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TRANSCRIPT OF
MEETING OF THE
STATE LANDS COMMISSION

MAY 13, 1957 - - 10:00 A.M.

PRESENT:

THE COMMISSION:

Messrs. John M. Peirce, Chairman
Harold J. Powers
Robert C. Kirkwood

STATE LANDS DIVISION:

Messrs. Rufus W. Putnam, Executive Officer
F. J. Hortig, Assistant Executive Officer
Kenneth C. Smith, Supervising Land Title Abstractor
Edward Werner, Assoc. Real Property Appraiser
and Negctiator
A. W. Pfeil, Mineral Resources Engineer
Mrs. Julia T. Stahl, Secretary
Miss Constance Castruccio, Jr. Legal Counsel

OFFICE OF THE ATTORNEY GENERAL:

Mr.J.L. Shavelson, Deputy Attorney General

APPEARANCES:

SENATOR JOHN J. HOLLISTER, JR.
ASSEMBLYMEN JAMES L. HOLMES, ALLEN MILLER and JOSEPH C. SHELL

RE: LONG BEACH

Mr. Harold A. Lingle
Mr. Philip J. Brady

RE: LEGISLATION AB 47, 2237, 3869

Mr. E. E. Pyles, Vice President, Monterey Oil Company

RE: SANTA BARBARA ANNEXATION

Mayor John T. Rickard
Mr. Milton L. Duncan, Summerland
Mr. Oren D. Sexton, Hope Ranch

REPORTER: Louise H. Lillico
Division of Administrative
Procedure

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1 MR. PEIRCE: The meeting will come to order. Colonel
 2 Putnam will proceed with the agenda. We will take up cer-
 3 tain routine items first and then when Governor Powers
 4 arrives we will return to the other items in the agenda.

5 MR. KIRKWOOD: The minutes look all right.

6 MR. PEIRCE: I looked over the minutes. They appear
 7 to be in order. All right, Mr. Kirkwood?

8 MR. KIRKWOOD: M-m-mh.

9 MR. PEIRCE: The minutes will stand approved as written.

10 MR. PUTNAM: And for the information of the Commission,
 11 we found some mistakes in the minutes of January - No. 17 ...

12 MR. KIRKWOOD: Have they been corrected?

13 MR. PUTNAM: We will pick that up later. It is an item
 14 in here. As to the next Commission meeting, again before
 15 the 15th of June, isn't that right, Long Beach?

16 VOICE: Fine.

17 MR. PUTNAM: Shall we pick your secretary?

18 MR. PEIRCE: She will contact the others and pick out
 19 a date?

20 MR. KIRKWOOD: It will be rough up to the 12th, I imagine.

21 MR. PUTNAM: Now, Ken, is Mr. Stonier here?

22 MR. SMITH: Not yet.

23 MR. PUTNAM: Then we better pass to Item 7 on page 2.

24 MR. PEIRCE: All right - Page 2.

25 MR. PUTNAM: Frank?

26 MR. HORTIG: Mr. Groshong has applied for a lease on

1 submerged lands in the Sacramento River for maintenance
 2 of a small wharf, used commercially for serving food,
 3 drinks, and servicing and renting boats, and in lieu of
 4 furnishing a performance bond it has been determined that
 5 equitably instead of the normal \$100 rental accompanied
 6 by a surety bond for a thousand dollars -- since Mr.
 7 Groshong is unable to obtain such a bond except at an exor-
 8 bitant premium -- it is recommended that there be a rental
 9 of \$150 annually and the requirement of the surety bond
 10 be eliminated.

11 MR. PEIRCE: Would that establish a precedent?

12 MR. HORTIG: No, sir.

13 MR. PUTNAM: We have done that three or four times
 14 in the last eight or nine years.

15 MR. HORTIG: An individual doing business individually
 16 has a difficulty in obtaining a surety bond for a long time
 17 as normally required in this type of lease.

18 MR. KIRKWOOD: I guess it is all right.

19 MR. PEIRCE: O. K. with you?

20 MR. KIRKWOOD: Yes.

21 MR. PEIRCE: All right, the recommendation is approved.

22 MR. SMITH: Page 3, Colonel.

23 MR. PUTNAM: A slight interlude -- I want to present
 24 to the Commission our Junior Counsel, Miss Constance
 25 Castruccio.

26 MR. PEIRCE: We are pleased to have you. You are an

1 attorney?

2 MISS CASTRUCCIO: That's correct.

3 MR. PEIRCE: That's fine. You will give the deputy
4 attornies general a little competition. It is nice to have
5 you on our staff and we are very glad to have you here today.

6 MR. PUTNAM: I thought it would be well for her to
7 sit in.

8 (At this point Lt. Gov. Powers arrived)

9 MR. PEIRCE: We just took up page 2, a routine item.
10 Now, perhaps we had better get back

11 MR. PUTNAM: I am just wondering if we have got the
12 representation of Santa Barbara County here complete.

13 MR. KIRKWOOD: Is the Senator coming up?

14 MR. PEIRCE: Perhaps we had better wait until he
15 arrives. Also, it may be that Mr. Thomas will be here.

16 MR. PUTNAM: What I was thinking of was that I wouldn't
17 want to present these things unless we had as many people
18 here as we thought would be coming.

19 MR. PEIRCE: All right.

20 MR. PUTNAM: Mr. Stonier is not yere yet?

21 MR. SMITH: No sir.

22 MR. PUTNAM: May I also present our new Mineral
23 Resources Engineer, Mr. Pfeil.

24 MR. PEIRCE: How do you do, Mr. Pfeil. Glad to have
25 you with us also.

26 MR. PUTNAM: O. K. Will you proceed, Jack?

1 (Assemblyman Holmes arrived)

2 MR. PEIRCE: Good morning, Mr. Holmes. Mr. Holmes,
3 we are waiting for a few minutes before we take up the Santa
4 Barbara annexation because there are interested persons who
5 are not here yet.

6 MR. PFEIL: Prospecting Permit P.R.C. 1509.2 covering
7 the NW $\frac{1}{4}$ of

8 MR. PUTNAM: I think I can present this right offhand
9 because I talked to you about that, Mr. Peirce? This was
10 a prospecting permit of Herman Akers and Harold Eade in San
11 Benito County, P.R.C. 1509.2, where they have proceeded for
12 quite some time under prospecting permit and then applied
13 for a development

14 MR. HORTIG: Preferential mineral lease ...

15 MR. PUTNAM: .. preferential mineral lease. Our
16 office made an investigation last June to see whether or not
17 the requirements of the preferential mineral lease were being
18 met -- and those requirements have to do with the amount of
19 production and how commercially valuable it is. Our inspector
20 reported back to our office that it would not qualify for
21 one of these preferential leases. We failed, as I told you,
22 to notify the prospecting permittee. Then we got to the
23 deadline of the expiration of the prospecting permit -- and
24 I have had authority conferred upon me by the Commission to
25 extend these things for another year. I did; but I would
26 like confirmation of it because the thing is

1 MR. PEIRCE: This is the instance where Attorney Charles
2 Gilmore interceded in behalf of his clients and you admitted
3 a mistake had been made in the past, so this confirmation
4 is in order ...

5 MR. PUTNAM: That's right.

6 MR. PEIRCE: I certainly would approve it.

7 MR. KIRKWOOD: Nobody can object to it.

8 MR. POWERS: That's all right.

9 MR. HORTIG: It is authorized ..

10 MR. PEIRCE: It has been moved and seconded that the
11 recommendation be approved, so will be the order.

12 MR. PUTNAM: Page 2.

13 MR. HORTIG: Page 2 is covered.

14 MR. PUTNAM: How about Long Beach? How about you
15 people? How soon do you want to get away? Frank, can you
16 dig up Long Beach? I think that's Jack's.

17 MR. PFEIL: There's one on 83, Supplemental Item 23.

18 MR. PEIRCE: What page?

19 MR. HORTIG: Page 83.

20 MR. PFEIL: The City of Long Beach has requested, in
21 the interest of greater clarity, that the words "the cost of
22 said subsidence remedial work" be included in the approval
23 in reference to the nature of the full amount of \$959,530
24 authorized on January 10. In the opinion of the office of
25 the Attorney General, the proposed modification of the wording
26 clarifies the evident meaning of the resolution and does not

1 constitute a modification of the former action. It is
2 recommended that the Commission authorize revision of the
3 resolution of January 10, 1957, Minute Item 17, to read:

4 "THE COMMISSION APPROVES THE COSTS PROPOSED TO BE
5 EXPENDED BY THE CITY OF LONG BEACH, INCLUDING
6 SUBSIDENCE REMEDIAL WORK UNDER PROJECT L.B. W.O.
7 10,005, BETWEEN JANUARY 1, 1957 AND JUNE 30, 1957,
8 THE COST OF SAID SUBSIDENCE REMEDIAL WORK NOT TO
9 EXCEED \$959,530; SUBJECT TO THE CONDITIONS, HOWE VER,
10 THAT THE AMOUNTS, IF ANY, OF EACH OF THE ITEMS TO BE
11 ALLOWED ULTIMATELY AS SUBSIDENCE COSTS, DEDUCTIBLE "

12 MR. KIRKWOOD: I vote the approval of the recommendation.
13 It's just the addition of that language.

14 MR. PFEIL: Yes, sir.

15 MR. LINGLE: We might interrupt a minute on this. We
16 appreciate very much having this particular correction.
17 There's only one other point, one question solely in the
18 interest of accuracy. The original records refer to an
19 attachment and on the attachment there was an inadvertence.
20 There were two items that indicated that we had gone ahead
21 and did some work prior to Commission approval; and we had
22 discussed that and I think the staff agrees that we have.
23 It is one of these items where part of the work was done in
24 one month, part in another month, and in carrying it forward ...
25 The City did not do any work without prior Commission approval.

26 MR. PEIRCE: It has been moved and seconded that the
27 motion be approved and so will be the order. (Moved by Mr.
28 Kirkwood, seconded by Mr. Powers.)

29 MR. PFEIL: Supplemental Item 24, Page 84. Considera-
30 tion of Subsidence Costs. On April 8, 1957 (Minute Item 7,

1 page 3047), The Commission approved the costs proposed to
 2 be expended by the City of Long Beach, including subsidence
 3 remedial work, during April 1957 and estimated expenditures
 4 in the first portion of May 1957 for payrolls and similar
 5 items.

6 The same elements of subsidence costs expenditures
 7 which are to be paid during May 1957, accountable under sub-
 8 sidence costs not included in projects approved heretofore
 9 by the Commission, will require approval by the Commission
 10 if credit is to be received by the City of Long Beach for
 11 such costs under the provisions of Section 5(a), Chapter 29,
 12 Statutes of 1956, 1st E.S. The staff of the Lands Commission
 13 has reviewed statements by the City of Long Beach with respect
 14 to expenditures made during May 1957. These amounts are tabu-
 15 lated in Exhibit "A" attached hereto. From a review with the
 16 office of the Attorney General relative to costs proposed to
 17 be expended in the amount of \$410,000 to cover costs of
 18 property acquisition, final item in Exhibit "A", it has been
 19 concluded that the estimates of the subsidence element in
 20 this item should be withheld and that no current approval
 21 should be given to further withholding of funds for property
 22 purchases. The amounts previously withheld by the City of
 23 Long Beach as subsidence deductions may substantially exceed
 24 the amounts which will be ultimately allowed. Since Chapter
 25 29 makes no provision for interest on the amounts returned
 26 to the State because of the excessive estimates of subsidence

1 costs, such estimates should approximate as closely as
 2 possible the amounts ultimately to be allowed. Pending an
 3 administrative solution of this problem with the City of
 4 Long Beach, it is suggested there be no current approval
 5 for tentative subsidence deductions, to prevent swelling
 6 the amounts already held. The City is, nevertheless,
 7 entitled to prior Commission approval of expenditures so as
 8 to preserve its right to subsidence deductions to the extent
 9 they are found to be legally allowable. In addition, the
 10 Long Beach Harbor Department has requested prior approval by
 11 the Commission of the amount of \$50,000 estimated to be
 12 spent during the month of June 1957 for payroll force account
 13 and voucher payments other than construction. The subsidence
 14 portion of this amount is estimated by the Harbor Department
 15 to be 89%.

16 MR. PEIRCE: Any comments from Long Beach with respect
 17 to this recommendation?

18 MR. LINGLE: We have discussed it extensively - -
 19 Mr. Shavelson and members of our office. We are not in
 20 accord. We believe that all of it ultimately would be allowed
 21 as subsidence. However, as there is the suggestion that we
 22 can get together and talk this thing over before your next
 23 meeting, we want to retain our right, that we don't agree.
 24 We believe that it isn't our idea to buy these lands as
 25 something we wish to buy. We feel we have to buy them to
 26 protect ourselves and because of that, that they are subsidence.

1 The other, our main objection, is this: That we received
 2 notice as of last Monday and they gave us very short order
 3 in time to act because we had contracts where we had agreed
 4 to purchase some of these properties and we didn't know
 5 where we were and how we could efficiently plan our budget.
 6 I realize Mr. Shavelson's position exactly, but we wish to
 7 maintain our position that we are entitled to these costs
 8 and the other point was that we would like to get it ironed
 9 out as rapidly as possible because we had planned in making
 10 these expenditures of \$410,000 and Monday we were told we
 11 would not be permitted to make the expenditures; and there
 12 were some contracts where we are in the position where we
 13 would have had to pay the money whether we got State approval
 14 or not because we would be liable to damages and there was
 15 no possible way to back out of the thing until we could get
 16 your approval on it. So we would like to get together so
 17 we can talk the thing over and plan efficiently what we
 18 can do.

19 MR. PUTNAM: Our suggestion is that we continue to
 20 work this out as rapidly as possible. On someother item -
 21 water pressurization - we haven't been able to come to the
 22 complete engineering review that we wanted, so it might be
 23 necessary for us to request a special meeting of the Com-
 24 mission -- I mean an interim meeting, around about the 25th
 25 of May, to take care of this item, which is a toughy for
 26 Long Beach, and this other one, water pressurization.

1 MR. PEIRCE: Is there any reason why we shouldn't
2 proceed to adopt this recommendation at this time?

3 MR. PUTNAM: No, because we have separated it, as I
4 take it, the particular matter of purchase of property.
5 That's right.

6 MR. HORTIG: The only thing that is to be suggested
7 is that the City not withhold moneys but to go ahead and
8 make the expenditures; whether they get them returned will
9 be dependent on the solution in the future.

10 MR. SHAVELSON: I just wondered if the reason for this
11 has been made clear as yet. In other words, we were --
12 the Attorney General was surprised that these lands that
13 were being purchased do have a definite value for purposes
14 other than subsidence. They are purchased for the purpose
15 of tentative subsidence but once purchased they do have a
16 value. We were also told that the final evaluation of these
17 lands couldn't be made in some cases for a period of one or
18 two years, and that is the reason why we acted in this manner.
19 We feel the State is entitled to credit for the value of
20 these lands for purposes other than subsidence. That's why
21 the allowances, although they should get prior approval,
22 may on final engineering review and audit -- they may not be
23 given 100% deduction and for that reason we don't want the
24 amounts withheld to greatly exceed the amounts that are
25 going to be ultimately allowed.

26 MR. PEIRCE: Any further discussion?

1 MR. KIRKWOOD: Move the recommendation.

2 MR. FOWERS: I second.

3 MR. PEIRCE: Mr. Kirkwood moves, Governor Powers seconds
4 the motion that the recommendation be approved. So will be
5 the order.

6 MR. BRADY: May I interrupt for a moment? My Name is
7 Brady -- I am from Long Beach. With reference to the water
8 amendment, is it my understanding that a recommendation will
9 be in order on May 20th and formal action will be taken?

10 MR. HORTIG: We don't know but we hope action will
11 be taken. There is one thing I did want to clear up in the
12 supplemental report. I think it was very fairly written
13 except for one possible misconception. While we feel
14 that the amendment will ameliorate or alleviate subsidence
15 conditions, the amendment under its terms and conditions
16 can legally only be drawn as a secondary recovery measure.

17 MR. KIRKWOOD: What are we talking about?

18 MR. HORTIG: We haven't covered this item which Mr.
19 Brady is speaking of.

20 MR. PUTNAM: We have an item coming up.

21 MR. HORTIG: Page 80.

22 MR. PUTNAM: Gentlemen, if you want to cover that
23 right now

24 MR. KIRKWOOD: We might as well cover all of Long Beach.

25 MR. PFEIL: On February 19, 1957, in compliance with
26 Section 10, Chapter 29, Statutes of California 1956, the

1 Long Beach Harbor Commission submitted for approval by the
2 State Lands Commission an agreement amending each of the
3 six existing drilling and operating contracts between the
4 Harbor Commission of the City of Long Beach and the Long
5 Beach Oil Development Company. The proposed amendment pro-
6 vided for an expanded water flood operation for the purpose
7 of developing data relative to alleviating subsidence. The
8 proposed operation will provide valuable data relative to
9 the effect of water injection as a remedial measure in sub-
10 sidence. As a secondary recovery measure, water injection
11 into the aquifer sands will materially increase the ultimate
12 recovery of oil from the reservoir. The proposed amendment
13 is currently being reviewed by the office of the Attorney
14 General as to legal compliance with Chapter 29, 1956, 1st
15 Executive Session, and by the staff as to engineering
16 feasibility.

17 MR. PUTNAM: That was the item that was also pulled
18 into this and we hope to have some answers on this toward
19 the end of the month and probably request a special meeting,
20 an emergency meeting of the Commission, to take care of
21 this item and the other.

22 MR. PEIRCE: Is there any further discussion? Do you
23 have anything further to say, Mr. Brady?

24 MR. BRADY: My only point in discussing the matter was
25 this -- it was the opinion of the City of Long Beach that
26 under the drilling and operating contracts with the Long

1 Beach Oil Development Company this amendment could only be
 2 entered into as a secondary recovery measure and that while
 3 everybody is very optimistic about the outcome and ameliorat-
 4 ing the subsidence condition, the amendment as drafted is
 5 drafted as a secondary recovery proposal.

6 MR. KIRKWOOD: What does that mean, that Long Beach
 7 expects to pick up the whole tab?

8 MR. BRADY: No sir, under the provisions of our operat-
 9 ing contract, we can only reimburse the Long Beach Develop-
 10 ment Company for those costs incurred in the production of
 11 oil in field practice. We felt that it would have to prove
 12 itself as good field practice in conjunction with the extrac-
 13 tion of oil rather than a poor subsidence measure as long
 14 as Long Beach Development Company and Richfield are involved.
 15 They are in the oil business, not in an attempt to ameliorate
 16 our problem. We hope that any increased oil recovery for
 17 the city and State will aid us in fighting the subsidence
 18 problem.

19 MR. PUTNAM: Mr. Chairman, this may be redundant, but
 20 under the terms of Chapter 29 of 1956, which govern the
 21 State Lands Commission's activities with respect to the City
 22 of Long Beach, any amendments to their existing contracts
 23 or any new contracts, as I understand it, must be presented
 24 to you for your action and that is what is involved here,
 25 because they are amendments to those contracts.

26 MR. PEIRCE: These amendments are in accordance with
 existing law?

1 MR. HORTIG: That's the question under study.

2 MR. PEIRCE: How does this tie into legislation
3 pending before the Legislature dealing with this same
4 question?

5 MR. HORTIG: Not directly, sir. It's a phase of
6 operations rather than a phase of any new legislation cur-
7 rently under consideration.

8 MR. PEIRCE: Well, that is for our information -- no
9 action is called for at this time?

10 MR. PUTNAM: That's it.

11 MR. KIRKWOOD: Is that all on Long Beach?

12 MR. HORTIG: I believe so.

13 MR. PEIRCE: Gentlemen from Long Beach, you are welcome
14 to remain but if you have other business we are through with
15 your section of the calendar.

16 MR. PUTNAM: Santa Barbara ready?

17 MR. PEIRCE: Senator Hollister is not here. Mr. Thomas
18 is not here. Mr. Holmes, is it your opinion that Senator
19 Hollister desires to be present when we discuss this matter?

20 ASSEMBLYMAN HOLMES: I haven't talked with Senator
21 Hollister on this. I didn't even know I was going to be
22 here. I have a lull before some bills come up this morning
23 and I am just sitting in.

24 MR. PEIRCE: What item do you suggest?

25 MR. HORTIG: Page 81, Item 22.

26 MR. PEIRCE: I would like to announce the presence of

1 Assemblyman Allen Miller and Assemblyman Joseph Shell. We
2 are pleased to have you here and hope that you will feel
3 free to participate in our discussion this morning. Shall
4 we hear from Mr. Pyles first?

5 MR. HORTIG: Probably in connection with this item
6 it would be appropriate.

7 MR. PEIRCE: All right. You give the background
8 information and then we will have Mr. Pyles.

9 MR. HORTIG: Seems logical. As you gentlemen already
10 know, at least partially, AB 47 - Mr. Miller, 2237 - Mr.
11 Shell, and 3869 - Mr. Allen (of which amended copies are
12 attached to your calendar following your last page) were
13 considered in the Assembly Committee on Manufacturing, Oil
14 and Mining Industry on April 16 and 23, 1957. The bills were
15 heard in Committee and Mr. Miller's bill and Mr. Shell's
16 bill were withdrawn on April 29 from the Committee. On the
17 following day, the Committee also passed, with no recommenda-
18 tion, Mr. Allen's bill. The three bills were heard on May 7
19 on special order and all were passed to the Senate and went
20 through by the votes indicated. The comparative effect of
21 these bills is summarized on the following tabulation. All
22 three bills are essentially in agreement on all factors except
23 one, which I can call your attention to -- except two, I
24 should say. The Miller bill and the Allen bill establish a
25 16-2/3% minimum oil royalty plus a mandatory sliding scale.
26 The Shell bill has 16-2/3% minimum and optional slide; and

1 item (e) in the Miller and Allen bills is identical, which
2 feature is not included in the Shell bill. Other than that,
3 there are no differences in proposed amendment to the act
4 under any of the three bills.

5 MR. PEIRCE: Now, before we continue to discuss this
6 matter further, we have with us Mr. E. E. Pyles, Vice Presi-
7 dent of the Monterey Oil Company, who has expressed a desire
8 to address the Commission; and, if I understand correctly,
9 his statement will supply us with background information of
10 the company's experience in exploring a lease granted to
11 his company at Huntington Beach.

12 MR. KIRKWOOD: Before we go into that, might I just
13 ask this of the staff? As I understand it, these three
14 bills, together with a bill of Mr. Cunningham, No. 795,
15 amended on May 10 and making, as I understand it, really
16 the only change from $12\frac{1}{2}$ to $16-2/3\%$ -- all bills are to be
17 heard by a Senate subcommittee tonight.

18 MR. HORTIG: Yes sir. As to the first three, they are
19 on file. I have assumed, as you have there, that Senator
20 Cunningham's bill will be included, although it is not in
21 the written record.

22 MR. PEIRCE: Mr. Pyles.

23 MR. PYLES: I have a copy for the Commission of my
24 statement. Mr. Chairman, with your permission I ask that I
25 may be seated at the table to present this.

26 MR. PEIRCE: Surely.

1 MR. PYLES: Gentlemen, I appreciate very much the
2 opportunity of appearing before this Commission because I
3 believe that I am in possession of certain facts that are
4 highly relevant to any discussion of royalty rates on leases
5 covering tide and submerged lands. I expect to emphasize
6 and support the contentions of some other operators with
7 some startling figures that I might say have (sic)* been
8 arrived at by deduction, but which are the result of actual
9 experience over the past two years on two State leases,
10 P.R.C. 1549 and P.R.C. 1550. These leases, as I am sure
11 you gentlemen know, lie off shore between Newport Beach and
12 Huntington Beach. Seaboard Oil Company, Humble Oil and
13 Refining Company, and Monterey Oil Company are associated
14 in this joint leasing venture, with Monterey Oil Company
15 being named as operators.

16 Before these leases were obtained, Humble and Monterey
17 had made a discovery on adjoining tide and submerged lands
18 held under contract with the City of Newport Beach and had
19 successfully completed some six or seven wells. The sub-
20 surface information developed during this drilling program
21 was amplified by offshore geophysical and subsea geological
22 surveys on both the underwater land parcels mentioned. On
23 the basis of these combined data, there was good reason to
24 believe that a producing structure underlay the leases. The
25 three companies that were party to the enterprise were in
26 entire accord on this and a request was, therefore, made to

1 the Lands Commission to put the two leases up for bid. Prior
2 to this time and at considerable expense, these companies
3 acquired a number of upland properties including subsurface
4 rights from Willow Land and Water Company, Pacific Electric
5 Railway Company and Mills Land and Water Company. These
6 were required in order to assure on-shore sites for direc-
7 tional drilling operations should we prove to be the success-
8 ful bidder on the two leases.

9 Following all this exploratory work and careful
10 planning, the two parcels were put up for bid and the three
11 companies - Seaboard, Humble and Monterey - being high
12 bidders, the successful bids were \$3,333,000 some odd dollars
13 for Parcel 1549 and \$1,333,000 for Parcel 1550. Almost
14 immediately, from the beginning of the granting of the
15 leases, Monterey as operator began drilling from upland
16 locations on P.R.C. 1549, the parcel nearest to the shore.
17 Four wells were drilled directionally to depths between
18 eight and ten thousand feet bottomed on the lease, but they
19 were all bone dry. Because of this ill fortune, the Com-
20 mission granted an extension of time to permit the lessees
21 to procure the special construction of and bring a drilling
22 platform around from the Gulf Coast. This was for the pur-
23 pose of drilling P.R.C. 1550, which lies more than a mile
24 from shore and along the westerly edge of 1549. After the
25 arrival of the platform, core holes were drilled on property
26 covered by this lease, also to depths of eight to ten thousand
feet, but these, too, were entirely unproductive.

1 Now, the cost of this operation was as follows:

2 Lease acquisition\$4,780,501
3 Geophysical and subsea
4 geological expense 45,501
5 Rentals 89,622
6 Drilling costs 1,779,205
7 Making a total of\$6,694,829

8 This I said simply to show that here we have three well-
9 established oil companies, having available in their own
10 ranks highly qualified geo-scientific personnel, equipped
11 with the most modern exploration instruments and know-how.
12 Amplifying the findings of these and agreeing with their
13 conclusions were independent geologists and geophysicists
14 of wide experience and excellent repute. That, I am sure
15 you will agree, was justification for something more than
16 mere hope. Coupled with the successfully completed wells
17 drilled by Monterey and Humble on immediately adjoining
18 Newport Beach property, it amounted almost to proof that
19 the lease would produce -- but it didn't.

20 It seems to me the Commission should take cognizance
21 of these facts and weigh them carefully. They constitute
22 irrefutable proof of the tremendous financial risk that is
23 involved in the search for offshore reservoirs, a risk that
24 is greatly enlarged by the inherent difficulty and increased
25 costs of almost every phase of submerged exploration and
26 drilling. It constitutes proof also that even those properties
which the most accurate and complete surveys indicate to be

1 the likely repository of oil can still be sore disappoint-
2 ments production-wise.

3 I would like to point out here, by the way, that the
4 State of California is well protected against improper
5 royalty provisions in its offshore oil leases by the Cun-
6 ningham-Shell Act. The act permits the leasing of alternate
7 blocks only and the retention of the unleased portions until
8 leased portions have been drilled. If production is devel-
9 oped in any one section, there are, of course, four con-
10 tiguous sections that can be leased at higher royalties for
11 the benefit of the State.

12 Finally, I feel it is necessary to accentuate three
13 important conclusions that are justified by the foregoing
14 facts:

15 1) The financial risk and, in fact, all other types
16 of risk involved in offshore operations are so much greater
17 than any normal upland operations, that the two processes
18 are quite unrelated. One should not, therefore, under any
19 circumstances be used to set a pattern for the other.

20 Now, at this point

21 I spent some time yesterday, I have a few figures here
22 on a piece of paper that I think will substantiate what I
23 have set forth in paragraph 1, for the purpose of making a
24 comparison of on-shore and offshore. These are actual and
25 factual. First, take the matter of transportation of per-
26 sonnel, which we call water taxis, and at the most favorable

1 location I think you can have all up and down the coast of
2 California that one item cost a little over \$6,000 a month,
3 just to transport the personnel that work from the end of
4 the pier at Seal Beach to the island, which is less than a
5 mile. Now, if you multiply that by 10 or 20, which all of
6 our oil fields in California have a life of that nature,
7 you get into a figure of a million and a half dollars for
8 an item that does not cost you a penny on shore.

9 Now, mud costs -- To drill a comparable well on shore,
10 the cost of the mud and the transportation of the mud to
11 disposal dumps on shore costs about \$6,000 per well. Off-
12 shore they have been costing about \$18,000 per well.

13 The four holes drilled on P.R.C. 1550 --- I asked our
14 manager of operations if we were going to drill four core
15 holes on shore in the immediate area of 1550 and we would
16 contract for the same identical machinery to drill them on
17 a daily basis -- which we certainly could get 'em on a con-
18 tract basis at less price, but operations out in the water
19 are not on a footage basis because there is not enough
20 experience for it and it must be on a daily basis -- to
21 drill on shore it would cost \$1100 a day. It actually cost
22 \$6145 a day for the drilling of the core holes on 1550,
23 or approximately six times as great.

24 Please bear in mind that these are factual figures.
25 We have heard a lot of statements as to cost of operating
26 in the water and on shore.

1 Now, here is a transportation cost item. For drilling
2 the same comparable wells on shore, the transportation cost
3 of transporting your casing and your tubing and pumping
4 units and the equipment that is necessary for the well, will
5 run around \$1500 per well, with a maximum of about \$2000.
6 The transportation cost per well has been \$22,000 or eleven
7 times the amount that it is on land.

8 Now there is one very outstanding thing about all
9 this -- and this is just some items that I took at random,
10 it is not a complete list of all of the costs attached to
11 it, but certainly shows you what the pattern is. Now, we
12 do not get one cent a barrel more for the oil that is pro-
13 duced from the tidelands at several times the cost than we
14 get for the same type of oil that is produced on shore at
15 one-fourth to one-fifth the cost. So I think those are
16 definite figures as to some of the costs of operation. I
17 am sure that the places where we have been operating are the
18 most favorable insofar as cost conditions are concerned; and
19 when the operators begin to operate in other areas of the
20 tidelands, where their distance is greater, that cost is
21 going up. Likewise, we have been operating in water 45 to
22 70 feet in depth and many of your prospects are in water
23 that is far greater in depth than that, up to two and three
24 hundred feet in depth, and when you start operating in water
25 of that depth then these costs here become very nominal.

26 2) Even with all the scientific data that can be made

1 available in these modern times, no person or group of
2 persons can successfully predict the oil possibilities of
3 any subsurface area until enough wells have been drilled to
4 prove or disprove the presence of oil and to give some idea
5 of its quantity and quality.

6 3) There is nothing to indicate that the experience
7 of three reliable and substantial oil companies cited here
8 will not be repeated by others, regardless of how well they
9 may be informed.

10 It seems very clear to me in view of these facts that
11 unless the State is willing to offer adequate incentives to
12 encourage industry to assume the great risk involved in off-
13 shore exploration and development, or to reduce it to some
14 rational proportion, there is great danger that capital
15 investors will be lured into more lucrative enterprises.
16 The cost is already so great that even the largest oil com-
17 panies find it expedient to join together to reduce the
18 individual hazard. With prevailing unrest in other parts of
19 the world and the vulnerability of foreign petroleum sources
20 in the East, it would be nothing short of a national cata-
21 strophe if California's offshore reserves remain undeveloped
22 for lack of adequate incentive.

23 Mr. Chairman, those remarks and the statement is one
24 that I certainly felt that I wanted this Commission to know
25 about, because we do have legislation that is pending in the
26 Legislature here and I wanted this Commission to have this

1 information for its own guide.

2 MR. PEIRCE: Mr. Pyles, I would like to ask you a ques-
3 tion. When your company took its geophysical measurements
4 and concluded that there was a structure capable of holding
5 oil within the boundaries of this lease, did your later
6 drilling prove the existence of the structure that your
7 geophysical studies indicated was there?

8 MR. PYLES: No sir, they did not. It was contrary to
9 it. We likewise have what I call subsea geologists. In
10 fact, I believe we were the first ones that had these sub-
11 sea geologists under contract for about two years, doing
12 subsea geology on the floor of the ocean; and geologically
13 and from work on the surface and seismic tests, all we were
14 able to determine was that we had a structure. We had
15 further proof of it because we had producing oil wells across
16 the line in the city of Newport Beach; but the net result
17 was that we drilled eight completely bone dry wells at
18 almost a cost of seven million dollars.

19 MR. PEIRCE, Any questions, gentlemen? GOVERNOR
20 POWERS? (No response)

21 MR. KIRKWOOD: I would like to -- on your page 4 --
22 "I would like to point out here, by the way, that the State
23 of California is well protected against improper royalty
24 provisions in its offshore oil leases by the Cunningham-
25 Shell Act. The act permits the leasing of alternate
26 blocks only and the retention of unleased portions

1 If production is developed in any one section there are
 2 four contiguous sections that can be leased for the
 3 benefit of the State." I do not know what pattern you are
 4 suggesting there.

5 MR. PYLES: It's just what you did offshore of Santa
 6 Barbara. There was a request for ten parcels as approxi-
 7 mately nine sections and the Commission elected to ---
 8 (unclear to reporter) ---- at the Wild Cat rate of 1/8 and
 9 retain the adjoining parcel.

10 MR. KIRKWOOD: That wouldn't give us four contiguous
 11 sections that can be leased.

12 MR. PYLES: It is sections -- you are thinking of
 13 parcels. It is sections of land on both sides of it.

14 MR. KIRKWOOD: There would only be the two. You are
 15 not thinking in terms of a section of land. You are think-
 16 ing in terms of a block of sections.

17 MR. PYLES: I didn't have a chance to correct that. It
 18 doesn't read quite right. What I am thinking -- you have an
 19 offset to the property you have leased and if it proves
 20 productive, then you have the opportunity for the State to
 21 get a larger bonus and a graduated royalty, as is provided
 22 by the Cunningham-Shell bill, because it is proven.

23 MR. KIRKWOOD: It is not your experience in the area
 24 you are talking about, that isn't full protection either to
 25 the operator or the State. You can have a block where you ---
 26 you moved across the section line and found that wasn't the
 answer.

1 MR. PYLES: Certainly if you leased one of these
 2 parcels and made a discovery and the one indicated oil, the
 3 oil companies would certainly look at it in the same light
 4 as we did. We looked at it in the light of proven property.
 5 The closest bidders -- we outbid them \$2,900,000 on that
 6 property because we thought we had the information. We
 7 had a lot of information, but not good.

8 MR. KIRKWOOD: As the situation has turned out, you
 9 may have an awfully good block in the Newport Harbor City
 10 limits, where a high royalty would be justified, and yet
 11 right next door you paid a whopping royalty that hasn't
 12 proven up. In one case it seems to me the landlord should
 13 have been able to protect himself better; in the other case
 14 you paid too much without protection, Talking in terms of
 15 the last page, you say "reduce it to some rational propor-
 16 tion." That seems to mean that the Shell-Cunningham Act
 17 as it stands now prevents us from reducing to rational
 18 proportions.

19 MR. PYLES: I don't think so. I think the Cunningham-
 20 Shell Act is meant to give some incentive. Certainly we
 21 are interested in the tidelands of California. We, along
 22 with other companies have spent money in seismic work, geo-
 23 logy and so on, but if we are to not bid on wildcat -- if
 24 it goes up in such range we would be fortunate to make any-
 25 thing, because when you get into the costs of operating in
 26 the waters off California, or anyplace, you are just

1 multiplying your cost many times. We know that, it isn't
 2 guesswork. So if there is an incentive to make another
 3 try --- and if you are not going to have an incentive you
 4 are not going to have this coastline developed because the
 5 costs I have indicated to you are minor compared to the cost
 6 in deeper water --- if there is any incentive to the companies
 7 to go out and spend money and they are going to drill and
 8 you are going to drill dry holes and therefore when you get
 9 one there is a chance to recoup on all of those bad ones --
 10 No oil business can stay in business, just like any business,
 11 if you can't make more than what you lose you go in bank-
 12 ruptcy. Now, companies can't go and just spend all this
 13 money and stay in business. We would just have to quit,
 14 throw in the sponge, if you are going out of reason and I
 15 think we have got facts and figures to substantiate why
 16 you should make it encouraging to the companies.

17 MR. KIRKWOOD: I don't think there is any question
 18 that we should make it encouraging. I think it is the degree
 19 of encouragement that is in disagreement, perhaps.

20 MR. PEIRCE: Are there any further questions? Mr.
 21 Miller and Mr. Shell? All right, thank you very much, Mr.
 22 Pyles, for your statement. It will add to our sum total of
 23 information on this very complicated subject.

24 ASSEMBLYMAN MILLER: Mr. Chairman, I think I should
 25 remark that Mr. Pyle's observation that this was mostly proven
 26 land (not clear) this was in the field of proven

1 land --- it was just a bad guess.

2 MR. BRADY: Substantiated by the Commission's own
3 consultants. They recommended it as proven land.

4 MR. PEIRCE: Mr. Hortig, you presented a progress
5 report on legislation pending, which deals with tidelands
6 oil development?

7 MR. HORTIG: Yes sir.

8 MR. PEIRCE: Now, is there anything further that the
9 staff has to report with respect to this legislation at
10 this time?

11 MR. PUTNAM: I think the only thing further, Mr. Chair-
12 man, is that ...

13 MR. HORTIG: Starting on Page 47 ...

14 MR. PEIRCE: Is there anything further?

15 MR. PUTNAM: We made no recommendation on this page
16 81 and 82 with reference to this legislation. I think we
17 out-recommended ourselves last December.

18 MR. PEIRCE: Well, the matter is before the Legislature
19 now.

20 MR. KIRKWOOD: Mr. Chairman, as you know I have given
21 to each of the other members of the Commission, and the
22 authors of the three Assembly bills, some suggested amendments
23 to the Shell-Cunningham Act. I would like to discuss those
24 either now -- or you were asking whether perhaps we should
25 dispose of the Santa Barbara situation and then return to
26 this -- whichever way the Chair wishes to do on that; but at

1 this meeting today I would like to have these discussed.
2 I feel quite strongly that we on the Commission should let
3 the Legislature know what our problems are and what our
4 thinking is, because we did do that two years ago. We
5 recommended this act and if we are having any problems
6 under it and can agree on amendments, I think that's our
7 obligation to make those suggestions. The staff has indi-
8 cated that it feels some changes are necessary. I think we
9 ought to either support or reject that position of the staff
10 at this time. So I would ask that either now or after the
11 rest of the calendar has been disposed of that we do go into
12 this matter further.

13 MR. PEIRCE: It will take about thirty minutes to dis-
14 cuss the subject?

15 MR. KIRKWOOD: I would assume ..

16 MR. PEIRCE: Senator Hollister, you desire to get back
17 to the Senate?

18 SENATOR HOLLISTER: I don't have to. These Assemblymen
19 may have to get back.

20 MR. PEIRCE: All right. Now, in order to have a con-
21 tinuity of discussion, let's proceed with discussion of the
22 Cunningham-Shell Act and amendments thereto. Mr. Kirkwood,
23 will you proceed to outline your views with respect to this
24 subject?

25 MR. KIRKWOOD: Yes, I handed drafts of these suggestions
26 to the two Commission members the other day. I don't know

1 whether or not you have them. Do you have an extra one of
2 that?

3 MR. PUTNAM: Yes.

4 MR. KIRKWOOD: Both of the discussion and the amend-
5 ments? Mr. Chairman, as you know, from the start of this
6 session I have felt

7 MR. PEIRCE: I have to be excused for three minutes.

8 MR. KIRKWOOD: I think the Chairman is familiar with
9 this, so I can go on. I have felt that the provisions of
10 the Shell-Cunningham Act were unduly restrictive as far as
11 the State Lands Commission's efforts were concerned to
12 obtain a satisfactory return from the tide and submerged
13 lands, and have gone along with the staff in their suggestions
14 that some changes were needed. I had hoped and had suggested
15 earlier that we try to get some outside expert advice, hoping
16 that by this time in the session that perhaps with that
17 kind of advice we could have made sound suggestions to the
18 Legislature. I apparently took the wrong course in being
19 hopeful that we could do that on a voluntary basis, in that
20 we have tried to get a group together to give us suggestions
21 along that line but it just hasn't worked out for one reason
22 or another, so I am satisfied that what we need, before we
23 enter into an extensive leasing program, or a leasing pro-
24 gram which would bind the State as far as what apparently
25 are the most likely oil producing areas offshore are con-
26 cerned, would bind those by lease, that we should get

1 probably three advisers on a paid basis, consultants, so
2 that there would not be a feeling that one of them was
3 bound by former ties or bound by some commitments; that we
4 would have three rather than a single person working, advis-
5 ing us from their experience in this particular area as to
6 how best the State can be protected.

7 Now, we haven't had those people working and advising
8 us to date. Our staff members have been limited in their
9 time and their experience is naturally limited to California
10 and the area here, and what they have been able to pick up
11 by drawing materials together from other areas. They have
12 not been in a position where they themselves have had to
13 negotiate agreements of this particular kind. So, again,
14 I think we can profit by the broader experience that people
15 who have actually negotiated leases of large properties for
16 private landlords can bring us.

17 Trying to pinpoint the areas in the Shell-Cunningham
18 Act where I felt that we needed discretion, if we were to
19 take advantage of the advice of experts in this field, I
20 have prepared ..

21 (Mr. Peirce returned to the Chair.)

22 MR. KIRKWOOD: .. a number of amendments to the Shell-
23 Cunningham Act in the hope that perhaps this Commission would
24 agree with me that they would give us a better basis of opera-
25 tions and that they would recommend them to the authors of
26 the bills currently before the legislative session. The

1 way I have drafted these amendments, they are not drafted
 2 to any bill currently before the Legislature. They are
 3 actually drafted in the form of a new bill, making amendments
 4 to the existing law. However, they do make amendments to
 5 the provisions of bills that have been passed by the
 6 Assembly.

7 I have felt that the hands of the Lands Commission
 8 were unduly or improperly tied, shall we say, in our ability
 9 to get an appropriate royalty which would still be an induce-
 10 ment to the operator and would, at the same time, mean a
 11 completely adequate return to the State. Under the existing
 12 Cunningham-Shell Act, as I say, I think our hands are im-
 13 properly tied.

14 All of the bills which are in apparently concede that
 15 16-2/3% is a more appropriate minimum than 12½. As I under-
 16 stand it, it has developed since the Shell-Cunningham Act
 17 was passed two years ago, that 16-2/3% is the royalty which
 18 is being exacted in the Gulf for offshore areas, not only
 19 by the government but the states operating there. Apparently
 20 the Legislature, in its expression of opinion so far, has
 21 indicated that they would not want to see this Commission go
 22 below 16-2/3%. I think that is a fair statement, so I have
 23 incorporated in my suggestions a minimum of 16-2/3%.

24 Now, that is a digression from the original recommenda-
 25 tion of the staff, which was asking for greater flexibility
 26 on the part of this Commission and started for that reason

1 at $12\frac{1}{2}$, but because of the indication of the Legislature
2 that they feel we should not lease under any circumstances
3 at less than $16\frac{2}{3}\%$, I have incorporated that figure instead
4 of $12\frac{1}{2}$.

5 I have felt in my own mind at least, and after some
6 discussion with people who are far more familiar than I
7 with this problem, that the sliding scale royalty as it has
8 been used, and as I believe it is spelled out in the bills
9 presently before the Legislature, may not be the best answer
10 as far as giving inducement to the operator and at the same
11 time protecting the State; that there are other ways of
12 possibly providing that protection; and I would feel that
13 the Lands Commission should have the ability to turn to the
14 most effective way, after consultation with experts in the
15 field. So I have suggested in these amendments that as an
16 alternative we be able to go to a step scale, based on the
17 gross production under the lease. In other words, we could
18 say that the $16\frac{2}{3}\%$ would apply for a certain million bar-
19 rels of oil, that after that for another few million barrels
20 it would be at a higher rate, and so on. This, I think,
21 has some advantages because, again after consultation with
22 the experts, we could attempt to make adjustments for the
23 sort of thing that Mr. Pyles was talking about -- the problem
24 of extra costs for drilling offshore. We could set the
25 number of millions before the adjustment was made, in order
26 to take care of that sort of situation. I think it has a

1 possible advantage there -- I think it has a possible advantage
2 tage over the average rate of production per well, as far
3 as the policing, as it were (that isn't a good term) of
4 this particular situation. In other words, we wouldn't
5 have to be seeing that the oil company or the operator was
6 producing a well at the maximum efficiency rate. That
7 would achieve or have no importance in this sort of scale,
8 so I think there we might have fewer arguments with the
9 operator over the period of the lease.

10 I have indicated in this amendment that you could
11 have a combination of the two types of scale, so that after
12 a field was fully developed and the average production per
13 well began to drop back to the point where, at the high
14 royalty rate, it might not be profitable, that we could put
15 the scale downward at that time so as to take care of that
16 particular situation. That, as I say, is an effort to find
17 a basis to be passed upon before it would be incorporated
18 in any lease, whereby we can remove some of this gamble and
19 whereby the State can take care of some of these extra costs
20 that we have offshore, but at the same time still assure the
21 State, in the event of a major find under a particular lease,
22 of a fair return.

23 Now, I have also made some suggestions as far as the
24 rental is concerned, during the period when the operator
25 is not required to commence drilling. Under the present law
26 that can go up to five years. Under the suggestion of at

1 least two of the bills passed in the Assembly, that period
2 is cut to three years. One of the things we have heard
3 constantly in meetings of this Commission is that we need
4 to know what our reserves are, we need to develop as
5 quickly as possible, we need to give employment to the
6 drillers, to the ship yards, and so on; and we can only
7 do that, it seems to me, if we embark on a thorough-going
8 program of leasing. We can't hold up blocks, hold them back
9 five or ten years from lease, and still satisfy these pres-
10 sures that have been brought to the Commission. So I
11 felt that there should be some means of calling for imme-
12 diate follow-through on any property that was put out to
13 lease. I understand that that is done in other lease agree-
14 ments by having the rentals during this period high, so that
15 there is an incentive to keep going. It could be that in-
16 stead of having a single cash payment made, that the cash
17 bonus would be based on a percentage increase of, say, the
18 first five years of rental that is charged under the lease.

19 These are areas where I have amended -- and it is
20 something that has not been reviewed by the Attorney General's
21 office, developed solely in our office, and I would want it
22 to be approved by the Attorney General, see that it does
23 what we think it does -- so that the doors are not closed
24 on the recommendations those experts can make to us; that
25 they do have elements of choice, all of which would lead,
26 however, to something more than the minimum royalty set out

1 in the bill.

2 Now, this would also permit the alternate type of
3 bid that is incorporated in the Miller and Allen bills on a
4 royalty bid rather than a cash bonus bid. The amendments
5 would permit, if this type of bid is resorted to, for us to
6 fix a minimum cash bonus in terms of payment to be made at
7 the start of the lease, which would not be permitted under
8 the present Shell-Cunningham Act. I felt, in the language
9 which I had originally suggested to Mr. Allen with reference
10 to this alternate of a royalty bid, that it did not reopen
11 the possibility of a bid factor. Either Mr. Allen or Mr.
12 Miller, in the discussion in the committee the other night,
13 indicated that they thought the language in their bills
14 did permit a bid factor. I had not so intended it in my
15 language. I think they have picked it up from a suggestion
16 of mine. It should be clarified one way or the other. I
17 wonder about using a bid factor myself. I don't think our
18 experience has been too good. I think a constantly over-
19 riding royalty would give us more flexibility, so I certainly
20 would have no objection if that language were adopted by
21 the Legislature.

22 I think that covers the amendments to the first part,
23 the royalty and bonus provisions. One thing we don't have
24 currently under the act is the right, at the end of the
25 lease or on cancellation, of any surrender of any part of
26 leased area, to acquire any operating equipment that the

1 operator may have on that property. It may well be that the
2 particular operator can't continue at a profit but that
3 another operator taking over could. It seems to me that in
4 the original lease we should spell out a basis under which
5 the State could acquire the operating properties and then
6 be in a position to negotiate with a new lessee. This would
7 be a permissive thing -- it would not be a requirement. I
8 haven't attempted to spell out the terms. They would have
9 to be spelled out in the offering of the lease.

10 The drilling term I mentioned a little bit earlier.
11 Two of the acts cut this term down from a maximum of five
12 years to a maximum of three. Both leave discretion in the
13 Commission to expand on this drilling term. My reaction is
14 that we might just as well leave it at the five, as long
15 as in our rental provisions we have some discretion there
16 and can exert some pressure in that way. At the present
17 time we are restricted under the act to a dollar a year
18 and I think the incentive in this particular case is perhaps
19 pulled out. So I think we ought to have flexibility there.

20 Basically, I think that that covers the amendments
21 that I have suggested that are new and are not included
22 in the Allen, Miller or Shell bills. There are other
23 essential amendments that are presently covered by all of
24 those three bills that I think should be adopted.

25 My position, I would say, was in disagreement with
26 the bill which Senator Cunningham has just introduced, which

1 has the effect really of doing nothing except to move the
2 royalty on wildcat areas from $12\frac{1}{2}$ to $16-2/3\%$. In some re-
3 spects, the amendments that I have prepared are closer to
4 the Allen and Miller bills than they are to the Shell bill,
5 in that this would require us to exact something more than
6 $16-2/3\%$ in one form or another. However, again it is my
7 feeling that this Commission should exact something more and
8 should be able to without removing the incentive to the
9 operator. On the other hand, if the Legislature felt that
10 this is an area where we should wait and have maximum
11 discretion in order that we can take advantage of the advice
12 of the consultants, I would feel that there was no objection
13 to making the alternate provision that there should be
14 " $16-2/3\%$ or - - " and have flexibility there. This reflects
15 my own opinion that in the long run we are going to find that
16 we can exact something more than $16-2/3$ and that is the
17 reason this bill is written in the form it is here.

18 Mr. Chairman, not too briefly I have outlined the
19 provisions of these bills and the thinking I have behind
20 it. I'd like -- what I will plan to do is to move that the
21 Lands Commission join me in recommending a bill in this form
22 to the Legislature, not saying whose bill it is but recom-
23 mending this as a principle, because I think it does give
24 us more discretion, because I think in the long run we will
25 be able to do a better job for the State of California than
26 we would either under the existing law or any one of the
current bills before the Legislature.

(RECESS 11:25 to 11:33 a.m.)

DIVISION OF ADMINISTRATIVE PROCEDURE, STATE OF CALIFORNIA

1 MR. PEIRCE: The meeting will come to order. We have
2 before us some recommendations submitted by Mr. Kirkwood,
3 which he thinks the Lands Commission may wish to recommend
4 to the Legislature.

5 Speaking for myself, I haven't had a chance to read
6 the amendments. I only read the memorandum this morning
7 and I don't feel that I am prepared to express an opinion
8 as one member of the State Lands Commission with respect
9 to these particular proposals. However, that does not
10 preclude Mr. Kirkwood and Governor Powers from submitting
11 a recommendation on this subject or a series of recommenda-
12 tions; or Mr. Kirkwood submitting them in his own behalf,
13 so that the Legislature may have the advantage of his think-
14 ing on this very important and very complicated subject.

15 Governor Powers, have you any comments to make with
16 regard to Mr. Kirkwood's recommendations and his suggestion
17 that we take some action with regard thereto?

18 MR. POWERS: Well, Mr. Chairman, I am not fully pleased
19 with all the provisions of the present Shell-Cunningham Act
20 and perhaps it needs changing -- and we have these bills to
21 change it; but I think, in view of the fact that we have
22 just received these recommendations, that Bob better present
23 them to the Subcommittee tonight himself, because I certainly
24 am not qualified -- I haven't studied your recommendations,
25 Bob. I saw them probably five minutes before the meeting
26 here today, probably ten minutes to ten, and for me to pass

1 on them in ten minutes, I would say if I were to pass on them
2 it probably wouldn't be a very competent act, and wouldn't
3 assist you any.

4 MR. KIRKWOOD: I agree that's a problem.

5 MR. POWERS: You may have a lot of good points there
6 but there are some points I am not absolutely sure I agree
7 on.

8 MR. KIRKWOOD: I think basically the problem that faces
9 us is whether we, as a Commission, want to have our hands
10 tied to a certain leasing program. The suggestion, certainly,
11 of the Cunningham bill is that we have no discretion what-
12 ever except to put out by block, that we would withhold
13 areas from any lease, and I am not sure how wide our dis-
14 cretion would be there without additional provisions in
15 the law. We would be restricted, certainly, to a minimum
16 of 1920 acres under that act as the minimum block that we
17 could put out under the bill, as I see it here. I just
18 looked at it hurriedly. I just haven't had a chance to
19 talk to you, Butch, about this. John and I talked about
20 it a bit, tried to, and we did at least talk about the
21 volunteers, asking them to make some suggestions to us;
22 but John indicated that he felt that we should -- and I
23 don't mean to put words in your mouth, John; if I am,
24 correct me -- that we would do well to propose hiring of
25 three consultants, men who have had experience in preparing
26 leases for private landlords, and get their recommendations.

1 Well, if all we have is the Cunningham amendments to the
 2 Cunningham-Shell Act, I think we would be wasting money in
 3 hiring consultants because they wouldn't be able to suggest
 4 anything we would have the ability to adopt. What I have
 5 tried to do here is to give us that ability, at least within
 6 some limits -- I wish we had greater discretion --- but to
 7 give us some ability to get the highest return and which
 8 people who have had experience feel is proper, giving proper
 9 inducement to the operator and at the same time giving us
 10 the other half of the picture -- proper return to the State;
 11 and the return to the State is our prime responsibility.

12 MR. POWERS: I realize that we should have, probably,
 13 more discretion; but there is one other line that I think
 14 should be explored further and that is on the checkerboarding.
 15 It seems to me that -- you say it is 1920 acres ...

16 MR. PEIRCE: Minimum.

17 MR. POWERS: .. minimum at the present time. I have
 18 given this some thought, but not actually any constructive
 19 work on it, that if that was cut to a much smaller acreage
 20 than that, that we would retain, in case of a discovery we
 21 would get more revenue than any other way. That is a line I
 22 think we should pursue further. I do not know whether Mr.
 23 Miller or Mr. Shell have given any thought to that. It
 24 seems to me if you cut that to 400 acres or 200 acres and
 25 you made a discovery, you would have a known field you could
 26 lease out on a sliding scale. You would have a known gravity

1 and an oil company would know what they were bidding on.

2 MR. PEIRCE: Mr. Shell.

3 ASSEMBLYMAN SHELL: Mr. Powers, in answer to the
4 Lieutenant Governor's question -- I had question here I
5 wanted to ask Mr. Kirkwood following his statement concern-
6 ing lease size, concerning whether he considered changing
7 the size of the lease.

8 MR. KIRKWOOD: All three of the bills that have passed
9 the Assembly have such a provision in them and I approve of
10 them, after consultation.

11 MR. SHELL: And you approve of that?

12 MR. KIRKWOOD: Yes, I feel that is a proper provision
13 and is a necessary amendment to the law.

14 MR. SHELL: Actually, under current law, Bob, there is
15 no legislation necessary to permit you to hire consultants.

16 MR. KIRKWOOD: No.

17 MR. SHELL: You can do it when you want to, when you
18 see fit to do it. Mr. Peirce, a couple of other questions,
19 may I?

20 MR. PEIRCE: Surely.

21 MR. SHELL: I know Mr. Miller and I have discussed it
22 separately and together with other people, concerning the
23 possibility of reducing the size of the leaseholds. Bob,
24 my question is this: I think that under 2237 the first
25 portion of your recommendation on these step royalties could
26 be accomplished. That's my bill. I wish you would check

1 and see if it could not be accomplished under the step
2 royalties.

3 MR. KIRKWOOD. That is the one to propose to the A.G.
4 then. I want to be sure. I am afraid in some of this
5 language we are not clear enough and are asking for trouble
6 and if that's intended, let's clarify it.

7 MR. SHELL: That's right. I did want to bring up a
8 couple of items, that I know you could not have known the
9 machinery behind, and that is on page 2 of your explanation
10 here.

11 MR. KIRKWOOD: That's the draft of the explanation.

12 MR. SHELL: The draft, where the drilling term is cut
13 from five to three years. Actually, I think all of the
14 bills came originally from the same source, from the recom-
15 mendations of your staff. Those items were left out. When
16 I reached that realization it was not quite the time in the
17 legislative machinery to amend it and I did put in a spot
18 bill AB 4141, which contains that, and actually amendments
19 are being drafted and they will be in the bill on the other
20 side.

21 Then, on the last paragraph, these amendments would
22 permit the Commission to fix a minimum cash bonus. Under
23 all the bills now, that is clarified under all three bills,
24 is it not?

25 MR. KIRKWOOD: I would doubt it and I have prepared
26 this draft and have kicked around the meaning of the language

1 and we raise doubts as to whether that is feasible. I
2 would like to say again, the Attorney General should clarify
3 on all of these things and if there is unanimity of opinion
4 as to what we are aiming at, let's

5 MR. SHELL: My other question here is concerning the
6 State's right to purchase equipment. I just got your copy
7 here ten minutes before I came up and my question would be
8 this: Would the opportunity to take over equipment be
9 limited to production equipment or would it include explora-
10 tory equipment?

11 MR. KIRKWOOD: I would think it would be production
12 equipment. That's something, again, that we developed
13 without expert advice. I can't quite see the need for our
14 taking over exploratory equipment.

15 MR. SHELL: The language says "on the abandonment of
16 the lease" and it could, therefore, be abandoned either in
17 the exploratory period or immediately after production
18 started. I was just wondering your intention on that.

19 MR. KIRKWOOD: Well - so if there was an operable
20 well we could continue to have the machinery to go on with
21 it.

22 MR. SHELL: Say it was a well but it was decided it
23 was too small to be commercial.

24 MR. KIRKWOOD: Now you are getting down to techni-
25 calities that I would have trouble with, Joe.

26 MR. SHELL: It was just a question I had, Bob, as to

1 whether it would be production and exploratory, or only
2 production.

3 MR. KIRKWOOD: I would assume it would be only pro-
4 duction. I haven't had time to go over these with Mr.
5 Frank Hortig. I did attempt to get it up to the three
6 authors and the two members of the Commission on Friday,
7 realizing that you all wouldn't have a chance to look at it
8 until today, but the others I had not even delivered until
9 this morning.

10 MR. SHELL: Those were the questions in my mind that
11 were not clear to me.

12 MR. PEIRCE: Mr. Miller, have you any questions you
13 would like to ask?

14 ASSEMBLYMAN MILLER: Not much in the form of questions.
15 Very frankly, I am very happy to have Mr. Kirkwood's view-
16 points expressed in as definite form as he has now and I
17 was rather hopeful this might have occurred before this....

18 MR. KIRKWOOD: So was I .

19 MR. MILLER: ... when I was in the drafting stage.
20 One bill I am handling, one Mr. Allen is handling, and a
21 lot of our thinking was influenced by your staff, trying to
22 fit in with the administration and still do justice to the
23 people of the State and the industry too. Just casually
24 commenting on the suggestions in the form Mr. Kirkwood has
25 presented them, they do encompass the broader aspect of the
26 possibility of widening the thing out. It was thought in

1 our bills, and he points it up too, that by giving a little
2 bit more discretion, particularly in relation to the alter-
3 nate method of bidding, that we might have more competition
4 and as a result of that competition certain people are pre-
5 vented, very frankly, from getting into this game by the
6 bonus factor alone. We feel that is one of the vices of the
7 present act. If you have additional discretion given you
8 through either these bills or Mr. Kirkwood's suggestion
9 to broaden it, and more people could get in, competition
10 would be greatly increased. We feel Mr. Kirkwood's sugges-
11 tions go to that broader policy and it would be beneficial
12 to the State and to the industry. Mr. Kirkwood has pointed
13 it up. I haven't sat down with the Attorney General's de-
14 partment to find out the specific interpretation of some of
15 these suggestions. In fact, one -- the wording of one of
16 the alternate phrases, we might have differences as to how
17 it is to be used. Tonight we will try to get those opinions
18 as far as we can but we welcome Mr. Kirkwood's suggestions
19 and we hope they may be incorporated. We have three more
20 weeks to go.

21 Mr. Chairman, I thought with sincerity that on the
22 discretion of the Land Commission, there might be a matter
23 of degree here. Probably the maximum discretion would be
24 minimum royalties and lease up to the Lands Commission. I
25 do not know how the Lands Commission would feel about that
26 I don't know whether anyone has given it consideration.

1 We get down to a matter of degree. I have no qualms at all
2 on the LandsCommission having authority to operate it and
3 I think under proper limits that discretion should be there.

4 MR. PEIRCE: Mr. Holmes.

5 ASSEMBLYMAN HOLMES: I made a note here that you wanted
6 to hire three consultants to recommend any changes and I
7 was just wondering why you waited for so long in asking for
8 that recommendation. We only have a short time to go. The
9 bills are imperative. I am interested, too, as a member of
10 the Legislature, in voting correctly on the bills.

11 MR. KIRKWOOD: Mr. Holmes, let me explain that because
12 that is certainly a very valid question and certainly one
13 that Mr. Shell and Mr. Allen to some extent have raised too.
14 This is, as you will recognize, a very difficult and important
15 area and one where experts are few in number outside of the
16 immediate operators and people who have these problems con-
17 stantly before them. We do have, I think, an extremely com-
18 petent staff and they have made recommendations asking for
19 discretion. They did two years ago. I think they have
20 hesitated -- their withdrawals from asking for complete dis-
21 cretion have been more on the basis that "We aren't going
22 to get it" than on the basis that "We would like to have it."
23 Our experts have indicated that we should be doing something
24 more than we are able to do under the Shell-Cunningham Act.

25 I might say that some of these things I have hit on
26 out of the dark in a sense, as wemoved on through the

1 Shell-Cunningham Act and making it effective. I think I
 2 can take credit for originally suggesting checkerboarding.
 3 If it had not been for my suggestion, they wouldn't have
 4 done it. It was for industry. Now they say that is the
 5 only way we can do it, that perhaps instead of nine square
 6 miles it should have been three. That wasn't suggested
 7 by the industry. I think I can say I was the one that made
 8 the suggestion. We had the committee say the other night
 9 that no change should be made, that 12½% was all right.
 10 Now we seem to have agreement that 16-2/3% is a perfectly
 11 proper royalty to ask.

12 What I am pointing out -- we are up against experts
 13 ourselves, who know their field, and we have been without
 14 expert advice. My suggestion to meet that, before the
 15 legislative session, was that we ask some of the major
 16 landlords in California to make available to us their lands
 17 men, the people that have had the experience making leases
 18 of this sort, to tell us what sort of leases we should be
 19 granting, so we could recommend to the Legislature what dis-
 20 cretion we needed. I made a mistake at that time in/recom-
 21 mending that we go out and pay for somebody, because it is
 22 just impossible to get a voluntary group together and get
 23 them concentrating on something. That's the problem we have
 24 run into. So instead of having those recommendations, I am
 25 sort of blindly, without that expert advice, making some
 26 suggestions here that would not be binding, we would not have

1 to act on them, but we could at least

2 I plan before we adjourn today to move that we do
3 hire three men and that we ask the staff to recommend
4 particular people to us. When we have something to work
5 with

6 MR. HOLMES: Would that be a recommendation for this
7 session or two years from now?

8 MR. KIRKWOOD: As far as the hiring of experts is con-
9 cerned, we can do that without legislative action. All we
10 need is a bill to put into effect the recommendations of
11 the experts.

12 MR. HOLMES: What I am getting at -- these recommenda-
13 tions that these three experts would make, would that be
14 for this session?

15 MR. KIRKWOOD: No, they would be for the interim, under
16 the terms of the legislation to move forward properly on
17 the basis of expert advice.

18 MR. SHELL: Bob, can I ask one more question? I am
19 confused. Is the term "step scale" the regularly used
20 term? For some reason I have failed to come across it.

21 MR. KIRKWOOD: Again, I don't know and Mr. Schmidt
22 can maybe clarify that with one of the form books, and the
23 only forms we can find are the operators' forms -- or that
24 he could on a quick look -- and we don't have the other
25 types of leases. Whether that is the appropriate thing --
26 it seems to me that with the explanation I made, with an