

MINUTE ITEM

This Calendar Item No. 23
was approved as Minute Item
No. 23 by the State Lands
Commission by a vote of 2
to 0 at its 7/24/86
meeting.

CALENDAR ITEM

A 4, 10, 11, 26
S 2, 5, 7

23

07/24/86
LSE E-415
PRC 714
PRC 729
PRC 2966
PRC 3743
PRC 3896
PRC 6498
Willard
Gonzalez

APPROVAL OF NEW GAS SALES CONTRACTS
AND AMENDMENTS TO GAS SALES CONTRACTS,
STATE OIL AND GAS LEASES

LSE E-415, PRC'S 714, 729, 2966, 3743, 3896 AND 6498
CONTRA COSTA, SACRAMENTO, SAN JOAQUIN AND SOLANO COUNTIES

LESSEE: Chevron U.S.A., Inc.
P. O. Box 5050
San Ramon, California 94583

LEASE INFORMATION, AREA AND TYPE OF LAND:
Summarized in Exhibit "B".

APPROVALS REQUESTED:
Approval of new gas sales agreements and
amendment of existing sales agreements as
listed in Exhibit "A" for subject leases.

BACKGROUND: Chevron as operator of State leases has entered
into individual lease and unit gas sales
agreements over the years with Pacific Gas and
Electric (PG&E), the only buyer of gas
production in the area. Leases PRC 3743 and
PRC 3896 are jointly held by Chevron and
Shell. Shell's 50 percent share of the gas is
transported to their Bay Area refinery for use
as fuel and payment for State royalty gas is
based on the price Chevron receives under its
gas sales agreement with PG&E.

(PAGES 98-98.22 ADDED 07/18/86)

-1-

CALENDAR PAGE	98
MINUTE PAGE	7890

CALENDAR ITEM NO. 23 (CONT'D)

These gas sales contracts state the price the "Buyer" (PG&E) is willing to pay the "Seller" (Chevron) for a minimum required purchase quantity of gas. This quantity is a percentage of the mutually agreed-to lease producibility. The percentage is called the "load factor". The load factor concept provides a means for the purchaser to meet its peak winter demands and adds value to the gas, although currently the price does not include any consideration for this flexibility.

The gas sales agreements are amended to reflect changes in price or load factor resulting from economic conditions or regulatory agency requirements.

PG&E has requested Chevron to agree to reductions in price paid it under the several gas sales agreements from \$3 per MMBTU effective January 1, 1985 to \$2.92 per MMBTU effective October 1, 1985, to \$2.66 per MMBTU effective November 1, 1985, to \$2.50 per MMBTU effective January 1, 1986, and finally to \$2.23/MMBTU effective April 1, 1986.

In addition, PG&E has requested Chevron to agree to reduction of the load factor for the Rio Vista Deep Zone (LSE 415) to 33 1/3 percent from the present 50 percent. (All of the other sales agreements between Chevron and PG&E relative to State leases have a 33 1/3 percent load factor).

PG&E advised that the amendments are required to permit PG&E to comply with the California Public Utilities Commission (CPUC) approved average cost sequencing guidelines, and will preserve Chevron's present sales sequencing position (i.e., for discretionary purchases Chevron's gas will have priority over interstate gas). PG&E further advised that under the CPUC mandate, PG&E will honor the minimum purchase requirements of all agreements and will make discretionary purchases only from those sellers who have agreed to the load

CALENDAR ITEM NO. 23 (CONT'D)

factor of 33 1/3 percent and the proposed sales price. In addition to the above amendments, Chevron and PG&E have:

1. Entered into two new gas sales contracts for the River Island and Isleton Fields, PRC 714 and PRC 729.
2. Entered into a new gas sales agreement for a newly-issued State Oil and Gas Lease, PRC 6498, for State owned lands of the Stockton State Hospital.
3. Included newly completed Well, State 20, in the gas sales agreement dated September 22, 1967 for Lease E-415.

Pursuant to terms of the various leases, the Lessee must obtain prior state approval before entering into any sales contracts for the disposition of production from the leased lands.

A summary of the requested approvals is attached as Exhibit "A".

OTHER PERTINENT INFORMATION:

1. On October 24, 1985 the Commission deferred action on this item pending clarification of Chevron's and PG&E's stated policy during certain public hearings held by the Commission in 1977 and 1978 regarding the use of California produced gas and its impact on consumer prices. Attached as Exhibit "C" is a staff report addressing this matter.
2. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (14 Cal. Adm. Code 15061), the staff has determined that this activity is exempt from the requirements of the CEQA because the activity is not a "project" as defined by CEQA and the State CEQA Guidelines.

Authority: P.R.C. 21065 and 14 Cal. Adm. Code 15378.

CALENDAR PAGE	98.2
MINUTE PAGE	1892

CALENDAR ITEM NO. 23¹ (CONT'D)

AB 884: N/A.

EXHIBITS: A. Gas Sales Agreement.
B. State Lease Information.
C. Staff Report.

IT IS RECOMMENDED THAT THE COMMISSION:

1. FIND THAT THE ACTIVITY IS EXEMPT FROM THE REQUIREMENTS OF THE CEQA PURSUANT TO 14 CAL. ADM. CODE 15061 BECAUSE IT IS NOT A PROJECT AS DEFINED BY P.R.C. 21065 AND 14 CAL. ADM. CODE 15378.
2. APPROVE THE GAS SALES AGREEMENTS AND AMENDMENTS TO GAS SALES AGREEMENTS COVERING GAS PRODUCED UNDER STATE LEASES LISTED IN EXHIBITS "A" AND "B" AND BY REFERENCE MADE A PART HEREOF.

EXHIBIT "A"
CHEVRON U.S.A., INC.
GAS SALES AGREEMENTS

Gas Sales Contract Date	Field	State Lease(s)	Document Submitted	Price Provision
6/30/67	Sherman Island	LSE E-415.1	Amendment 10/8/85	Modify price to \$2.66/MBWTU eff. 11/1/85
8/19/85	Stockton	PRC 6498.1	Amendment 10/8/85	Modify price to \$2.66/MBWTU eff. 11/1/85
7/18/57	West Thornton	PRC 2966.1	Amendment 10/8/85	Modify price to \$2.66/MBWTU eff. 11/1/85
9/22/67	Rio Vista Deep (State)	PRC 415.1	Amendment 2/21/86	Modify price to \$2.50/MBWTU eff. 1/1/86
5/16/40	Rio Vista (State)	PRC 415.1	Amendment 2/21/86	Modify price to \$2.50/MBWTU eff. 1/1/86
1/1/56	Rio Vista Gas Unit	PRC 415.1	Amendment 2/21/86	Modify price to \$2.50/MBWTU eff. 1/1/86
1/20/85	River Island & Isleton	PRC 714.1 & 729.1	Amendment 2/21/86	Modify price to \$2.50/MBWTU eff. 1/1/86
11/26/68	Ryer Island	PRC 3743.1 & 3896.1	Amendment 2/21/86	Modify price to \$2.50/MBWTU eff. 1/1/86
6/30/67	Sherman Island	PRC 415.1	Amendment 2/21/86	Modify price to \$2.50/MBWTU eff. 1/1/86
8/19/85	Stockton	PRC 6498.1	Amendment 2/21/86	Modify price to \$2.50/MBWTU eff. 1/1/86
7/18/57	West Thornton	PRC 2966.1	Amendment 2/21/86	Modify price to \$2.50/MBWTU eff. 1/1/86
9/22/67	Rio Vista Deep (State)	PRC 415.1	Amendment 4/1/86	Modify price to \$2.23/MBWTU eff. 4/1/86
5/16/40	Rio Vista (State)	PRC 415.1	Amendment 4/1/86	Modify price to \$2.23/MBWTU eff. 4/1/86
1/01/56	Rio Vista Gas Unit	PRC 415.1	Amendment 4/1/86	Modify price to \$2.23/MBWTU eff. 4/1/86
1/20/85	River Island & Isleton	PRC 714.1 & 729.1	Amendment 4/1/86	Modify price to \$2.23/MBWTU eff. 4/1/86
11/26/68	Ryer Island	PRC 3743.1 & 3896.1	Amendment 4/1/86	Modify price to \$2.23/MBWTU eff. 4/1/86
6/30/67	Sherman Island	PRC 415.1	Amendment 4/1/86	Modify price to \$2.23/MBWTU eff. 4/1/86
8/19/85	Stockton	PRC 6498.1	Amendment 4/1/86	Modify price to \$2.23/MBWTU eff. 4/1/86
7/18/57	West Thornton	PRC 2966.1	Amendment 4/1/86	Modify price to \$2.23/MBWTU eff. 4/1/86

CALENDAR PAGE	108.4
MINUTE PAGE	10.4

EXHIBIT "A"
CHEVRON U.S.A., INC.
GAS SALES AGREEMENT

Gas Sales Contract Date	Field	State Lease(s)	Document Submitted	Price Provision
9/22/67	Rio Vista Deep	LSE E-415.1	Amendment-12/17/84	Modify price to \$3.00/MBTU eff. 1/1/85
9/22/67	Rio Vista Deep	LSE E-415.1	Amendment-7/17/85	Reduce load factor to 33 1/3% eff. 1/1/85
6/30/67	Sherman Island	LSE E-415.1	Amendment-12/17/84	Modify price to \$3.00/MBTU eff. 1/1/85
7/18/57	West Thornton	PAC 2996.1	Amendment-9/11/85	Modify price to \$2.92/MBTU eff. 10/1/85
11/26/68	Ryer Island	PAC 3743.1 & 3896.1	Amendment	Modify price to \$3.00/MBTU eff. 1/1/85
11/26/68	Ryer Island	PAC 3743.1 & 3896.1	Amendment-9/11/85	Modify price to \$2.92/MBTU eff. 10/1/85
8/19/85	Stockton	PAC 6497.1	Amendment-9/11/85	Modify price to \$2.92/MBTU eff. 10/1/85
1/20/85	River Island & Isleton	PAC 714.1 & 729.1	Amendment-9/11/85	Modify price to \$2.92/MBTU eff. 10/1/85
1/1/56	Rio Vista Gas Unit	LSE E-415.1	Amendment-3/12/84	Modify price to \$3.00/MBTU eff. 1/1/85
1/1/56	Rio Vista Gas Unit	LSE E-415.1	Amendment-9/11/85	Modify price to \$2.92/MBTU eff. 10/1/85
5/16/40	Rio Vista (State)	LSE E-415.1	Amendment 9/11/85	Modify price to \$2.92/MBTU eff. 10/1/85
1/20/85	River Island & Isleton	PAC 714.1 & 729.1	New Contract-1/20/85	Price \$3.00/MBTU
9/22/67	Rio Vista Deep	LSE E-415.1	Amend Contract 9/6/85	Include new well, State 20, eff. 3/26/85
8/19/85	Stockton	PAC 6497.1	New Contract-8/19/85	Price \$3.00/MBTU
9/22/67	Rio Vista Deep (State)	LSE E-415.1	Amendment 10/8/85	Modify price to \$2.66/MBTU eff. 11/1/85
5/16/40	Rio Vista (State)	LSE E-415.1	Amendment 10/8/85	Modify price to \$2.66/MBTU eff. 11/1/85
1/1/56	Rio Vista Unit	LSE E-415.1	Amendment 10/8/85	Modify price to \$2.66/MBTU eff. 11/1/85
1/20/85	River Island & Isleton	PAC 714.1 & 729.1	Amendment 10/8/85	Modify price to \$2.66/MBTU eff. 11/1/85
11/26/68	Ryer Island	PAC 3743.1 & 3896.1	Amendment 10/8/85	Modify price to \$2.66/MBTU eff. 11/1/85

EXHIBIT "B"

LSE E-415.1

Chevron U.S.A., Inc.
State Lease Information

LSE E-415.1 - Lease issued on June 1940. The Rio Vista Field includes State-owned and submerged lands within an 8000 acre block of private and federal land in Solano, Contra Costa, San Joaquin and Sacramento Counties. State submerged lands are in the beds of the Sacramento, San Joaquin and Mokelumne Rivers and Threemile and Sevenmile Sloughs.

PRC 714.1 - Lease issued in April 1952. Held by Chevron and Union Oil Company. In the River Island Field, contains 377 acres of State submerged lands in the beds of the North Fork of the Mokelumne River and Georgiana Slough.

PRC 729.1 - Lease issued in June 1952. Held by Chevron and Union. In the Isleton Gas Field and contains 357 acres of State submerged lands in the bed of the Sacramento River, north of Isleton.

PRC 2966.1 - Compensatory Agreement issued in June 1962. Held by Chevron, Texaco and Union. Part of the West Thornton Field and contains approximately 294 acres of submerged lands in the Sacramento and Mokelumne Rivers and Snodgrass and Georgiana Sloughs.

PRC 3743.1 - Lease issued in April 1967. Held by Chevron and Shell. Contains approximately 2200 acres of tide and submerged lands around Ryer Island, Suisun Bay. Ryer Island Gas Field.

PRC 3896.1 - Lease issued in January 1968. Held by Chevron and Shell Oil. Approximately 1400 acres of tide and submerged lands in Suisun Bay around Middle Ground and Snag Islands, in the Ryer Island Gas Field.

PRC 6498.1 - Lease issued in September 1983 to Chevron. Contains 112 acres of State-owned lands of the Stockton State Hospital, Stockton, San Joaquin County.

CALENDAR PAGE	98.6
MINUTE PAGE	1006

Memorandum

To : D. J. Everitts

Date : June 5, 1986

File No. : W 9738

From : A. D. Willard
STATE LANDS COMMISSION
245 West Broadway, Suite 425 - Long Beach, CA 90802

Telephone: ATSS
()-

Subject : Northern California Gas Purchasing Policies

1. Review of Public Record (1977/78 Transcripts on Determination of Reasonable Market Value of Natural Gas) Regarding the Use of California Produced Gas.

On October 24, 1985, the Chairman of the State Lands Commission requested staff to review and report on P.G. & E.'s and Chevron's previous testimony on how California gas was being used for the benefit of the consumer. Did PG&E and Chevron testify that they would produce and use California gas to the maximum extent possible?

We have reviewed all records of testimony presented to the Commission (see Exhibit "1" Listing of Public Hearings) regarding the determination of reasonable market value of natural gas in Northern California in 1977 and 1978. We have also had discussions with PG&E on its present practices. The review and discussions show that there has been a shift in PG&E's practices and that this shift has occurred because of statutory and regulatory changes.

- : The testimony provides that it is PG&E's policy to produce California gas to the maximum extent possible given its responsibility to husband such gas for use during periods of peak demand. Mr. Jack F. Fallin, Jr. an attorney representing PG&E testified that the California Public Utilities Commission (CPUC) requires PG&E to husband California produced gas for use in meeting winter peak demands of the consumer. He further stated that although most California gas is used for peaking purposes, it is not exclusively used in that manner. A portion of California gas as required under the various sales agreements (load factors, wet well minimums and exchanges) is produced and delivered on a steady basis. Attached as Exhibit "2" are excerpts of testimony by Mr. Fallin on this matter.

CALENDAR PAGE	58.7
MINUTE PAGE	1837

Additional testimony by Mr. Greville Way of the CPUC confirms the PUC's position on conserving California gas for use of residential customers. Although he did not specifically testify that PG&E was ordered to husband California gas for peaking use, its purchasing practice sanctioned by the PUC is evidence of its policy (Exhibit "3").

Chevron did not testify on the specific issue of its position on the production of California gas. Perhaps they felt this was a given, on the theory that producing such gas to the maximum extent possible is obviously in Chevron's best interest.

Based on preliminary results of a current audit of Gas Lease Agreement E 415, it appears that Chevron may not have enforced the minimum purchase obligations (take or pay) under certain sales contracts with PG&E. This practice may have resulted in less California gas being produced. However, such action could be consistent with PG&E's directive to husband California gas for the residential customer. Chevron's position in this matter is not yet clear as more information is being sought under the audit.

2. Reasonable Market Value

Following the lengthy investigation by the Commission for determination of the reasonable market value of natural gas in Northern California the Commission in August 1978 established such prices for the period January 1977 through June 1978. These prices were based on the evidentiary record including the results of recently completed arbitration proceedings between P.G. &E. and Texaco-Aminoil-Superior.

3. Statutory and Regulatory Changes

In November 1978 the Natural Gas Policy Act (NGPA) was enacted which continued controls over interstate supplies and extended the price controls to intrastate supplies. The regulatory framework of the NGPA provided ceiling prices with procedures for ultimate price deregulation by January 1, 1985. During the period of price controls California produced gas was initially sold below the ceiling price, but was gradually negotiated upward to the ceiling price in January 1982. PG&E's purchasing policy of

California gas was evolving during this period because of the rapidly increasing price of Canadian gas. California produced gas became an economically attractive source of supply, not only for peak winter demands but for base supplies. Thus during the early 1980's PG&E was progressively purchasing larger quantities of California gas.

In 1983 California gas purchasing policy was officially changed with enactment of the California Gas Policy Act (Section 785 of the Public Utilities Code). As amended in 1985 the act provides in part that "To the extent consistent with Federal law and regulations and contractual obligations regarding other available gas, the Commission shall ... encourage on a first priority, the increased production of gas in this state ... and shall require ... every gas corporation to purchase that gas ... which is produced in this State having an actual delivered cost, measured in equivalent heat units, equal to or less than other available gas ...".

PG&E's gas purchasing practices are established in its rate proceedings before the CPUC. When gas supply exceeds existing demand, the CPUC hearings include determination of "sequencing" guidelines for purchases of gas by PG&E. The current approved practice requires purchases of contractual and operational minimums first, then discretionary purchases are to be made sequentially, on a least cost basis. It is in PG&E's determination of "least cost" that disagreement occurs. PG&E, with confirmation by the CPUC, has determined the sequencing price for California produced gas as the average of the delivered (border) price of El Paso out-of-state and PGT - Canadian gas less \$0.44/MMBTU (\$0.34/MMBTU, PG&E's gathering cost of California gas, and \$0.10/MMBTU, a "window" to prevent large swings in sales volumes with small changes in prices). PG&E has recently submitted to the CPUC a study of its Northern California gathering costs. The study concluded that the gathering costs applicable to its purchases from California producers should be increased from \$0.34 MMBTU to \$0.40 MMBTU. California producers have challenged the gathering cost and window deductions before the CPUC and the matter is under investigation with resolution expected later this year.

Therefore, presently, in order for California produced discretionary gas (above contract minimums) to be sequenced ahead of out-of-state and Canadian discretionary gas purchases it must be equal to or less than the border prices minus \$0.44/MMBTU.

The key elements to assurance that California gas will be produced and purchased at maximum deliverabilities are:

1. That discretionary gas purchases are greater than the available California discretionary gas; and
2. That California gas is price competitive with El Paso and Canadian gas (after deduction of the gathering and window costs).

The discretionary gas purchases by PG&E have far exceeded the volumes of available California gas. As long as PG&E continues this practice in its negotiations of minimum take provisions, California gas can be produced and sold at maximum deliverabilities under the sequencing policy established by the legislature for the benefit of the consumer and the California producers.

Essentially all California gas purchased by PG&E is pursuant to 33% load factor (minimum purchase obligation) contracts (see attached Exhibit "4"). Sales prices for California gas have been "negotiated" (fiat by the monopoly purchaser) by insisting that producers accept the formula price or be subject to minimum contract purchases. The sequencing price effective November 1, 1985, for California produced gas was \$2.66/MMBTU. This is based on the delivered cost of PG&E's El Paso out-of-state purchases of \$3.11/MMBTU (the lower of PG&E's El Paso and PGT Canadian gas purchases) less \$0.44/MMBTU, or \$2.67/MMBTU. Therefore, pursuant to the sequencing formula approved by the CPUC, all California discretionary gas available to PG&E at \$2.66/MMBTU must be purchased before any out-of-state discretionary gas purchases in order to achieve a "lease cost gas mix". Although objections have been filed with the CPUC regarding the deductions used in arriving at the sequencing price, California producers have conditionally agreed to the formula price.

Under most California gas purchase contracts prices are established on January 1 of each year (this is in addition to price changes brought about by the sequencing purchases). The annual price "negotiations" are to be based on the "fair market value". Therefore effective January 1, 1986 PG&E established the "fair market value" at \$2.50/MMBTU. This price being significantly lower (0.16/MMBTU) than the sequencing price in effect under the CPUC approved sequencing guidelines. The recourse to accepting a non-negotiable price is to request arbitration

under the contract, at a very lengthy and costly process. During arbitration, PG&E could and probably would discontinue taking gas under the contract, resulting in a significant economic impact, as well as a potential for reservoir damage. Such action certainly appears contrary to legislative policy and the CPUC's implementing orders.

Effective April 1 the price of gas purchased by PG&E from El Paso and Canada was \$2.74/MMBTU and \$2.6769/MMBTU respectively. This translates into a sequencing price for California gas of \$2.23/MMBTU (\$2.6769 - \$0.44).



A. D. WILLARD
Supervising Mineral
Resources Engineer

ADW:vn

attachment: Exhibits 1 - 4

CALENDAR PAGE	98-11
MINUTE PAGE	1901

Exhibit "1"

Public Hearings

August 11, 1977	Public Hearing on Natural Gas Pricing conducted by staff.
September 29, 1977	State Lands Commission regular meeting - Minute Item No. 19.
January 12, 1978	Public Hearing - Reasonable Market Value of Natural Gas in Northern California conducted by staff.
January 26, 1978	State Lands Commission regular meeting - Minute Item No. 55.
February 23, 1978	State Lands Commission regular meeting.
March 30, 1978	State Lands Commission regular meeting - Minute Item No. 10.
August 31, 1978	State Lands Commission regular meeting - Minute Item No. 25.

Exhibit "2"
September 29, 1977 - Meeting of the
State Lands Commission

1 mix of gas -- your client does. Your client chooses to use
2 California gas for peak load only, and chooses not to use it
3 for full utilization.

4 MR. FALLIN: Two things --

5 CHAIRMAN CORY: And you're in essence using your
6 cheaper supply of gas -- your domestic California gas: Ryer
7 Island, Rio Vista gas -- for peak load, not for full utiliza-
8 tion; and you're taking Canadian gas constantly.

9 MR. FALLIN: First comment: PG&E doesn't get Ryer
10 Island gas. That's an exchange arrangement. That's Standard
11 Oil's gas.

12 CHAIRMAN CORY: River Island. Pardon me.

13 MR. FALLIN: Second, we do not use California gas
14 only on peak. That's wrong. We do use it for a lot of
15 peaking purposes --

16 CHAIRMAN CORY: These particular contracts --

17 MR. FALLIN: -- are not used only on peaking at
18 all. They are used more heavily on peaking, but it's not
19 at all accurate to say they're used only for peaking. I
20 think the staff will agree with that statement. To carry it
21 still further --

22 CHAIRMAN CORY: Let's go to your alternate fuel
23 sources.

24 MR. FALLIN: I would like to finish answering your
25 first question. We have been directed by the California

Exhibit "2" continued

1 very real sense this gas, the state's gas from Rio Vista,
2 has been dedicated to those residential customers at those
3 rates which currently recover us an absolute loss. If you
4 want to use that system to price this Rio Vista gas, you're
5 going to end up coming out below \$1.20, because if you want
6 to provide the cost of taking it to those residential
7 customers and provide a rate of return on the facilities
8 involved and back it up to a price, it's going to come out
9 below \$1.20.

10 That's a little bit of a long run. I think it's
11 followable, however.

12 MS. SMITH: On what basis or how did you determine
13 that the staff's method of calculating the reasonable market
14 value is against public policy?

15 MR. FALLIN: Okay. Essentially that is, I guess,
16 what you would call a matter of law as opposed to strictly
17 a matter of fact. We know the method used. The method used
18 was testified to by Mr. Lippitt before the staff, and Mr. Cory
19 has confirmed the method used. It is to include those
20 Canadian prices which have no relationship to the standard
21 you're using, which says "market value". They're not set
22 in any market. That's a contractual question, or a question
23 that we all can deal with.

24 The second question is: how are those prices
25 determined? It's our contention that those prices are

Exhibit "2" continued

1 Public Utilities Commission to husband supplies of California
2 gas for the very reason you're talking about, for the same
3 reason the government talks about husbanding supplies of
4 domestic crude oil: in an attempt to defend those supplies
5 against the fact that they're controlled from without. It's
6 just simply that true. The Commission has told us to husband
7 California gas.

8 Now that brings up a very interesting point. The
9 staff throws up another high number in our faces, and says,
10 "Well, gee, industrial customers pay \$2.29 for gas from PG&E.
11 The staff well knows -- Mr. Lippitt knows it perhaps better
12 than the rest of them do -- that PG&E's rates have been
13 skewed for policy reasons. We now have a lifeline arrange-
14 ment, which means that for the lowest levels of residential
15 gas customers, we're serving gas at essentially no return
16 at all -- in fact, at a return which is close to if not
17 below our average cost of purchased gas: in other words,
18 an absolute loss.

19 In turn industrial customers are paying a much
20 higher level. That's true. Putting that number in front
21 of you and in front of the public can't be described in any
22 other way but as deceptive.

23 But to carry the point a little further, the fact
24 that PG&E has been directed to husband this gas for the
25 California residential customer raises the point that in a

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CALIFORNIA PAGE
MINUTE PAGE

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Exhibit "3"
September 29, 1977 - Meeting of the
State Lands Commission

16)
1 because certainly the gas consumer has a right under
2 contracts that the utilities or pipelines may have to the
3 gas. The only real benefit the consumer can get is by
4 higher price for new gas yet to be discovered. It does
5 seem to me that that does have some benefit to the consumer.
6 But to just continually price up gas that's not entitled
7 to higher prices doesn't really do the consumer much
8 benefit.

9 CHAIRMAN CORY: The question of gas he's entitled
10 to: there was previous testimony that there is a public
11 policy posture of the PUC that we should minimize our
12 consumption of California gas. Can you explain that
13 policy and that concept? You just stated that the consumer
14 is entitled to that older gas. They seem to be in conflict.
15 Is that the public policy?

16 MR. WAY: I think at one of the hearings two years
17 ago a question was raised -- I think it was raised by
18 Henry Lippitt -- as to whether or not California gas should
19 be produced at a higher rate than it was. PG&E historically
20 has used California gas as a peaking gas. You must
21 appreciate that compared to the gas that is now received
22 from Canada, and the quantity of gas that's now received
23 from El Paso, California gas is not a major item.

24 Of course I guess the other thing is -- at least
25 looking at it in a more close-to-home framework -- the

Exhibit "3" continued

1 Canadians about two years ago raised the issue of curtailing
 2 gas out of Canada. Certainly that's always in the wings.
 3 Therefore it doesn't seem to me that to some extent
 4 conserving the production of California gas is an advantage
 5 to the state.

6 But as I say, I think PG&E has contract commitments
 7 to produce a level of gas. They do produce it. They do
 8 use the gas primarily for peaking purposes.

9 CHAIRMAN CORY: I guess I don't like the dilemma
 10 I'm in with conflicting instructions in terms of how to
 11 look at this problem, and I presume you find yourself at
 12 the Public Utilities Commission in similar binds from time
 13 to time. But how can they use our gas for peaking rather
 14 than constant load if it's less expensive? I would feel
 15 far more compelled to seek \$1.20 or even 90 cents if they
 16 were showing evidence of good faith in using that first
 17 and foremost, rather than using it for peaking and using
 18 the higher priced gas.

19 Am I missing something? That's where I'm really
 20 having trouble deciding who's wearing the white hat in
 21 this whole mess. I'm not sure that anybody is.

22 MR. WAY: If you cut back on your Canadian takes,
 23 which I certainly wouldn't advise doing, and if you cut
 24 back on your takes from El Paso, which is one way of doing
 25 it, and produce California gas at a maximum, I think you

Exhibit "3" continued

1 would exhaust California gas rather quickly, because there
2 really is not a --

3 CHAIRMAN CORY: But you've got to play that hand' out.
4 If you take that statement which you just said, maybe our
5 best public policy is to jointly go to the Legislature and
6 say, "Hey, our public policy should be to not allow these
7 things to be produced at all. Let's save them." I don't
8 know. Maybe that's what we should do.

9 But again if we look at costs, it seems to me we
10 should arbitrarily set all state-owned gas at 90 cents
11 and run it out as fast as we can. I don't know the answer
12 to that.

13 MR. WAY: Well, I don't either. It's certainly
14 very complicated. But as I say, there is an advantage,
15 I think, to also being sure that you're not totally cut
16 off from your gas supplies if Canada or somebody else
17 curtails.

18 Certainly the United States government at the
19 present time is storing sizable blocks of oil just in
20 assurance that the Arabs won't cut --

21 CHAIRMAN CORY: That is just as bizarre. We're
22 pulling out of Elk Hills, so we have oil to keep the price
23 down, and then taking other oil and putting it in a hole
24 in the ground. I sort of feel like no matter what I do,
25 it's got to be wrong.

Exhibit "3" continued

1 MR. WAY: Could well be.

2 (Laughter.)

3 MR. WAY: I don't think there are easy answers to
4 any of these questions or that there is one definitive
5 answer.

6 MR. McCAUSLAND: I move we go to the Legislature
7 and cap all the wells.

8 CHAIRMAN CORY: I'm prepared to go to the Legislature
9 if I could figure out what the hell to ask them for. I
10 really can't identify what the best position for the public
11 is. I really honestly can't.

12 I see some inconsistencies. Your statement is very
13 simple and very brief and sounds very nice, but the reasons
14 you buttress it with seem to be at loggerheads with one
15 another, and I can't figure out what the hell to do.

16 MR. WAY: Well, perhaps not, but the other thing
17 you must appreciate is that gas in the ground is like
18 money in the bank. If it's not produced, it's there. But
19 you also must appreciate that the producers have expended
20 a considerable amount of money to explore and develop gas
21 that is now being produced. Certainly I think there's an
22 entitlement on their part to recover these investments,
23 so I think --

24 CHAIRMAN CORY: I'm just wondering, though: maybe
25 we should jointly go and condemn it back. Pay them what

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Exhibit "3" continued

1 they've got in it, and get out of these inane contracts
 2 we have with two middlemen. We take the people's gas,
 3 sell it to two middlemen, who make a profit on it, to
 4 sell it back to the people. Harry Truman had a word for
 5 that.

6 MR. WAY: I think the only one who is making a profit
 7 on it is the producers, because PG&E does not make a
 8 profit on the product they sell as a cost of gas. What
 9 they're making a profit on is their investment in the
 10 facilities to deliver the gas.

11 CHAIRMAN CORY: What would be the effect of that
 12 last statement, so I understand it. If we decided not
 13 to produce the gas, would their capitalized cost of that
 14 gathering system still be in their rate base or not?

15 MR. WAY: Yes, it would, but you must appreciate
 16 it would have an impact on the consumers in that PG&E
 17 would want to recover the cost of its facilities, which
 18 are not being used to the extent that they had previously
 19 been used. So if you did cut off the production of
 20 California gas, you would have, to some extent, a rate
 21 increase out of that.

22 CHAIRMAN CORY: So they've got the system rigged
 23 so that no matter what, they get the rate increase.

24 MR. WAY: I'm not sure it's rigged. I think it's
 25 all by law or statute as to what they're entitled to recover.

Exhibit "3" continued

1 If you want to do what you want to do, it would be to pass
2 something in the Legislature forbidding any more exploration
3 activities beyond developmental drilling within reserves
4 that are now known.

5 CHAIRMAN CORY: I don't know if that's what I want
6 to do. I'm trying to ask you if you have any --

7 MR. WAY: I think that would be one way of approaching
8 what you want to do. That would then maintain the
9 production from the present reserves. But it could of
10 course have an impact on --

11 CHAIRMAN CORY: -- long-term gas supplies.

12 MR. WAY: Yes, you could have an impact on the
13 availability of gas into the future.

14 CHAIRMAN CORY: Staff, why don't you bring us easy
15 problems?

16 MR. McCAUSLAND: Let me ask a question.

17 CHAIRMAN CORY: Go ahead.

18 MR. McCAUSLAND: Along that line of thinking, if
19 we stayed at \$1.20, there's relatively little incentive
20 to upgrade the production capability of the existing fields.
21 Is there any thought in your mind that there might be
22 adequate supplies under the ground -- that if the price
23 were raised those fields would be producing at a higher
24 level and consequently exhaust it sooner?

25 MR. WAY: Well, of course, that could well come to

EXHIBIT 4

PG&E NATURAL GAS SUPPLY

<u>1985/86 Sources</u>	<u>Supply BTU x 10⁹</u>	<u>Percentage of Total</u>	<u>Price \$/MMBTU</u>
El Paso	317.377	40.5	3.11
Canada	302.365	38.5	3.14
California	147.434	18.8	2.66
Rocky Mountain	17.519	2.2	3.46