MINUTE ITEM
This Calendar Item No. 55
was [illegible]
55
2
[illegible] 0 at its 1/26/78
meeting.

MINUTE ITEM

1/26/78
Willard

55. DETERMINATION OF THE REASONABLE MARKET VALUE OR CURRENT MARKET PRICE OF NATURAL GAS FOR THE PURPOSE OF ESTABLISHING ROYALTY DUE THE STATE UNDER STATE GAS LEASES IN NORTHERN CALIFORNIA - W 9738.

During consideration of Calendar Item 51 attached, Mr. A. D. Willard, Supervising Mineral Resources Engineer, summarized the background of this item.

Mr. Robert Paschall, Senior Petroleum Appraisal Engineer for the State Board of Equalization, appeared. Mr. Paschall was not appearing as a representative of the Board, but as a consultant hired by the staff of the State Lands Commission.

The following appearances were made in opposition to the staff's recommendation:

Hon. William M. Bennett, member, Board of Equalization, Third District

Mr. Bennett objected to tying the price of gas produced in California which has no transmission costs, with Canadian gas and Middle Eastern prices. In addition, he contended that the hiring of Mr. Henry Lippitt as a consultant created a serious conflict of interest.

Chairman Kenneth Cory asked why the Public Utilities Commission had not previously been involved in controlling prices for natural gas in California. Mr. Bennett agreed that the PUC should declare a policy on this subject. (A main contention of the Commission throughout the entire hearing was that they were put in a position of a regulator rate making body rather than the administrator of the State lease, with the Public Utilities Commission serving as the rate setting public agency.) Mr. Cory stated that if the private sector can receive the current market price for its gas, the public sector should be allowed to do the same. At this time Mr. Cory stated he is willing to approve a price and at the same time advise the PUC that the State Lands Commission is willing to have them come in and regulate prices. He wanted the record to show that he had suggested to PG&E that in July 1976 an accommodation be put in for the consumer whereby the price would be $1.31, less 11 cents per MCF for gathering charges, and that PG&E had rejected it as inappropriate. However, since then, they have been paying much higher prices for their gas from Canada and other sources.

Hon. Richard Gravelle, Commissioner, Public Utilities Commission

Mr. Gravelle submitted a letter dated January 25, 1978 for the record from Commissioner William Symons, Jr., a minority of one member on their Commission supporting the staff's recommendation. He stated the majority of the PUC is opposed to this recommendation.

A 5, 9, 10, 12
S 4, 6 7

Mr. Gravelle further stated that if the price were to go above the $1.20, litigation would be pursued. At the conclusion of this testimony, Mr. Gravelle also pointed out that the hiring of Mr. Lippitt was a clear conflict of interest. Mr. Cory then stated that since the hiring of Mr. Lippitt had been so opposed, he was prepared, in reaching his decision, to exclude anything Mr. Lippitt had to say. Commission-Alternate Sid McCausland also made a similar statement for the record. Mr. Gravelle strongly recommended that the staff stay with the $1.20 price figure. Mr. Cory stated that if the Commission should arrive at a price at this meeting with the caveat that if the PUC should enter the field and set the rates, the Commission would be willing to determine that their price and judgment was appropriate.

Mr. Cory expressed concern that if the Commission deferred and accepted the lower price and other sellers received a higher price because of the PUC's reluctance to enter into the area of price regulation, the Commission would have failed in the exercise of its responsibilities under the State lease.

Commission-Alternate Betty Jo Smith asked 1) what figure was used by the PUC to arrive at the proposed increase to the consumer of $110 million; 2) over what period of time this increase would be spread; and 3) what the impact to the consumer's monthly bill would be. Mr. Gravelle indicated he would attempt to have his staff develop these figures and send a letter to the Commission advising of same.

Ms. Sylvia Siegel, representing Toward Utility Rate Normalization

Ms. Siegel indicated that if the Commission adopts the staff's recommendation, her organization intends to institute litigation proceedings against the Commission, ask the Governor to intercede, and request a legislative investigation on how the Commission functions.

Mr. Earl Radford, attorney, representing Shell Oil Company

In addition to opposing a price higher than the $1.20, Mr. Radford contended that 1) Shell had been denied due process in that during the administrative hearings, they were not allowed to cross examine; and 2) the State has no right to determine a price other than $1.20 for any period at this time. He stated that Shell did not enter into any agreement with PG&E and that Chevron was not selling Shell's gas under the contract. He stated that Shell handles the selling of their gas independently. He explained that Chevron, as the lease operator, performs the physical work on their half of the jointly owned lease.

Mr. Ed Perez, Deputy City Attorney, City of Los Angeles

In addition to objecting to the staff's recommendation, Mr. Perez criticized the staff for denying them due process by not allowing cross examination during the administrative hearings.

Mr. Robert Peckham, Coordinator, Producing Contracts and Titles, representing Chevron U.S.A, Inc.

Mr. Peckham clarified the record explaining how the gas is handled under the subject contract. Due to the confusion which arose concerning Chevron and Shell's joint lease in the Ryer Island Field, Mr. Cory instructed Mr. Peckham to advise the highest corporate level at Chevron that henceforth on every joint venture coming before this Commission, a written explanation of [illegible]o Chevron represents will be required to avoid any future er[illegible]s.

Mr. Leonard Snaider Deputy City Attorney, City of San Francisco

Mr. Snaider addressed the issue of the gift of public resources and the question of using Canadian prices in determining the current market value of the gas.

Mr. Greville Way, Chief Gas Engineer, Public Utilities Commission and Mr. Vincent MacKenzie, Principal Counsel, Public Utilities Commission appeared and commented briefly.

Mr. Jack Fallin, attorney, representing Pacific Gas and Electric Company

Mr. Fallin prefaced his statement with a question as to why the State did not determine whether or not the California producers were receiving an adequate return on their investment under present prices. Chairman Cory and Mr. Northrop responded to the effect that such investigation and studies were irrelevant to the determination of the reasonable market value and was more appropriate in the regulation of prices, a function of the PUC.

The bulk of Mr. Fallin's presentation was a reiteration of his previous testimonies at past hearings by both the Commission and its staff.

The following is a list of individuals appearing in support of the staff' recommendation:

Mr. Ron Leineke, representing the California Independent Producers Association

Mr. Monte Doris, in pro per

Mr. Stanwood Williams, co-owner, Sumpf Williams Company

Mr. Sumpf, co-owner, Sumpf Williams Company

Mr. Henry Lippitt, II, Executive Secretary, California Gas Producers Association, representing Buttes Resources Company.

Mr. Lippitt submitted two copies of letters for the record:

Letter January 25, 1978, from Anacapa Oil Corporation to Honorable Kenneth Cory.

Statement of Buttes Resources Company.

For a complete text of the hearing on this matter, refer to the transcript dated January 26, 1978, on file in the office of the State Lands Commission.

At the conclusion of the hearing, Mr. McCausland stated that due to the Commission's charge under the statutes and their responsibilities as landlords, it is inappropriate to begin asserting themselves into the determination of what the price of natural gas should be. He stated it was his judgment that the price should be determined by a regulatory body who has more expertise in the field. Ms. Smith agreed with Mr. McCausland and stated that because of her interest in the consumer, the staff's recommendation of prices is unacceptable to her and that PG&E's position is also unacceptable. In that line Mr. McCausland moved, and Ms. Smith seconded, that the resolution as set forth below be adopted by the Commission.

~~Upon motion duly made and carried, the following resolution was adopted by a vote of 2-0, with one abstention.~~

Upon motion duly made and carried, the following resolution was adopted by a vote of 2-0.

THE STATE LANDS COMMISSION AUTHORIZED THAT THE REASONABLE MARKET VALUE OR CURRENT MARKET PRICE OF THE GAS PRODUCED AND SOLD FROM THE RIO VISTA, RYER ISLAND, RIVER ISLAND AND ISLETON FIELDS FOR THE PERIODS IN QUESTION SHALL BE THOSE PRICES THAT ARE THE RESULT OF THE PENDING ARBITRATION BETWEEN PACIFIC GAS AND ELECTRIC COMPANY AND TEXACO, AMINOIL AND SUPERIOR; PROVIDED, HOWEVER, THAT SHOULD THE PUBLIC UTILITIES COMMISSION DETERMINE TO REGULATE THE PRICE FOR CALIFORNIA PRODUCED GAS AND IMPOSES A CEILING ON THE PRICE THAT A CALIFORNIA PRODUCER MAY CHARGE, THE DETERMINATION OF THE STATE LANDS COMMISSION SHALL BE THAT CEILING PRICE FOR ALL TIME PERIODS IN QUESTION.

Attachment:
Calendar Item 55 (4 pages)

(Technical amendment made 7/21/78)

CALENDAR ITEM

55.

1/78
W 9738
Willard

DETERMINATION OF THE REASONABLE MARKET VALUE OR CURRENT MARKET PRICE OF NATURAL GAS FOR THE PURPOSE OF ESTABLISHING ROYALTY DUE THE STATE UNDER STATE GAS LEASES IN NORTHERN CALIFORNIA

On September 30, 1976, the State Lands Commission approved an interim price for its royalty gas from state leases in the Rio Vista, River Island and Ryer Island gas fields in Northern California which are operated by Chevron USA, Inc. The interim price was $1.20 per MMBtu, and the approval of this price was for a period of 6 months beginning July 1, 1976. The approval was given on the condition that it shall not be deemed a determination by the State of the reasonable market value of the royalty gas. The approval was subject to the right of the State, at the end of the 6-month period or any time thereafter, to make a determination of the reasonable market value or current market price of the royalty gas for the purpose of establishing the price to be paid to the State beginning January 1, 1977, for its royalty gas from its Rio Vista, River Island and Ryer Island leases.

On December 15, 1976, the Commission delegated to its Executive Officer the powers conferred by Section 6103 of the Public Resources Code and Article 2 of Chapter 2 of Division 3 of Title 2 of the Government Code (Sections 11180 et seq.) to conduct an investigation into the reasonable market value of natural gas in Northern California for the purpose of accumulating data to aid the Commission in its determination of the reasonable market value of gas produced in the Rio Vista, River Island and Ryer Island gas fields. A hearing conducted by the Executive Officer was held in Sacramento on August 11, 1977. Oral and written statements were presented at the hearing by the Staff of the State Lands Commission and by a number of interested parties including Pacific Gas and Electric Company, Chevron USA, Inc., and the California Public Utilities Commission. Several written statements were submitted subsequent to the hearing.

A staff recommendation of prices to be used in a determination of the reasonable market value of the State's royalty gas was submitted to the Commission in the form of a calendar item at its meeting on September 29, 1977. Considerable testimony was given by interested parties in opposition to the staff's recommendation, and the subject generated

A 5, 9, 10, 12

S 4, 6, 7

considerable discussion among members of the Commission. At the conclusion of the testimony and discussions, the Commission decided to defer any determination to a later meeting so that it could further investigate the matter and study the record.

In the course of its further investigation, the Commission issued subpoenas for the production of several sales contracts for gas produced in Northern California, including the contracts and other agreements between PG&E and Union Oil Company and PG&E and Phillips Petroleum Company governing the sale and exchange of gas produced in the Union Island field in San Joaquin County. At its meeting on November 30, 1977, the Commission placed in the investigatory record all documents theretofore and thereafter subpoenaed in the course of its investigation.

A second hearing conducted by the Executive Officer, as delegatee of the Commission's investigatory powers, was held in Sacramento on January 12, 1978. The principle purpose of the hearing was to receive information concerning and analyses of the Union Island agreements. Analyses by the Staff of the State Lands Commission, an employee of the Board of Equalization and PG&E were presented. Statements were presented by other interested parties. Several written comments were received after the hearing. Written comments were receivable until January 20, 1978, while oral comments may be presented at the Commission meeting.

Based on the materials that have been received into the record throughout the investigation, the staff is proposing that the reasonable market value or current market price of natural gas produced and sold from the State's leases in the Rio Vista, River Island and Ryer Island gas fields be determined in accordance with the weighted average of the prices paid by PG&E for its purchases of natural gas in the Northern California gas market that are competitive with its purchases of gas from the Rio Vista, River Island and Ryer Island fields. The prices or values under this method would be derived from the weighted average border price of PG&E's purchases of El Paso out-of-state gas, the weighted average price of the deliveries to PG&E at the California border of Canadian gas from the Pacific Gas Transmission Company, and the weighted average of the prices paid by PG&E for California produced gas. These weighted average prices would be adjusted for Btu content and the load factor or "peaking value", i.e., the flexibility premium PG&E pays for having gas available for peak day needs. The resulting prices or values for the State leases in question are as follows:

			Reasonable Market Value or Current Market Price ($/MMBtu)		
Lease	Field	Load Factor	Jan.-June 1977	July-Dec. 1977	Jan.-June 1978
E 415	Rio Vista	33%	$1.75	$1.91	$2.08
E 415	Isleton	65%	1.62	1.77	1.93
PRC 714 & 729	River Island	33%	1.75	1.91	2.08
PRC 3748 & 3896	Ryer Island	33%	1.75	1.91	2.08

The above values are based on deliveries of 1,000 Btu per cubic foot and will be adjusted for the heat content of gas actually delivered.

The staff has analyzed the Union Island agreements in order to determine the costs to PG&E for gas purchased from Union and Phillips during the term of these agreements. These costs, prorated for the gas purchased during the period of 18 months under consideration by the Commission, are as follows:

	$/MMBtu
Jan.-June 1977	$1.70
July-Dec. 1977	1.82
Jan.-June 1978	1.94

The staff does not believe that these prices alone are sufficient to establish the reasonable market value for natural gas in Northern California. They are indicative of the fact that PG&E is currently paying a price for gas produced in Northern California that is significantly in excess of $1.20/MMBtu.

The Attorney General in a letter to the Executive Officer dated November 10, 1977, has advised that in making its determination of the reasonable market value of the State's royalty gas, the Commission may consider the prices paid in California for gas produced out-of-state and in foreign nations, prices subject to governmental regulation and set by governmental action, and prices set by arbitration.

According to that letter of advice, the Commission may not consider the delivered price of gas and alternate fuels for industrial use. The Attorney General advised also that the lease terms "reasonable market value" and "current market price" have essentially the same meanings and that the same evidence may be used in a determination of both the "reasonable market value" and "current market price" of natural gas.

IT IS RECOMMENDED THAT THE COMMISSION DETERMINE THAT THE REASONABLE MARKET VALUE OR CURRENT MARKET PRICE FOR ROYALTY GAS PRODUCED UNDER THE FOLLOWING LEASES SHALL BE:

			Reasonable Market Value or Current Market Price ($/MMBtu)		
Lease	Field	Load Factor	Jan.-June 1977	July-Dec. 1977	Jan.-June 1978
E 415	Rio Vista	33%	$1.75	$1.91	$2.08
E 415	Isleton	65%	1.62	1.77	1.93
PRC 714 & 729	River Island	33%	1.75	1.91	2.08
PRC 3743 & 3896	Ryer Island	33%	1.75	1.91	2.08

THE ABOVE VALUES ARE BASED ON GAS DELIVERIES OF 1,000 BTU PER CUBIC FOOT AND WILL BE ADJUSTED FOR THE HEAT CONTENT OF GAS ACTUALLY DELIVERED. FOR THE PERIODS AND LEASES LISTED ABOVE, THESE VALUES SHALL BE USED FOR THE PURPOSE OF DETERMINING ROYALTY PAYMENTS TO THE STATE.