hundred wells
9 are located on the ground and where their pipelines go, necessi-
10 tates considerable indoctrination period if there is to be a
11 smooth transition without a drop in efficiency at midnight on
12 March 20th.

13 Therefore, it has been previously suggested as a desir-
14 able minimum for the contract effective March 20th, that the
15 contract should be awarded and the contractor know he is going
16 to have this obligation on March 20th by no later than January
17 2, 1964. This would require a start of the thirty-day charter
18 waiting period no later than December 2nd; and preceding the
19 start of the charter waiting period, before award of a contract
20 pursuant to a bid, there is required in the statutes, in the
21 Public Resources Code, State Lands Commission approval of the
22 bid before the contract can be awarded. This, therefore, to meet
23 this starting date of December 2nd, would have to be before the
24 Lands Commission at the meeting currently scheduled for November
25 21st.

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

31 MR. HORTIG: Yes. Approval is required or no deal --
approval of the Lands Commission.

1 MR. CRANSTON: If it is turned down, to go off the
2 schedule for a minute, we obviously are not going to have time
3 to have a contractor by March 20th.

4 MR. HORTIG: We would not.

5 MR. CRANSTON: What happens if we don't have a con-
6 tractor by March 20th?

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

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

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

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

29 MR. HORTIG: That's correct. Now backing up one step
30 further, if the Harbor Commission staff and State Lands Commis-
31 sion staff are going to have time to do an adequate job of

1 staff evaluation of the bids without being in our interminable
2 crash program and crisis schedule, it would be desirable if at
3 all possible -- it would have been, to have the bids received by
4 November first. That being the case, and again having in mind to
5 give the operator or prospective bidders an adequate opportunity
6 to determine what the bid should be in the light of the contract
7 here being considered, the City should have published notices
8 of intention to receive bids on September 2nd -- which we have
9 already passed. So we are behind schedule now by at least thirty
10 days; and these thirty days are going to have to be made up by
11 shortening wherever we can to save time.

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

15 MR. HORTIG: Yes, sir.

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

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

31 The ultimate argument on this, of course, is that you

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

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

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

14 MR. CHAMPION: If it puts other bidders at a disadvan-
15 tage, don't you end up with an advantage?

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

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

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

30 MR. HORTIG: The Long Beach Oil Development Company,
31 which is a stock corporation. Principal stockholders at the

1 present time are in the approximate percentages of Signal Oil and
2 Gas Company, fifty per cent; Standard Oil Company of California,
3 twenty-five per cent; and the remaining twenty-five per cent
4 scattered, as reported at the last meeting on September 30th.
5 The precise statistics are: Standard Oil of California, 28.5;
6 Signal Oil and Gas Company, 57.0; Humble Oil and Refining Com-
7 pany, 8.5%; the Termo Company, 2%; Macrate (either oil company
8 or as an individual, I am not certain) 2%; and one of the Con-
9 tinental group, 2%.

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

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

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

30 MR. CRANSTON: Perhaps Alan has other questions.

31 MR. SIROTY: I have some questions. Perhaps if I

1 can raise them now, we might be able to work on them between now
2 and three o'clock.

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

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

13 MR. SIEROTY: I know that.

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

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

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

29 MR. SPENCE: I hope not.

30 MR. CHAMPION: If we end up by posing it for you, we
31 will have to discuss what can be done about it; but I think that
discussion might be academic at this time.

1 MR. SMITH: We are now in a position to distribute this
2 package, which we feel does contain adequate information for
3 potential bidders to evaluate our proposal. We have not distri-
4 buted it yet, primarily because we were waiting for an approved
5 form of contract. It is conceivable that a radically changed
6 contract would require additional information, deletion of in-
7 formation, or modification of some of this information.

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

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

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

23 MR. SIEROTY: I have no information as to what time
24 oil companies need to digest this. I think it is an extremely
25 important point. You want to encourage bidders. If there is
26 any possible bidder who would be cut off in his examination and
27 study of this, I think it might be in the interest of the City
28 and State to extend the period of time and perhaps if there is
29 somebody here that would like to speak on that we could get
30 that information. I notice we are thinking in terms of January
31 2nd to March 20th as a period of time in which the new contractor

1 can familiarize himself with the new operation. That seems to me
2 perhaps a little longer than required, and I'd like to see any
3 extra time given to study time.

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

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

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

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

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

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

25 MR. SMITH: I really believe so.

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

28 MR. SMITH: That is correct.

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

30 MR. SIEROTY: I have some other questions.

31 MR. CHAMPION: Well, we are approaching the hour of

1 twelve thirty. We will plan to meet by three o'clock. If there
2 is anyone else who has questions they want to raise or who are
3 going to want to speak on this thing, I'd appreciate if you
4 would let Mr. Hortig or someone on the staff know, so we can
5 apportion the time. We would like to conclude today and hope-
6 fully take action today; and with that expectation I'd like to
7 have anyone who wants to speak to have an opportunity to do it,
8 but I want to get cleaned up and take enough time to do so.

9 We will stand recessed until three o'clock.

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

11
12 MR. CHAMPION: The meeting will please come to order.
13 Mr. Hortig, I know Mr. Sieroty has some questions to raise. Did
14 anyone else register anything further with you with reference to
15 appearing or making statements?

16 MR. HORTIG: No, sir.

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

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

26 MR. SMITH: As I said before, Mr. Sieroty, if it were
27 possible to put this package of information out with the pro-
28 posed contract form, then we would be sure that we would be
29 putting out the correct information they would need to make their
30 analysis. It is available to be put out if the acceptance of
31 the form of contract is going to be delayed for an appreciable

1 period and we would certainly consider putting it out.

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

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

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

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

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

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

24 MR. SIEROTY: All right.

25 MR. RIDINGS: Mr. Sieroty, if I might answer your last
26 question, you said "irrespective of what the Commission does" --
27 A great deal of the information of this book has been tailored to
28 fit the particular type of contract we are discussing here. If
29 there is to be a substantial change in the type of contract, our
30 time will have already been wasted and the time of anybody who
31 has started study along those lines would also have been wasted.

1 MR. SIERTY: I am not sure it will be wanted. I was
2 assuming that there was economic information and petroleum
3 studies, and so forth, that were somewhat different and not
4 dependent on the form of contract.

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

9 MR. SIERTY: Now, the contract provides for a termina-
10 tion clause in the event that the contract is not profitable and
11 notice of that is how many days, Mr. Hortig, do you recall?
12 How many days is it -- one hundred eighty days' notice?

13 MR. HORTIG: I believe its one twenty.

14 MR. SPENCE: One hundred eighty days after the deter-
15 mination has been made.

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

19 MR. SPENCE: Yes.

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

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

31 MR. SIERTY: Well, we are thinking twenty-five years

1 in advance -- twenty years, or fifteen years.

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

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

14 Further, this will not come at a time when the econom-
15 ics of the field are so great as they are now, but under a dif-
16 ferent set of circumstances when the magnitude of the field is
17 substantially less and the problems likewise substantially less.
18 It has been felt to hold a contractor in an unprofitable posi-
19 tion for longer than six months may, as we have considered in so
20 many other cases, require him to hedge in his bid; and these
21 fractional percentages that he might hedge will amount to so many
22 dollars in the earlier years. It is very important to get the
23 highest return for the State and City.

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

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

30 MR. SIEROTY: Paragraph 4 in the Shell Oil Company
31 letter asks about taxes -- a question about severance tax; and

1 I understand this has been informally discussed, and I think it
2 ought to be answered in the record, answering the question raised
3 in paragraph 4.

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

15 MR. SPENCE: The City of Long Beach concurs in that,
16 Mr. Chairman.

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

25 MR. HORTIG: Over one year.

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

1 purchaser under the contract.

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

4 MR. SHAVELSON: That is correct.

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

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

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

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

30 MR. CHAMPION: The State often faces that problem.

31 MR. GOLDIN: Mr. Chairman, to minimize this possibility,

1 is it not practicable to ask that the bid factor be carried out,
2 perhaps, to four decimal points? It will, therefore, minimize
3 the possibility of the precise bid being submitted by multiple
4 entities.

5 MR. CHAMPION: I assume that this is at the option of
6 the bidder, if he would like to do it. I hardly think we can
7 tell them to do it. Is there any objection to anybody submitting
8 a bid in four decimal figures? (No response) I just don't see
9 how we can issue a directive of that kind. That's like saying
10 somebody wants to bid ninety-two per cent, they have to bid
11 92.111 or something.

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

14 MR. HORTIG: Would you read the question, Mr. Sieroty?
15 I don't have a copy of the letter before me.

16 MR. SIEROTY: "How will the contract treat tie bids or
17 several bids that are 100% or better? Can there be more than
18 100% net profits? Will all bids 100% and over be treated as
19 100%?"

20 MR. HORTIG: I believe the answer is the same as pre-
21 viously -- if such bids are received pursuant to particular
22 specifications in the bid offer, the first legal question is go-
23 ing to be that the bids received are responsive to the particular
24 form of bid offer which is to be considered by the Lands Commis-
25 sion here today; and thereafter, the legal question of legal
26 sufficiency of a bid in excess of 100% in the net profits. There
27 is one tenable interpretation -- this is not necessarily legal --
28 that a bid over 100% could be viewed as an offer to pay, in
29 effect, posted price plus a bonus for the oil.

30 MR. SIEROTY: Now, question Number 5 refers to page 32,
31 lines 18 through 23, and this particular clause provides that if

1 the contractor, or one or more of the persons, firms or corpora-
2 tions comprising the contractor, purchases oil from others in the
3 field, the price for the oil taken by any such purchaser under
4 this agreement shall be the higher of either the price as cal-
5 culated above or the price paid by such purchaser to others.

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

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

25 The other side of the coin, as reported on the agenda
26 item this morning with respect to this item, is that inasmuch as
27 there is obviously no certain method by which to forecast what
28 the corporate relationships and the stock relationships of the
29 potential bidders are going to be, and therefore some parties
30 to such an operating contract who might be the successful bidder
31 could conceivably be subject to other purchases by another party

1 on his own account in a manner so as to reflect on the basic con-
2 tract to such a degree of uncertainty and inability to evaluate
3 what the economic hazard of this would be in the future, we feel
4 again constitutes an uncertainty as to the applicable price base
5 and this would again necessitate a discount on the bid offer of any
6 prospective contractor.

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

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

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

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

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

28 MR. HORTIG: Well, the hazard, of course, of the other
29 eighty per cent ownership being subject to the possibility of hav-
30 ing to pay a higher price because the favored nation clause
31 was triggered by someone holding twenty per cent of the stock,

1 would be such an uncertainty as to again discount the bidding
2 and require insurance and no matter what value we select - -
3 if we select twenty per cent, I am almost certain whoever goes
4 out and buys at the higher price will only have nineteen per cent
5 so he doesn't trigger.

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

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

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

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

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

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

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

31 MR. SIEROTY: I don't think there is any question of

1 enforcing it. We will know the composition of the corporations
2 which bid.

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

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

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

23 MR. SIEROTY: I don't think it is an idle act at all.
24 If you want to reduce the percentage of ownership to ten per
25 cent, that's fine. The point is that these oil companies that
26 are going to be a part of the corporation, -- let's take L.B.O.D.--
27 we will know the composition of the corporation, I assume, and
28 then there is no administrative problem, as far as I see. At
29 that point, the corporations, the oil companies which own let's
30 say ten per cent or more of that corporation, would be obliged
31 to report their purchases in the field; and if their purchases

1 are at a higher price than what the State and City are going to
2 be receiving, then the State and City would have the benefit of
3 that higher price. That's the purpose of this suggestion. I
4 don't see it is a problem mechanically or administratively.

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

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

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

20 MR. HORTIG: Mr. Chairman, may I ask an administrative
21 question of Mr. Spence? Jack, would a modification of this mag-
22 nitude, as just suggested, constitute a substantive change suf-
23 ficient to require this contract to be resubmitted to the Harbor
24 Commission and the City Council?

25 MR. SPENCE: No, sir.

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

28 MR. SPENCE: Where is that?

29 MR. SHAVELSON: On page 32, after line 26: "where
30 contractor is a corporation, persons, firms or corporations
31 comprising the contractor shall include any person, firm or

1 corporation buying oil in the Field who owns ten per cent or more
2 of the stock of said contractor."

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

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

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

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

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

22 MR. SIERTY: Now, the question of highest posted
23 price or average posted price doesn't bother me as much as the
24 use of the posted price as a test, because in practice the
25 average posted price and highest posted price have been much the
26 same; but I am concerned with using posted price as the sale
27 gauge and we have had objections to other formulas, such as:
28 "Well, we don't have any other information." All right.
29 Now, one suggestion I'd like to make is that in this paragraph
30 18.3 of page 32, in the same area we were just discussing, that
31 we enlarge the language in line 20 which says "in the Field," to

1 include the other fields that we have been using here for the
2 posted price -- Signal Hill, Inglewood, Huntington Beach. The
3 effect of this would be that if a contractor or if oil companies
4 which are a part of the contractor, whether it is a corporation
5 or syndicate, buys oil at a higher price than, let's say, the
6 average posted price, which is so far our test -- if one of these
7 companies buys oil at a higher price not only in the Wilmington
8 Field, but in the Huntington Beach, Signal Hill and Inglewood
9 Field, then the State and the City would have the benefit of
10 that higher price as the gauge for pricing out the oil under
11 this contract.

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

23 MR. CHAMPION: Does the staff have any comment on this?

24 MR. HORTIG: Yes, Mr. Chairman. The fundamental prob-
25 lem with respect to additional controls in this proposed con-
26 tract form is applicable to this suggestion in terms of provid-
27 ing a greater base against which to determine possibly a slight
28 higher price on the average by, in effect, invoking the most
29 favored nation clause as to all fields and not limiting it to
30 simply the Wilmington Field and the contractor, as it is now
31 stated, carries with it, of course, the problems and the econ-
omic ramifications of all operators operating in these other
fields. Of necessity, therefore, not being able to forecast

1 what their economic requirements and purchase requirements are
2 going to be, field by field, for the next twenty-five years, to
3 insure themselves against, again, being penalized or forced to
4 pay a bonus under this contract because of a higher price paid
5 in another field, is another economic consideration.

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

7 MR. HORTIG: This will undoubtedly discount the bid.

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

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

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

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

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

31 MR. SMITH: Yes. You express my thoughts very well,
Mr. Champion.

1 MR. SIERTY: I have one more suggestion before I
2 quit here and this, I think, is really a basic question again.
3 I would like to see us be able to develop a test of the price of
4 the oil in terms of the price generally prevailing and paid in
5 the field. Now, we have this as a suggestion in the contract,
6 in the event that there is no posting; and I would think that,
7 even if there is posting, that this ought to be used as a test.

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

17 MR. HORTIG: The problems in numerical order are, of
18 course, number one, again a degree of uncertainty would be intro-
19 duced, wherein the successful bidder would never be certain as
20 to when an administrative agency might decide to undertake
21 studies of prevailing market price and necessitate and study
22 that they were at such extreme variance with the posted price
23 base that they should become applicable. This again would take
24 insurance in the bid and, frankly, there is no governmental
25 agency in the United States today that is making studies of this
26 type for application to calculation of either net profits or oil
27 royalties under any existing contract. Establishment of such an
28 agency, it would appear to me, would be necessary; and it cer-
29 tainly should be from an administrative standpoint, I would feel,
30 an independent body -- because patently any determination by the
31 Harbor Commission and/or the Lands Commission as the landlords

1 would invariably be subject to challenge in every instance that
2 the prevailing market price had been set too far up as a matter of
3 obvious economic advantage to the lessor.

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

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

1 MR. HORTIG: And the only indicator existent.

2 MR. SIEROTY: I am not convinced it is a true indica-
3 tion of the market price. This is just a difference of opinion.

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

7 MR. SIEROTY: No.

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

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

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

13 MR. SHAVELSON: Adding a new sentence after the word
14 "contractor," on line 26 of page 32, reading as follows: "Where
15 contractor is a corporation, persons, firms or corporations com-
16 prising the contractor shall include any person, firm or corpora-
17 tion buying oil in the Field who owns ten per cent or more of
18 the stock of said contractor."

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

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

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

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

30 MR. SIEROTY: No.

31 MR. SHAVELSON: That's correct; in other words, the

1 oil taken by him, as if he were a joint bidder. The purpose of
2 this is simply to make the stockholder, put the stockholder in
3 the same position as if we had a joint bidding situation. I
4 think that's all we can accomplish.

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

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

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

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

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

18 MR. CHAMPION: That is right.

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

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

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

31 MR. SHAVELSON: Right. On Line 22, after the word

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

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

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

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

15 MR. CHAMPION: That was included.

16 MR. CRANSTON: Likewise the termination.

17 MR. CHAMPION: No, the termination was not.

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

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

31 MR. SIEROTY: Yes, I think the City and State would

1 probably receive in the long run less revenue as a result of the
2 highest posted price is probably true because of the fact that
3 the difference is so negligible in practice, whereas the fear
4 of the bidders, apparently, is rather substantial as to the
5 chances of somebody coming in and trying to put in a phony high
6 price; t-at the bid would be substantially less and in the long
7 run the amount of money the City and State would receive would
8 probably be less.

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

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

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

29 MR. CHAMPION: I'll second that motion; and I would
30 like to add only that because we do feel the pressure of the
31 time situation does not mean, at least for me personally, that

1 I do not think that we have examined every single question that
2 has been presented, looked at every piece of evidence or question
3 that anybody has wanted to present to this Board. I am satis-
4 fied, not only that we ought to act now, but that we are acting
5 on a proper instrument on which to act and I would not like to
6 have the inference so far as our action that because we do point
7 out this need for haste -- we do that out of deference to the
8 fact that a number of legislators wanted more time to look at
9 it -- we do not, at least I myself, do not believe that this
10 Commission needs more time for judgment. We cannot defer to
11 those who have asked for this delay because of the time situa-
12 tion; but as for me personally, I don't think any more time is
13 required. We have made an adequate and exhaustive inquiry into
14 all the points that have been made.

15 That was a second.

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

19 MR. CRANSTON: Aye.

20 MR. CHAMPION: Aye. Adopted unanimously.

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

25 MR. CHAMPION: The meeting is adjourned.

26
27 ADJOURNED 4:15 P.M.
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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 [redacted] in the meeting of the State Lands Commission held at Sacramento, California, on October 10, 1963.

Dated: Sacramento, California, October 12, 1963.

Louise H. Lillico

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

4 Dear Sir:

5 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, III, IV and V) was discussed, the Chairman requested comments and suggestions by interested petroleum industry parties.

6 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 true 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 Tidelands Parcels during a stated period, the governmental bodies could be certain that they were receiving the highest obtainable price.

7 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 Tidelands 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.

8 One advantage to the State and City under such an arrangement would be that the Tidelands 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.

9 We consider the above arrangement to be the most advantageous possible to the State and City, both from the

1 standpoint of assuring the highest fair price for the oil and
2 most competent and economical operation of the Tideland proper-
3 ties, and respectfully suggest that it be considered by the
4 Commission.

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

9 Very truly yours,

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

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

13 *****

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

17 Gentlemen:

18 The State Lands Commission, at its last meeting on
19 September 30, 1963, requested comments on the last draft sub-
20 mitted on captioned matter.

21 We received the revised draft on Wednesday, October 2,
22 1963, for which we wish to publically acknowledge. We also re-
23 ceived a copy of transcript of the September 30th meeting on
24 Friday, October 4, 1963. We wish to make some comments on the
25 contract.

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

29 "(c) CONTINUING PURCHASERS shall mean purchasers who
30 have, during each of the preceding twelve (12) calendar
31 months, purchased an average of at least one thousand
32 (1,000) barrels of oil per day in the Field. "In the
33 absence of information to the contrary it shall be
34 deemed that every purchaser posting prices in the
35 Field is such a Continuing Purchaser."

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

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

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

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

45 We wish to submit that the contract, as written, does not re-
46 quire a company to purchase "at least a thousand (1,000) barrels
47 of oil per day." As written, a company could buy thirty thousand

1 (30,000) barrels of oil on April 30th, thirty-one thousand
2 (31,000) barrels of oil on May 1st and thirty thousand (30,000)
3 barrels on June 30th etc. and satisfy the definition in the con-
4 tract, since they would have averaged at least one thousand
5 (1,000) barrels of oil per day. If the contract is supposed to
6 require the purchase of at least one thousand (1,000) barrels of
7 oil per day, as assumed, then it should be made to so read. As
8 it now stands, a company would have to buy three hundred and
9 sixty-five thousand (365,000) barrels of oil over a yearly period.
10 This could be done buying thirty or thirty-one thousand barrels
11 of oil, one day each month. We do not think this is a proper
12 definition.

13 We also wondered why it was necessary to make it an average of
14 one thousand (1,000) barrels of oil per day when the September
15 30th transcript indicated that Richfield is buying, and has
16 purchased in the past, large amounts of crude. I suppose it is
17 because they do not go through the ritual of posting. There-
18 fore, a twenty thousand (20,000) barrel of oil per day purchasdr
19 is disqualified in helping determine the value of crude under
20 this contract, unless and until they post. We recommend that
21 the Commission determine how many other continuing purchasers
22 there are in area that do not post prices.

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

28 The sentence to be stricken reads as follows, which is line 10,
29 through 13, page 6 of the draft of the contract:

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

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

37 Reference is made to the transcript of September 30th, where
38 one company states that it has bought large quantities of oil in
39 the past and is presently purchasing about twenty thousand
40 (20,000) barrels a day. Since they do not POST their price could
41 not be considered. How many other large purchasers in the field
42 actually buy but do not post? The State can no longer permit
43 its compensation to be determined by only those companies who
44 go through the ritual of posting.

45 In 1955, after the Legislature passed the Tidelands Bill, the
46 State Lands Commission adopted the policy of requiring the
47 highest price for its oil. It is still following that policy
48 on Tidelands leases. It must continue to have one price
49 formula for all Tidelands oil or be a party to chilling bids
50 and eliminating competition. The State must insist on the
51 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.

1 3. It is recommended that the terms "unprofitable" be defined
2 in Section 4, page 16, and 17 of the contract. The transcript of
3 September 30th indicated that no one seems to know what it means.
4 How can a bidder bid on a contract when the people who wrote the
5 contract do not know what they meant when the term was put in
6 the contract? This is a very serious problem, since some company
7 may bid an extremely high "net profits" bid. It might be argued
8 that it was "unprofitable" from its inception.

9 4. How will the contract treat tie bids or several bids that are
10 100% or better? Can there be more than 100% net profits? Will
11 all bids 100% and over be treated as 100%?

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

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

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

30 6. We have previously made ourselves abundantly clear on our ob-
31 jection 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.

32 7. Reference is made to Section 18.2, page 30 and 31 of the
33 contract, regarding the 12 1/2% of oil the City may take in kind.
34 In reading the transcript we gather that the City would be re-
35 quired 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 7/8 of the oil? It is difficult
for me to understand how an ordinance, charter or statutory pro-
vision applies only to the 12 1/2% and not to the balance. Certain-
ly the intent of the people is clear in requiring highest price
for public property.

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

40 8. We strongly recommend that the State Lands Commission
41 approve the award of the highest bid and signify same by execut-
ing the document. The document, as now written, does not pro-
vide 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.

1 There are many other points which we could raise
2 concerning the documents. We will not take up your time with
3 them until the major issues raised by this letter are dispensed
4 with by the Commission and the documents rewritten.

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

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

9 *****

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

12 Dear Sir:

13 In connection with your pending consideration of the
14 terms under which the subject parcel is being offered, we re-
15 quest that consideration be given to the following matters:

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

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

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

 3. We suggest that Sections 5.2 and 26 of the pro-
posed 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 subsid-
ence 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) re-
tained 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.

1 5. We assume that the specifics of any collateral
2 agreements between the City and/or Harbor Board and the State
3 Lands Commission will be made known to all interested companies
4 prior to the time the contract is formally offered for bidding.

5 Yours very truly,

6 SHELL OIL COMPANY

7 /s/ D. E. Clark, Manager
8 Lands Department

9 Copies to F.J.Hortig, and M.D.Hughes, Long Beach Harbor Dept.
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