

MINUTE ITEM

This Calendar Item No. 34
was approved as Minute Item
No. 34 by the State Land
Commission by a vote of 2
to 0 at its 6/30/88
meeting.

CALENDAR ITEM

A 57, 58

34

06/30/88
W 13001
Pace

S 29

APPROVAL OF 1988 LONG BEACH TIDELANDS
DRY GAS PRICE AGREEMENT

Pursuant to provisions of Chapter 29, Statutes of 1956, First Extraordinary Session, the Long Beach Gas Department shall receive into its system all Long Beach tidelands dry gas which it can economically utilize and which is not required for oil field operations and shall pay to the State the reasonable wholesale market value for such dry gas. Chapter 29 also provides that the reasonable wholesale market value of tidelands dry gas shall be determined from time to time jointly by the City of Long Beach and the State Lands Commission in light of prices for processed dry gas prevailing from time to time at absorption plants where wet gas produced in the Los Angeles Basin is being processed.

The statutory directive that the City and State agree upon the reasonable wholesale market value for tidelands dry gas has been the cause of considerable dispute between the City and State in the past. In 1967, after several years of wrestling with the price issue, the City and State entered into an agreement in which, among other things, they established as the reasonable wholesale market value, the price paid each month for dry gas purchased by Pacific Lighting Gas Supply Company from absorption plants in the Los Angeles Basin, adjusted for heating value. However, over the years as energy costs began to increase, the absorption method for removing gas liquids from produced wet gas was replaced by the refrigeration method, and absorption plants gradually were closed or converted to refrigeration plants. This change in processing methods prompted attempts by the City and the State to obtain a change in the 1967 price agreement. Finally, the City and State entered into an agreement in 1981, when absorption plants were completely eliminated, in which they set the price payable to the State for tidelands dry gas at the weighted average of prices paid each month by Pacific Lighting under long term

(ADDED 06/28/88 - PGS. 218-218.3)

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contracts at all processing plants in the Los Angeles Basin, adjusted for heating value. However, they could not agree on the effective date for the new agreement. The State maintained that under provisions of the 1967 agreement, the new agreement was to be effective retroactively to 90 days from the date it gave notice to negotiate a new price. The retroactive application would yield the State an additional \$1.1 million. The State sued the City to recover this amount and won in the Los Angeles Superior Court. The case is now on appeal.

On March 4, 1988, the City gave the State written notice of its request for negotiations to change again the formula for determining the reasonable wholesale market value of tidelands dry gas. The City's notice was precipitated by the recent California Public Utilities Commission decisions significantly restructuring the regulatory framework of the California gas market and making the prices paid at processing plants in the Los Angeles Basin no longer reflective of the reasonable wholesale market value of dry gas. Under these new decisions, gas customers are divided into three market segments-- core (residential and small commercial customers), noncore (large commercial, industrial, utility electric generation, cogeneration and enhanced oil recovery customers that can burn alternate fuels as well as gas) and wholesale (special noncore customers like Long Beach Gas Department). Utilities are to remain the sole provider of service for core customers, but noncore and wholesale customers may purchase gas from the utility or any nonutility supplier.

A new method for pricing gas supplied by utilities was required by the market restructuring. The Public Utilities Commission has ordered the three major gas utilities, Southern California Gas Company, Pacific Gas & Electric Company and San Diego Gas & Electric Company, to maintain two gas supply portfolios corresponding to the bifurcation of the market into core and noncore segments. The core portfolio will consist of long-term purchases and some short-term, including spot market, purchases. The noncore portfolio will consist only of short-term and spot market purchases. The composition of the core portfolio for each utility will change not more often than twice a year, and the composition of the noncore portfolio for each utility will change not more often than twice a month. The core portfolio price will be the weighted average cost of the gas purchases in the core portfolio ("Core WACOG"). The noncore portfolio price will be the weighted average cost of the gas purchases in the noncore portfolio ("Noncore WACOG").

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The Core WACOG and the Noncore WACOG provide the prime determinants of the market price of gas in the newly restructured gas market. The Noncore WACOG, which reflects short-term and seasonal fluctuations in the price, should be a better determinant of the current market price for dry gas than the Core WACOG, which will lag behind current prices due to its reliance on long-term contracts and its infrequent changes. In addition, the wholesale Noncore WACOG for the Southern California Gas Company ("SOCal") is the price at which the City's Gas Department purchases its gas from SOCal.

The Staff and the Attorney General's Office have negotiated a price agreement with the City that provides for payment by the City for tidelands gas effective June 1, 1988, at SOCal's wholesale Noncore WACOG, adjusted for heating value. In the event the SOCal Noncore WACOG ceases to exist, the agreement provides that the price of tidelands gas taken by the City shall be based on any successor pricing mechanism reflecting the weighted average price of SOCal's short-term gas acquisitions.

Because the short-term market price for gas is currently lower than the border price provided by the long-term contracts in effect at local processing plants, the new pricing agreement will result in a lower price for current tidelands gas purchases than the State is receiving under the existing 1981 agreement. However, the new price formula will keep up with the changes in the short-term market, reflecting, as it does now, the relatively low domestic and foreign gas prices as well as their increase when that increase occurs. The staff and the Attorney General's Office believe that the new price agreement, which has been approved by the Long Beach City Council, is a fair agreement. It not only reflects the statutory mandate that the State shall receive the reasonable wholesale value, but provides a formula that will insure such a price during future changes in the gas market, thereby minimizing the chance of price disputes in the future.

A copy of the 1988 Long Beach Tidelands Dry Gas Price Agreement is on file with the State Lands Commission in Long Beach.

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.

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

AB 884: N/A.

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 THE ACTIVITY IS NOT A PROJECT AS DEFINED BY P.R.C. 21065 AND 14 CAL. ADM. CODE 15378.
2. APPROVE THE 1988 LONG BEACH TIDELANDS DRY GAS PRICE AGREEMENT.
3. AUTHORIZE THE EXECUTIVE OFFICER TO EXECUTE THE 1988 LONG BEACH TIDELANDS DRY GAS PRICE AGREEMENT ON BEHALF OF THE COMMISSION.

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