

1 of the record you have right now is you have to assume there  
2 is no cost justification for these rates.

3 If the justification comes it's got to come from  
4 just the reasonable market value standard. You also have  
5 to exclude, because there is no evidence that in fact it  
6 will happen, the notion that if you drum the consumer with  
7 this amount, magically, it's going to be converted at a  
8 90-percent rate into exploration for new gas. That's not  
9 a fact that's in front of you. If it were puttable, I'd  
10 say it would be fine and, all right, let's go on that basis,  
11 but it isn't.

12 We have talked with the producers and with the  
13 Commission about trying to set up a tiered pricing system  
14 which would include specific new gas incentives. Again,  
15 you're looking at the reason why it hasn't worked. Because  
16 any new gas price we put up, there is going to be somebody  
17 that wants to turn around and use it to jack up flowing  
18 gas prices, and this is flowing gas we're dealing with. It  
19 was discovered in 1930. I imagine, again without seeing  
20 the numbers, that there are precious few costs that haven't  
21 been recovered.

22 I can point out a couple of numbers in the Occidental  
23 arbitration. There wasn't a single field that, as far as  
24 I can recall, was recovering under about 30 percent; and  
25 there was one that was 140 or 150 percent, and that would

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12  
1 have been at 75 cents.

2           Maybe that was an unusual case. People mutter  
3 about it. Fine. If it is, I'd like to find out about it.  
4 I sense from some of the things that have been said here  
5 that you'd like to find out about it. In fact, some of  
6 the independent producers, at least, seem to be willing to  
7 lay some of those facts out; but they're not here today.

8           Okay. I've extemporized. Now --

9           MR. McCAUSLAND: That was valuable extemporizing.  
10 I followed all of that, too. I hope your written presentation  
11 today is as clear and lucid.

12           MR. FALLIN: I'll do it again. That's about the  
13 fourth compliment. I've got to say, the truth, when you  
14 strike it, it rings.

15           (Laughter.)

16           MR. McCAUSLAND: It's clear you've become a legend  
17 in your own mind.

18           (Laughter.)

19           MR. FALLIN: I might say, too, when we talk about  
20 procedures, I'm not sure that it might not have been the case  
21 where it would have made sense for one or more of the  
22 members of the Commission to sit on quote evidentiary  
23 hearings, and maybe that's something --

24           MR. McCAUSLAND: I think this case has probably  
25 presented us with a number of problems we can look at closely

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1 in terms of whether or not tried and true historical procedures  
2 meet the full test of the 1978-79 environment, but clearly  
3 I think we were using time-honored and tested procedures  
4 here that we believe will stand the test of a court case.

5 MR. FALLIN: Before I come into the steps that  
6 brought us here, I'd like to list the events that PG&E and  
7 the other parties feel if the Commission accepts the border  
8 price formula advocated by Mr. Lippitt. Here I will say  
9 that the border price is Mr. Lippitt's. If Mr. Lippitt is  
10 out, there is precious little support left for that border  
11 price formula.

12 MR. McCAUSLAND: What about the weighted average  
13 formula. Would you capture that from a border price?

14 MR. FALLIN: Absolutely.

15 MR. McCAUSLAND: You better discuss it.

16 MR. FALLIN: I will.

17 Some of these numbers I can perhaps quantify for  
18 you. The State Lands Commission we estimate would receive  
19 from PG&E and its ratepayers an additional \$1.46 million  
20 for the 18-month period through June of 1978. That's the  
21 period from January '76 through June of '78, and thereafter  
22 some \$1.15 million annually for gas produced at Rio Vista.  
23 That would be that increase carried forward into the future.

24 Ryer Island, where PG&E is not involved, might  
25 yield another \$1 million, although having sat through the

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1 earlier proceeding, perhaps that would be 500,000.

2 Mr. Lippitt -- in this sense, he can't be left  
3 out -- will use the Commission's acceptance of the formula --  
4 by the formula, I mean what you have in Northern California  
5 plus FERC, plus Canada -- in pending arbitrations in which,  
6 so far as I can tell, he's already been retained to testify.  
7 I don't know that it's been clear here, but he testified  
8 in the Occidental arbitration. Before he was hired here,  
9 I think he was probably retained to testify against us in  
10 the Texaco/Superior/Aminoil case before he was hired to  
11 work here, and he will go from here into those arbitrations  
12 which in fact are pending and will come off, I think, in  
13 February.

14 Strictly on the arbitration, there is a situation  
15 where, contrary to the allusions about mixing, the companies  
16 have been successful in running a merged proceeding with  
17 such tiny fellows as Texaco and Superior and Aminoil, which  
18 happens to be a division of R. J. Reynolds, I think.

19 I was asked this question before: Well, what about  
20 these guys for whom arbitration is a significant price  
21 barrier? The answer is, as was indicated with the 90 cent  
22 price discussion we had last time, our position has always  
23 been that until we had a substantial number of people signing  
24 at a given price, we didn't consider that one riding or  
25 prevailing as reasonable market value. We went back and

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15  
1 picked up those 90 cent prices. They all went to \$1.20.

2 The way the process works, effectively, the price  
3 is set by the people most capable of fighting it because  
4 it's the largest producers who end up holding out the  
5 longest; and, for them, the arbitration cost is a lot less  
6 significant than it is for us even.

7 Anyway, Mr. Lippitt takes your approval of Canadian  
8 prices -- I'm not talking about a number here. All he has  
9 to do is have you come down and say it's reasonable for us  
10 to look at these prices, they ought to be included. That  
11 result is carried into arbitrations that are already pending.

12 If successful, at the staff's number, that would  
13 cost us quickly another \$24 million. This is retroactive.  
14 This would go from '76 to July of '78.

15 Third, the Commission's acceptance of the border  
16 price would be used to get an arbitrated or renegotiated  
17 prices in all of our other gas contracts coming up this  
18 July. Now, if that's successful, this effort could cost the  
19 consumer some \$110 million. As indicated earlier, that number  
20 reflects our actual 1977 consumption, a figure which we  
21 didn't have available until, whenever it was two or three  
22 weeks ago.

23 The point was made or mentioned by Chairman Cory,  
24 what do we do about normal increases that might have occurred?  
25 I think you'll find that Mr. Lippitt has been very careful.

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1 I'm not the only one who's careful in here.

2           The 2.08 stops on July 1st. I have every reason  
3 to believe from the past track record that there will be  
4 an inflation element put in on January 2nd to pick that  
5 price up higher. What we're assuming is that conventional  
6 inflation would have worked through both systems so that  
7 the answer to your question, the \$110 million a year will  
8 continue. That's an annual amount. Just as the State's  
9 return is, whatever it is, whether it's a million or two  
10 million, that's an annual amount that will continue.

11           As a consumer of gas, the State will see its own  
12 annual rates for natural gas increase by some \$1,219,000 in  
13 Northern California. That \$500,000 from Shell might be  
14 kind of important because that might throw the net transaction.  
15 That's without a ripple effect.

16           All in all, this is not a bad piece of work for  
17 Mr. Lippitt. At our hearing January 12th, Mr. Leineke  
18 appeared for the first time on behalf of CIPA, and he  
19 expressed, as he's expressed again, the consequences of  
20 accepting those prices. Mr. Leineke indicated that there  
21 wasn't much to worry about since Commission acceptance of  
22 the formula will only, quote, trigger 15 percent of PG&E's  
23 gas purchases.

24           That doesn't sound bad at all except 15 percent  
25 equals 128,304,752 MCF a year. When increased by the staff's

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17  
1 formula, that's \$110 million.

2 As Mr. Way said in his own quiet way at the last  
3 hearing, for this Mr. Lippitt should be paying you, not  
4 vice versa.

5 The beginning of all this came with Mr. Lippitt's  
6 position that in determining reasonable market value, the  
7 Commission should ignore the fact that the price for the  
8 State's gas set by negotiation between Standard Oil, Chevron  
9 and PG&E -- that's a \$1.20 MCF -- was at or above the  
10 prevailing price for all other gas supplies sold in Northern  
11 California.

12 In order to find a higher price level, Mr. Lippitt  
13 invited the staff to look at Canada, a worthy choice. The  
14 evidence is undisputed that Canada, by governmental edict  
15 has linked its gas prices to the price of, quote, alternate  
16 fuel. Quote, alternate fuel price, of course, works out  
17 to be the OPEC dictated price of oil, and its gas prices  
18 have mounted at a pace closely matching the cartelized oil  
19 prices.

20 Mr. Lippitt's theory was presented by him at a  
21 hearing held last August before the staff's director,  
22 Mr. Northrop. At that same hearing PG&E pointed out the  
23 fact that the prices paid for gas comparable to the State  
24 produced throughout Northern California fully supported the  
25 \$1.20 per MCF price. We also explained at that time that

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18  
1 there is no support for the proposition that non-wellhead  
2 prices from total distinct producing areas can ever be  
3 used in setting reasonable market value.

4 Chevron USA testified as to the bargaining that  
5 surrounded negotiation of that price and to its opinion  
6 that it represented reasonable market value.

7 There has been quite a few tosses of secret agree-  
8 ment around in the hearing earlier. The question was asked  
9 what about this deal where PG&E agreed with Chevron that  
10 it would pick up increases that the Commission imposed under  
11 this reasonable market value standard. Ask yourselves,  
12 where would we be today if PG&E weren't a party to this  
13 proceeding?

14 You'd be right back at whatever that number was  
15 back in August. The only way we could guarantee a foot in  
16 the door when you were finding, as a public agency charged  
17 with some element of public interest what reasonable market  
18 value was was to take that and become a party. So, here  
19 we are.

20 CHAIRMAN CORY: The date of that agreement was  
21 what?

22 MR. FALLIN: That agreement was signed, I imagine,  
23 in spring of 1976.

24 There was a slight discrepancy earlier. The price  
25 that you are currently getting from PG&E is the \$1.20 price.

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19  
1 Using a \$1.20 won't change that at all.

2 CHAIRMAN CORY: The problem I have with you coming  
3 here as representing PG&E in a clean hands statement is  
4 that about that time, as I recall, PG&E was offered a \$1.31  
5 less 11 cents, and you rejected that offer, or your employer  
6 did.

7 MR. FALLIN: My quick answer is that a \$1.31 isn't  
8 a \$1.20. It wasn't offered to me, and I really have no say  
9 one way or the other in that. I will say this, that we have  
10 a problem that you can obviously proceed in entering into  
11 any "secret" settlement with the Commission that we're  
12 not ordered to enter into. We come up with a dollar figure  
13 that isn't justifiable.

14 CHAIRMAN CORY: Pardon me. I thought we got here  
15 with your justifying a secret deal which enabled you to be  
16 a participant in the proceeding.

17 MR. FALLIN: It's hardly a secret deal, Chairman  
18 Cory. I wouldn't be here but for the fact that everybody  
19 knows about it.

20 Quickly, to answer your question honestly, I didn't  
21 have anything to do with that offer if it was made, and we  
22 have obviously --

23 CHAIRMAN CORY: You're doubting that it was made?

24 MR. FALLIN: I don't know that it was made or  
25 wasn't made.

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1 CHAIRMAN CORY: I'd like the record very clear on  
2 the point. It was made. It was rejected. That is incon-  
3 trovertible. Lots of witnesses, lots of people participating.  
4 Go ahead.

5 MR. FALLIN: What I can say about that is it's  
6 not market value. That's our position. The \$1.30 --

7 CHAIRMAN CORY: Less 11. A \$1.31 less 11 cents.  
8 That's the deal I offered, net a \$1.20 to PG&E. That's what  
9 they pay for gas, and they said, up your ear, friend.

10 MR. FALLIN: Why didn't you just take a \$1.20  
11 whatever it was?

12 CHAIRMAN CORY: I don't know why you didn't take  
13 a \$1.20. It's your move. The ball is in your court.

14 MR. FALLIN: If that's an offer, I'll take it.  
15 If you're saying that you don't see any increase in the  
16 royalty amount because a \$1.20 is a fair price, I'll take  
17 it right here and now. I don't think I need authority to  
18 take a \$1.20. If that's up on the table, let me know about  
19 it, and we'll take it. We can all go home.

20 CHAIRMAN CORY: It was offered and rejected.

21 MR. FALLIN: A \$1.20 --

22 CHAIRMAN CORY: That is correct.

23 MR. FALLIN: -- which would mean no increase in  
24 royalty payments at all.

25 CHAIRMAN CORY: At that time they were saying to us

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1 no, the market value is not a \$1.20, but 90 cents.

2 EXECUTIVE OFFICER NORTHROP: Compression value  
3 was involved.

4 MR. McCAUSLAND: We offered a \$1.31 less 11 for  
5 compression, and it came to a \$1.20.

6 MR. FALLIN: Oh. So your valuation for compression  
7 was 11 cents at that point. This is a piece of evidence --  
8 staff has never admitted to any value in compression in this  
9 whole case. Chevron USA had to put a 17 cent compression  
10 value. Every piece of testimony you have calls our price to  
11 you a \$1.20 when it's really a \$1.37; is that correct?

12 CHAIRMAN CORY: We had no evidence of what it was,  
13 but based upon the limited record, we made that offer.

14 The record has been substantially expanded since  
15 then, and there are a lot more facts on the table, but I  
16 think it's important --

17 MR. McCAUSLAND: It was a compromise 11 cents.

18 MR. FALLIN: Let me get into that a little bit  
19 because if in fact -- the record you have before you now,  
20 and this is clear, there is no controversy with respect to  
21 compression value. There is only one piece of evidence in  
22 the case, 17 cents. Staff never put up any opposition to  
23 that number. Now, if I hear an objection to that, let's  
24 hear it now.

25 CHAIRMAN CORY: I think there is a substantial

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22  
1 amount of things from the Paschall report and others that  
2 the true value of compression is substantially less.

3 MR. FALLIN: Gathering.

4 CHAIRMAN CORY: Pardon me. You are correct.

5 MR. FALLIN: I'd asked Mr. Paschall if he was  
6 asked to look at compression cost, and the answer was no.

7 CHAIRMAN CORY: I stand corrected on that.

8 MR. FALLIN: The important thing is now that this  
9 is on the table. I think I try my best to be honest even  
10 when you ask me about settlement offers. If you mean what  
11 you say about considering values, the value of Rio Vista  
12 that you're getting at Rio Vista today is a \$1.37, and that's  
13 what you've got on the record. What you have to find is  
14 a price that indicates that \$1.37 is unreasonable.

15 Okay. Too bad it wasn't on the table because, as  
16 I said, if a \$1.20 is there, I'm going to take it.

17 Okay. That was the first hearing where I had  
18 the experience which, you may be right, is wholly defensible  
19 but it's not wholly pleasant at not being able to cross  
20 examine people but being cross examined myself. On September  
21 29th we came to this Commission. At that hearing staff  
22 presented this scheme for raising California gas prices,  
23 began with the prevailing Northern California price of a  
24 \$1.20. Use of those Northern California prices as a base  
25 is absolutely unavoidable.

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23  
1 I guess I should deal with the issue that's been  
2 raised now at this hearing, which wasn't before, about  
3 \$1.20. It's tough. It's in the staff's analysis. I can  
4 say, well, we've just got it in there and let's stick with  
5 it, but I'll respond to that point.

6 PG&E is a big buyer. There is no question about  
7 it. Our competition is, I think, primarily Dow and Shell.  
8 There is some competition and some of the prices you're  
9 looking at, we have no gas prices at a \$1.20 that were set  
10 in direct competition with Dow and Shell.

11 PG&E's position hasn't changed. It's been a big  
12 buyer ever since the season was assigned, ever since these  
13 contracts were entered into. It's a fact of the market.

14 The opinion you have before you with respect to  
15 the law takes the position, which I think is right, that  
16 you have to take the market as it is. You can't pretend  
17 that these producers are in Texas or Canada or Louisiana.  
18 They are in Northern California.

19 PG&E is big. What that means is we have a market  
20 advantage that is measurable by the size of our service  
21 area. In other words, if you want to use it out, you've  
22 got to build a pipeline in. No question.

23 What the witness said earlier is that there is  
24 that competition on the fringe that still exists. If it's  
25 worth someone's while to build transmission into the service

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1 area and take it out, they can get it.

2           The important thing to understand is that that  
3 position has not been abused. A, the contracts all have  
4 the arbitration out to reasonable market value; and, in effect,  
5 the prices that we pay are set by the biggest of the people,  
6 the people for whom arbitration is no significant barrier.  
7 I know, because they're coming up in February with three of  
8 them now combined.

9           B, when you look at the statistics, you will find  
10 that on average California producers have done better than  
11 producers anywhere else that we know of in this country.  
12 Mr. McCausland, watch it. That's a careful statement. I'm  
13 not saying they are doing better at the margin right now.  
14 I'm not saying they don't wish they were in Texas at the  
15 marginal prices that are being paid now. What I'm saying  
16 is when you look at the mix of all the prices for old and  
17 new gas, they're doing better here than they're doing in  
18 Texas; and that's significant when one of the questions you're  
19 asking is, is there some terrific reason why we should throw  
20 out Northern California prices.

21           I mention that only in passing because the staff's  
22 position is our position. Northern California prices have  
23 to be used. I think Mr. Hager's opinion fully supports  
24 and indicates that use has to be made.

25           We agree, of course, with the actual wellhead

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25  
1 prices. After that, we depart company with the staff.  
2 Despite the fact that it has over 180 flowing gas contracts,  
3 each of which was renegotiated to cover the period, the staff  
4 went further to use Mr. Lippitt's FERC and Canadian prices.  
5 Why? The only way to get prices up is to go to them.

6 At the hearing we pointed out the total lack of  
7 legal support for such an adventure along with the cartel  
8 link character of Canadian prices. We pointed to the fact  
9 that this Commission has for years viewed the prevailing  
10 Northern California price as the measure of reasonable market  
11 value despite the obvious differences between those prices  
12 and Canada's border price.

13 In 1975, the 75 cent per MCF figure was approved.  
14 At the time Canada's price was a \$1.14. At the hearing the  
15 Commission began asking why it should be using Canada's  
16 OPEC-linked price if it doesn't have to. Accordingly, the  
17 hearing ended with the direction that a formal opinion of  
18 the Attorney General be secured dealing with the question  
19 whether Canadian prices should be so used.

20 The hearing last September was attended by some  
21 publicity. I've already talked about this section. I'll  
22 mention it here. Afterwards Mr. Lippitt was quoted as saying,  
23 quote, "All we want is our cost back plus a fair profit."

24 Fine. Mr. Lippitt and staff would have you believe  
25 that prices in Northern California have been totally

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1 unresponsive to changing energy values and that the producers  
2 here have suffered terribly. That's the proof of the pudding  
3 of this terrible, mean monopoly claim. If you've got a  
4 real monopolist in a buying situation, he's going to be  
5 buying stuff at one cent over the cost of dropping out, and  
6 he's going to be paying a different price to each producer  
7 because each producer is going to have a slightly different  
8 dropping out price.

9           You will find that we've always equalized the  
10 amounts we've paid throughout California and the prices here  
11 have risen over 400 percent in the last six years. I don't  
12 think there is any dispute about that. External factors  
13 like Canadian prices have influenced the market. They  
14 haven't dictated it, as Mr. Lippitt would have them do.

15           Let's go further and actually compare the producer's  
16 production with conditions in Canada and elsewhere. The  
17 California producer after royalties will experience a return  
18 between a dollar and \$1.05 of flowing gas supplies at a  
19 \$1.20 price. That's assuming about a 16 percent royalty,  
20 which I think is conventional.

21           Canadian wellhead prices after royalty in Alberta  
22 and British Columbia now are in the 78 to 79 cent range  
23 for old gas. Even for new gas, the range is only 96 to  
24 \$1.03. At a \$1.20, California producers already are doing  
25 better than their Canadian brethren.

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27  
1           If your staff succeeded in boosting the California  
2 price to the 2.05 level they proposed, California will become  
3 a virtual paradise for producers of old gas.

4           Lest Mr. Lippitt now say that it's somewhat unfair  
5 to look so closely at the Canadian situation as he urges  
6 you to do, you can also look with the rest. The Bureau  
7 of Mines publishes annually the overall wellhead prices  
8 in each of the gas producing states. Latest data for  
9 1976, the year in which a \$1.20 went into effect in California  
10 in the principal gas producing states the totals were:  
11 Arkansas, 53 cents; Kansas, 42 cents; Louisiana, 46; Nebraska,  
12 41; New Mexico, 56.5; Oklahoma, 50.2; Texas, 71.8 and West  
13 Virginia 57. Those are prices for both new and old. In  
14 California the old gas price went to a \$1.20.

15           In '76 the weighted average wellhead price for  
16 the entire country was 58 cents.

17           MR. McCAUSLAND: What value was reported in that  
18 report for California that year?

19           MR. FALLIN: The mid-year cross-over value would  
20 have been probably 83, 84 cents. Staff claims that in  
21 California --

22           CHAIRMAN CORY: The figure you gave, are you doing  
23 that from your memory of what the prices were or your memory  
24 of having read it in the document?

25           MR. FALLIN: As I believe, I can check, it was

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1 83 cents that would have been California's.

2 CHAIRMAN CORY: The question I'm trying to get at  
3 is whether or not the base year is arrived at from the year  
4 of publication, '76, or the year to which the data --

5 MR. FALLIN: That's why there is no more current  
6 numbers available, because the report came out in '77 for  
7 the year 1976.

8 CHAIRMAN CORY: So you're going back from your  
9 memory of what PG&E was generally paying.

10 MR. FALLIN: No. No, 83 cents was the reported  
11 wellhead average in California because it only picked up  
12 half of a \$1.20. Another point that might be made, there  
13 is reference in Mr. Hager's piece to the unusual situation  
14 in California where we're a net importer or gas producing  
15 our own.

16 It's not really that unusual. There are a lot of  
17 other states that also produce their own and import some,  
18 and the prices run in the same general scheme: Colorado, 48;  
19 Illinois had a high 198; Indiana, 52; Kansas, 42; Kentucky,  
20 55; Louisiana, 46. I should say for the bulk of those  
21 contracts those are full-year prices, and they're not picking  
22 up the increase that occurred the next year with a \$1.20.

23 We had no objection to having the Attorney General  
24 take an objective look at the market value issue. In fact,  
25 we welcomed it; but somehow the staff maneuvered it so that

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1 the only opinion written was an informal note written by  
2 the lawyer assigned to the staff for his client, the staff.  
3 In fact, the lawyer chosen to do this little job, Mr. Hager --  
4 there's a little confusion over that -- we were informed by  
5 staff was the man who arranged for Mr. Lippitt's hiring in  
6 the first place.

7 MR. STEVENS: Mr. Chairman, I have to take some  
8 exception in support of the staff on this point. The assign-  
9 ment of the informal letter of advice that went to the  
10 Commission was made in our office, represents the best views  
11 that we could give you within the time that we had to do it.  
12 There was no maneuvering or other steps taken by division  
13 staff in that respect. It was entirely our work and our  
14 advice.

15 MR. FALLIN: Thank you, Mr. Stevens. I would like  
16 to carry it further, though, and point out the extremely  
17 difficult position that the mechanics of that operation  
18 placed Mr. Hager in.

19 He was required to produce an opinion for the  
20 people he was assigned to represent with respect to a case  
21 whose preparation he participated in. You don't have to be  
22 a lawyer to see the difficulty placed upon him.

23 I happen to have a very high opinion of Mr. Hager's  
24 integrity. That cuts both ways in an issue like this. I  
25 think it's got to be taken into account that what you have

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1 in front of you in fact is advice from an attorney to his  
2 client. You take it on its face value. The good parts are  
3 good and the bad parts are bad, but it's no direction from  
4 the Attorney General that you are bound to follow. That is  
5 not so, and I don't want there to be any confusion on the  
6 record on this score.

7 MR. McCAUSLAND: I think it's clear to the members  
8 of the Commission that an informal letter of opinion of  
9 the Attorney General is treated essentially as a counsel/client  
10 communication.

11 MR. FALLIN: Okay. Mr. Hager was forced to accept  
12 the fact that staff's references to industrial gas rates  
13 and alternate fuel oil costs had to be thrown out since  
14 the cases simply do not "permit consideration of market  
15 prices of alternate fuels as determinative of the market  
16 value of gas whose market prices are available."

17 In quote, "unless the lease provides otherwise,  
18 the market value of the wellhead is the proper measure."

19 I'm quoting from Mr. Hager's letter to Mr. Northrop  
20 at page 13 and 14. However, Mr. Hager's valiant effort not  
21 to completely scuttle staff's attempt to use Canadian prices  
22 forces him to depart from the very principles he described.

23 He's right. The cases are absolutely clear that  
24 establishing the value of gas sold at the wellhead can only  
25 be done at the wellhead. FERC and Canadian prices are not

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1 wellhead prices at all. There is simply no way around the fact.

2 Mr. Hager was unable to locate any case anywhere  
3 authorizing use of postproduction, postgathering, post-  
4 compression, post transmission prices in setting wellhead  
5 value. It might be argued that if one were able to strip  
6 off the postproduction values, the law would permit use of  
7 only the wellhead component of FERC and Canadian prices,  
8 but that won't work either since it's clear that the only  
9 wellhead price paid for gas under substantially the same  
10 circumstances prevailing at the wellhead can be used.

11 The reasons are obvious. The gas is produced in  
12 Northern California, not in Texas or Canada. No amount of  
13 wishing can move it there. The only case cited by Mr. Hager  
14 on this issue actually illustrates the weakness of the  
15 argument. The Hugoton case prices from other states were  
16 allowed only because the producing region -- as mentioned  
17 earlier today, it's a great name, the Hugoton embayment --  
18 happens to cross state lines. If any producing region under  
19 consideration here happened to cross into Nevada or Oregon,  
20 it might well be helpful to look at prices there. It just  
21 isn't so.

22 Producing regions in Southern California don't  
23 cross even one state line, let alone the three states and  
24 two provinces needed to get the Canadian gas.

25 It's also worth noting, as I think Mr. Perez aptly

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1 pointed out, that the court in Hugoton was careful to stress  
2 that there was no proof of any substantial difference in  
3 the governmental or regulatory climate in the states in  
4 question. The inference was if there had been such proof,  
5 prices might well have been excludable even though they came  
6 from the same producing regions.

7 In this case the proof could hardly be more  
8 conclusive that there are radical differences between the  
9 governmental conditions under which gas is produced in  
10 Canada and the system prevailing in this state, which brings  
11 us to the crux of the matter: What does Mr. Hager have to  
12 say about Canada?

13 He acknowledges the fact that Canada's gas prices  
14 are precisely analagous to OPEC's oil prices, the oil  
15 prices he defines as clearly "unfair and unjust." One would  
16 think that that would end the analysis, particularly in  
17 view of the inability to find any support for the proposition  
18 that non-wellhead prices paid for gas produced under wholly  
19 different circumstances can be used; but in fairness to  
20 Mr. Hager, he had his client to look out for.

21 Mr. Hager did not say that Canadian prices must be  
22 used, nor did he say that rejecting Mr. Lippitt's scheme  
23 would in any way conflict with law, logical economics on the  
24 gift question. All he was going to say was that in view of  
25 the broad scope of administrative discretion, et cetera,

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1 the Commission might be able to get away with using non-  
2 wellhead, nonmarket "unfair and unjust" prices.

3 Of course, we disagree with the notion that the  
4 Commission will be able to hide behind administrative  
5 discretion if it chooses to inflict Mr. Lippitt's price  
6 levels on us. Mr. Hager's own opinion states that the law  
7 requires use of wellhead values. That alone hits the Canadian  
8 prices.

9 The same letter rejects the use of alternate fuels  
10 as a way of reaching market value, yet Canada's prices are  
11 based on that very system.

12 Finally, the proposition that cartel-linked unfair  
13 and unjust prices can be called reasonable without anybody  
14 noticing is silly. Obviously, we should not be using unfair  
15 and unjust prices. The use of those prices is contrary to  
16 case law unless you are compelled to do so.

17 This brings the other question. Perhaps there  
18 was some compunction that says if you don't do that something  
19 terrible is going to happen. You're violating the Constitution.

20 I think that if you ask Mr. Hager directly he  
21 probably would agree with the proposition that use of  
22 Canadian prices is not compelled. Hopefully, he could also  
23 agree that if you reject the Canadian prices under the record  
24 you have in front of you, that would not carry with it any  
25 significant legal problems, even apart from the volunteered

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1 statement that the producers won't test it.

2 What I'm saying, in a familiar phrase is ask not  
3 what you can get away with, but ask what you should be doing.  
4 The inescapable --

5 MS. SMITH: Who should we be asking?

6 MR. FALLIN: You should be asking the figure that  
7 sits somewhere between Mr. Hager and myself.

8 MS. SMITH: Who is that?

9 MR. FALLIN: That's the Attorney General in the  
10 sky that we never got the opinion from.

11 MR. STEVENS: The Attorney General is and always  
12 will be counsel to the State Lands Commission, Mr. Chairman,  
13 I'm afraid pursuing this isn't going to get us very far.  
14 We always have a duty as counsel to the Commission.

15 MR. FALLIN: What I'm saying in more precise  
16 answer is that I think the evidence shows and the law more  
17 specifically shows that there is no justification for bringing  
18 in Canadian prices; and if that's so, it should not be used  
19 unless there is some compulsion, and no one has intimated  
20 that you're compelled to use them.

21 Apparently the next step I think perhaps concerned  
22 about the writing on the wall after the last hearing. A  
23 new effort was made. Essentially Mr. Lippitt and the staff  
24 now we move into the combined thing -- seek to have the  
25 Commission believe that unique new gas arrangements should

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1 be used to set prices for old gas sales.

2           There was a time when new gas and old gas were  
3 mysterious terms to the general public. It's not so any more.  
4 President Carter said last November we should reward indi-  
5 viduals and companies who discover and produce new oil and  
6 gas, though we must not give them huge windfall profits on  
7 their existing wells at the expense of the American people.  
8 The effort to pass off new gas for old focused on PG&E's  
9 purchases from the largest new gas discovery in a decade,  
10 Union Island. Rio Vista was discovered some 40 years ago.  
11 Since if included in the base Union Island would constitute  
12 about 12.9 percent of the relevant California production,  
13 its desirability from the producers' point of view is obvious.  
14 It's a fairly big weighting in the equation.

15           We dealt in detail with Union Island at the last  
16 hearing held January 12th. Essentially, some 47 cents of  
17 the Union Island price is due solely to the elements that  
18 were unique to it as a large new discovery.

19           Mr. McCausland, I caught from your earlier  
20 statements that you were hung up on the special delivery  
21 agreement. I'm not sure. I think it's clear enough in the  
22 statement we put in what that was designed to do and what  
23 it did. The reason why we used the standard that you referred  
24 to, which is the low sulfur fuel oil price, only for those  
25 small increments if they occur was the fact that that was

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1 what would have to physically be employed to replace the  
2 supplies. We actually have the right to pre-empt someone  
3 who has a purchase from that field at the most critical  
4 point in the year completely. The price that was set in  
5 there simply replaces or substitutes for what he's going to  
6 have to do to replace that gas.

7 A point, you don't have in front of you a contract  
8 that says, as some do, in Southern California the royalty  
9 shall be based on border prices. It could have been written  
10 that way. It wasn't. The same is true of this LSFO  
11 business. It's possible to write a royalty of a contract.

12 There have been contracts in California that based  
13 gas prices on oil. The last one disappeared about 10 or  
14 15 years ago. They were rejected because prices have never  
15 tracked one another.

16 MR. McCAUSLAND: They may start to now.

17 MR. FALLIN: May or may not start to.

18 The staff -- I think this is true -- has not  
19 disputed the values ascribed to the peaking premium element  
20 in that contract or the values ascribed to the additional  
21 wellhead expense.

22 MR. McCAUSLAND: Let me understand that. When  
23 you speak of peaking premium value, are you describing the  
24 special delivery agreement itself or the peaking elements of  
25 the base contract?

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1 MR. FALLIN: As an element in the price. It's  
2 both.

3 MR. McCAUSLAND: Okay.

4 MR. FALLIN: Because what was obtained at the  
5 margin, at the edge of our supply was a package that provided  
6 for three years' purchase, ten years' security, and it was  
7 a ten-year figure that enabled us to defer and reform  
8 construction of the LNG plant.

9 CHAIRMAN CORY: Can I follow up? Let me follow  
10 up on that one. Are they the same, the peaking that is  
11 done at Union Island versus the peaking done on our field?

12 MR. FALLIN: Actually, no. Perhaps it shouldn't  
13 be that way, but it is. Rio Vista is an old field. It's  
14 got some really serious problems. I think it's about a  
15 40-percent wet well minimum, which means in fact it can't  
16 be peaked anywhere close to one-third load factor.

17 I'll tell you what a wet well minimum is quickly.  
18 That means in certain fields, although contractually you  
19 can cut them back completely as long as you use one-third  
20 of their total production every year, because you've got a  
21 water incursion problem you can't do that. In other words,  
22 we can't cut Rio Vista back past about 40 percent or some-  
23 thing like that.

24 CHAIRMAN CORY: You heard Mr. Willard's testimony  
25 earlier comparing the peaking value of Rio Vista to the

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1 peaking value of Union?

2 MR. FALLIN: No, I --

3 CHAIRMAN CORY: My recollection was that he did  
4 that, and I would --

5 MR. FALLIN: I think he was giving a daily  
6 maximum production figure.

7 MR. WILLARD: Actual peaking characteristics of  
8 the Rio Vista field. It produces in excess of 200,000  
9 MCF per day.

10 MR. FALLIN: That's a baseload figure. Peaking  
11 becomes a peculiar value only if you can cut back and then  
12 increase. Union Island in the last ten years is a solely  
13 peaking contract. In other words, there is no baseload  
14 at all.

15 CHAIRMAN CORY: Union Island is.

16 MR. FALLIN: It's pure peaking in those last years  
17 now.

18 MR. McCAUSLAND: You're saying the fact that you  
19 can only roll Rio Vista back to 60 MCF per day -- these are  
20 1976 production numbers -- versus our peak load day of 230,  
21 almost 240,000 MCF per day, is that base of 60,000 that  
22 disturbs you?

23 MR. FALLIN: Well, the question --

24 MR. McCAUSLAND: It seems to me like you use it  
25 for peaking.

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1 MR. FALLIN: In the parlance of the trade, Rio  
2 Vista is almost a 50-percent factual load factor contract.

3 CHAIRMAN CORY: It doesn't look like it from the  
4 testimony here.

5 MR. FALLIN: If that's wrong, the staff can  
6 answer me. The wet well minimum is pretty high, I think.

7 CHAIRMAN CORY: We have a substantial period where,  
8 according to this chart, Exhibit 2, that from May through  
9 October I would say the average, looking at it on the graph,  
10 is 60,000; and November-December was 220,000.

11 MR. FALLIN: To be an equivalent on an MCF basis  
12 to Union Island, you'd have to be able to set that out  
13 totally in all of those months, and your only contractual  
14 requirement would be to take it on in the winter. But that's  
15 the measure of your flexibility. That's how much storage  
16 space you save.

17 CHAIRMAN CORY: Okay. Your contractual obligation,  
18 as I understand it from the testimony thus far in the record,  
19 for our Rio Vista field is only for peak. You can use it.  
20 You can cut it back if that's your contractual obligation.  
21 There may be some technical --

22 MR. FALLIN: We have to use at least -- we're  
23 always talking one-third. I think that's a one-third load  
24 factor contract.

25 EXECUTIVE OFFICER NORTHROP: That's correct.

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1 MR. FALLIN: Theoretically that means -- no, it's  
2 not just for peaking. It's not just for two weeks in winter.  
3 We have to use at least one-third of the field's total  
4 production, which is always going to be more than just  
5 peaking. That's contractually. Factually, because of the  
6 wet well minimum -- and maybe this should be considered too  
7 no longer performs as a one-third load factor contract  
8 because we have to take that base amount all the time in  
9 order to protect the wells.

10 MR. McCAUSLAND: Is that why you're taking quite  
11 a bit of it down to Moss Landing and other places for  
12 utilization?

13 MR. FALLIN: We have to keep pulling from that to  
14 save the field. For those who are economists instead of  
15 lawyers, there is a real question whether the wet well  
16 minimum isn't something that you could justify paying the  
17 guy who takes it for, because if he doesn't take it, your  
18 wells fail. It actually has a negative economic value.  
19 We will pass that for the moment.

20 MR. McCAUSLAND: I bet you put it to good use  
21 anyway.

22 MR. FALLIN: I think there's a question that you  
23 may have -- the fact is that Union Island's value occurred  
24 at the margin. It had that unique value to us because it  
25 happened when it did and was as big as it was. There's no

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1 question that when Rio Vista came in, it may have had a  
2 heck of a big value too. I think Rio Vista is still about  
3 the biggest field in the state. I think that probably --  
4 well, I can this clearly. If part of what Union Island says  
5 to the producing population, depending on how badly we get  
6 drummed with it here, is that if you bring in a field that's  
7 that big and fits our situation that closely, you're going  
8 to get paid for it. There's no question about it. What  
9 we're doing here is trying to compare things. You're trying  
10 to compare that price with the price of what you've got.  
11 What you've got is something that was contractually committed  
12 for years ago.

13 (Thereupon a brief recess was taken.)  
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1 CHAIRMAN CORY: Okay.

2 MR. FALLIN: I think we lapsed on Union Island.  
3 As I explained, the difference really was where it happened.  
4 Specifically at the time, in order to cover -- how shall I  
5 describe it -- the tip of the peak, we had some questions  
6 about is there a difference between needle peaking and peaking.  
7 It's probably subjective, but I think there is. When we  
8 talk about needle peaking, we're talking about the top and  
9 the insurance. That's both the capacity to see the peak  
10 when everything is operating and also to satisfy it, hopefully,  
11 if something goes wrong, the pipelines ruptured or compressor  
12 failed or something else.

13 At the time Union Island came along we were in  
14 the process of putting together something called an LNG  
15 needle peaking facility. That's a plant where you essentially  
16 either buy or make or create the LNG, put it in storage  
17 containers and keep it there against these peak day require-  
18 ments. It's a very efficient but very expensive way of  
19 meeting needle peaking requirements, push the button and  
20 it goes, but it also has some disadvantages because your  
21 depletion of storage once it's gone it takes a considerable  
22 amount of time to build it back up.

23 CHAIRMAN CORY: Let me make sure I understand  
24 this concept. You're talking about not the concept of  
25 importing LNG from outside of California, but taking our

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SACRAMENTO, CALIFORNIA 95826  
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1 existing domestic supply, liquefying it for storage purposes  
2 and meeting peak needs there.

3 MR. FALLIN: Yes. Theoretically, it can be done  
4 either way. In the time span we were looking at, it would  
5 have had to have been manufactured here.

6 CHAIRMAN CORY: Syn gas.

7 MR. FALLIN: It would be LNG. It would be  
8 liquefied natural gas.

9 CHAIRMAN CORY: The manufacturing you refer to  
10 is the liquefaction manufacturing, not the creation --

11 MR. FALLIN: Yes. It would be made from natural  
12 gas.

13 Union Island coming in when it did with 110,000,  
14 118,000 -- I can't remember what it is -- MCF a day deliver-  
15 ability probably not only allowed us to change that, but  
16 in terms of valuation, it got us out of a very difficult  
17 situation. In other words, it wasn't clear at all that even  
18 if we carried out all the programs, the timing on that LNG  
19 plant, it would have been on stream in time to protect  
20 against the perceived problem.

21 Getting Union Island didn't mean we could cancel  
22 the plant entirely. It's not a one-for-one substitution.  
23 What it meant was, if I recall correctly, we could defer  
24 construction of the entire 400,000 MCF plant for "X" number  
25 of years, perhaps three or four. When it was built, it would

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1 only have to be build to 300,000 MCF out to the tenth year,  
2 and it was only in the tenth year that that storage element  
3 would have to be added.

4 That's the calculation we've given you with respect  
5 to the peculiar peaking premium that Union Island was able  
6 to command. It should also be stressed that we do pay  
7 peaking premiums. Under a one-third load factor contract  
8 you get 18 cents an MCF more than the fellow who has a 100-  
9 percent load factor. You are getting a premium right now  
10 in your contract.

11 The other element that Union Island -- and at this  
12 point we cross into what I think can be defined specifically  
13 as a new gas incentive -- was the -- I think it works out  
14 to be about 16 cents that we were willing to go to. I have  
15 to stress here, too, because we're dealing with economics  
16 and we're dealing with future situations, I'm not saying  
17 that we're always going to be willing to pay "X" amount of  
18 dollars under any formula for every new gas supply that comes  
19 along.

20 I am saying that if we have the same situation,  
21 the same supplies, we'd do it again.

22 It may be, and if it happens, we're going to --  
23 I'm in a very difficult area because I don't want to say  
24 too much because part of what I'm saying is dependent on  
25 whether you use this new gas contract to pull up old gas

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1 prices. I can make commitments with respect about what we'd  
2 be willing to do, but those commitments don't ride if it's  
3 used to pull up old gas prices.

4 CHAIRMAN CORY: I'd be more interested in where  
5 you're going to be philosophically on this problem of using  
6 LNG from other sources if somebody finds \$1.20 gas here and  
7 you've already built the LNG facility and contractually  
8 obligated yourself. Are we, as California consumers, going  
9 to pay the 3 and \$4 for that figure because you've made the  
10 decision to go ahead and do it? Are we going to be protected  
11 from that?

12 MR. FALLIN: That gets us quickly to an issue that  
13 was alluded to before. All the things we're doing here  
14 stop July 1, 1978. There is no supply of LNG or anything  
15 else that's going to arrive here within the time period we're  
16 talking about.

17 CHAIRMAN CORY: Mr. Fallin, let me try to tell you  
18 why I'd like an answer to that question.

19 MR. FALLIN: I think the answer was would we like  
20 to have California gas --

21 CHAIRMAN CORY: No. No. I'm trying to find out  
22 with what kind of clean hands you come to this hearing as  
23 a representative of PG&E and how much value I can place  
24 upon your good will in what you say generally. I'm trying  
25 to find out where the company is philosophically when they say

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1 they need LNG facilities and that when they have to bite  
2 the bullet of deciding that if a new field comes in, a new  
3 Union Island field was available, domestic producers find  
4 that and they can produce gas for, given for inflation,  
5 arbitrarily a buck fifty, a buck seventy-five, are you willing  
6 to not use the LNG facility and have the stockholders eat  
7 the cost of interest payments in those, or are we, the  
8 consumers, going to pay for that anyway?

9 MR. FALLIN: The answer is that we're going to do  
10 as far as --

11 CHAIRMAN CORY: It's the other side of the --

12 MR. FALLIN: I'm going to do and everybody else  
13 that I know is going to do exactly what is reasonable under  
14 the circumstances. If it was reasonable to have taken the  
15 chance and put in a facility considering that you wouldn't  
16 develop this much thereafter, then that should be treated  
17 conventionally.

18 CHAIRMAN CORY: I understand your answering. Go  
19 ahead with your point. Sorry to interrupt you.

20 MR. FALLIN: Okay. In this case something additional  
21 was there, too. The new gas incentive was cost justified.  
22 That was important to us, you might even say essential to  
23 us in terms of ultimate justification to anybody who would  
24 come and say, well, how on earth did you dream up this kind  
25 of amount?

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6  
1           Mr. Leineke thankfully was at our last hearing  
2 and was able to confirm the accuracy of the numbers I gave  
3 then about just how much more expensive drilling at Union  
4 Island was. There is no dispute between us on those amounts.  
5 With respect to the amounts at Union Island I've used in  
6 this piece and I think I used in the last submittal I made  
7 at the January 12th hearing, Mr. Paschall's numbers for the  
8 years 1976 through 1978.

9           Mr. Paschall, of course, is the man from the  
10 Board of Equalization. He used '76 to '78 as the period  
11 under consideration. He can watch this if he will. I think  
12 he's probably already seen it. Maybe he's not here anymore.  
13 Somebody has probably checked it.

14           The combined value he comes up with for the years  
15 in question is a \$1.52. That's including the gathering  
16 fee and making no offsets for the new gas, the peculiar  
17 aspects, what I've said are the peculiar aspects of Union  
18 Island.

19           I think I've laid out what happens if you take  
20 47 cents of that number. You get to a \$1.05. The gathering  
21 fee is the only thing the staff I think really disputes.  
22 There have been a couple of numbers around. All I can say --  
23 I will be open on this -- is that we went into that with the  
24 understanding that it was to be basically set off against  
25 bare expenses. We have asked. We haven't been able to get

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1 Union any detailed workup of their gathering system cost.  
2 For the time being you can treat that 8 cents up or down.  
3 It doesn't make a lot of difference. It's either a \$1.05  
4 or 97, taking out what I think we rightfully say are unique  
5 features.

6 Now, let me give you something else that I provided  
7 already. What does this do? What is Union Island's impact?  
8 If you decide to use it, if you decide to use Mr. Paschall's  
9 figures for 19 -- this was in the supplemental submittal  
10 after the January 12th letter -- if you use that number and  
11 don't make a single adjustment to it, you don't take out  
12 of it the amount we're willing to pay because of the additional  
13 drilling expense, you don't take out of it the needle peaking  
14 premium, that's not just -- as you mentioned there is a whole  
15 separate contract that goes with that that we don't have.  
16 Leave it at a \$1.50 and put it in with the Northern California  
17 price, you come up with a \$1.23. That's the impact we're  
18 talking about.

19 So, why am I so concerned, everybody asks them-  
20 selves. The reason I'm concerned goes back to the point at  
21 which I think we and the producers link up. Again, we are  
22 very interested in new gas. And Union Island, because it  
23 happened when it did, was an effort to try new gas incentivating,  
24 if that's a word. Whether we can continue with that  
25 constructively depends in large part on how these prices

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8  
1 are treated, but that's their impact.

2 If you use Union Island, it's 12.9 percent. Well,  
3 the numbers are in evidence. You use his numbers for those  
4 last two years, for '76 to '78, it has a 3 cent impact on  
5 the overall Northern California price.

6 There is an issue raised. Staff departs from  
7 Mr. Paschall in ways that I frankly don't follow completely.  
8 Frankly, I would urge that you use his numbers. One thing  
9 I can see that they've done is talked about liquidating the  
10 exchange gas balance after the third year.

11 What does that mean? Union and Phillips have  
12 delivered gas to us which we have used. Under the contract  
13 we have a right to call that gas back in the future or,  
14 within certain limits, to liquidate it for cash. The fact  
15 is that it doesn't make any sense at all for them to  
16 liquidate it for cash. It would cost them more to replace  
17 than they would get for selling it to us. To replace they'd  
18 have to buy it at industrial rights. It's not going to  
19 happen.

20 The equation then becomes what is the difference  
21 between the gas that you use that you are able to get income  
22 from and earn the interest on that income out to the point  
23 where you had to replace it from your supply. As we've  
24 testified, that works out to be a wash for a couple reasons.

25 For one thing, our gas in the system is a mix of

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1 old and new. We have some in storage which theoretically  
2 goes back to the 75 and 45 cent prices. When we pay it back,  
3 it wouldn't be paid back at the margin anyway. Add to that,  
4 in case you are interested at this late date, the transporta-  
5 tion fee, which is -- there is no incremental cost incurred  
6 for that, if you understand what I mean. In other words,  
7 we get a fee for the exchange gas, but it doesn't cost us  
8 anything to move around.

9 CHAIRMAN CORY: It doesn't cost anything to move  
10 it around?

11 MR. FALLIN: Yes, because it's actually an exchange.  
12 It's not a transportation. We deliver out of the pipeline  
13 that already goes to their refineries. You don't take a  
14 package and have to line out some different supply of gas  
15 and move it around until you get it there.

16 CHAIRMAN CORY: I'm not sure that I understand,  
17 but go ahead.

18 MR. FALLIN: We don't even have to change a valve  
19 or do anything else to do it.

20 CHAIRMAN CORY: But the utilization of the facility,  
21 as I understand PG&E's testimony, is not worthy of income.

22 MR. FALLIN: We earn a return on it, but it's no  
23 incremental cost to us and, in fact, it's a return that we  
24 wouldn't have earned but for the exchange. If you're trying  
25 to analyze overall value --

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1 CHAIRMAN CORY: I'm just trying to decide where  
2 you are with relation to the PUC on income.

3 MR. FALLIN: You would set it off as a detriment  
4 or you would set it off against any detriments.

5 Okay. The staff has now, at least judging from  
6 their agenda item, not pinning any specific increase on  
7 Union Island. The item for this meeting, while jiggering  
8 the price upwards -- remember, too, that we stopped in July  
9 of '78 the issue of whether they might hypothetically extend  
10 it to '78 will become relevant at the next meeting we have  
11 on those prices. The prices now are the three-year schedule.

12 Why wouldn't they exercise it is another question.  
13 The answer is it was designed to provide them with protection  
14 at not getting short with their pipeline not built. If their  
15 pipeline is built, I would imagine they'll go ahead and use  
16 it rather than having it sit there with that investment.

17 Now, as to the agenda item, it's presented only  
18 as one "high price" without any specific claims to relevance.  
19 The answer is that properly adjusted it's not a high price,  
20 and unadjusted it's wholly incomparable to the State's old  
21 gas supply. As we have said before, the most direct indica-  
22 tion of Union Island's remoteness from this case is the  
23 fact that Union Oil Company, one of the participants,  
24 accepted a \$1.20 as a reasonable value for all its own old  
25 gas supplies after Union Island.

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11 1           Where does it all leave us? The answer lies in  
2 the staff's presentation again today. They have returned  
3 to Canada and are once again asking the Commission to punish  
4 us with prices their own advocate equates with "unfair and  
5 unjust" cartel-driven prices. Something you've got to keep  
6 in mind, you can't get to the prices they're talking about  
7 without going to Canada.

8           I have a thing back here somewhere. Mr. Cory will  
9 probably remember back in those soft autumnal days of  
10 September we had a release on what might happen at that  
11 hearing, and staff had listed in the attachment you had to  
12 that our El Paso prices. They are a \$1.12.

13           As I pointed out in our last submittal, if you  
14 combine the flowing prices for gas supplies in Northern  
15 California with the FERC regulated prices, you get a \$1.17.  
16 I had written here, and it's true, I'm almost out of words.  
17 If you guys can't see now the legal, logical and political  
18 unacceptability of this Canadian scheme, I can't be of much  
19 further help; but remember, you start from an agreed base  
20 of Northern California prices that fully support a \$1.20  
21 in MCF. The burden is on the staff to show that it's  
22 necessary to go beyond those prices.

23           CHAIRMAN CORY: You're not out of words.

24           (Laughter.)

25           MR. FALLIN: I can see the end right now. The staff

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12 1 hasn't done that. There is no moral, legal, economic or  
2 political compulsion for you to go to Canada for those prices.  
3 Remember, too, as Mr. Hager pointed out, alternate prices  
4 don't work. He didn't say why. One of the reasons they  
5 don't work is there has been talk monopolies.

6 CHAIRMAN CORY: Did you lose sight of the end?

7 (Laughter.)

8 MR. FALLIN: Having been so successful or unsuccess-  
9 ful with my first, I'll extemporize at the tag end. Because  
10 it's another issue that deserves ventilation. I discuss  
11 the monopoly argument --

12 CHAIRMAN CORY: Are you paid by the hour?

13 (Laughter.)

14 MR. FALLIN: Actually, I just work for wages, which  
15 is pathetic. That's the way it is.

16 Anyway, the Canadian price is what the market  
17 will bear. That is a monopolist price. It's not just that  
18 it's determined by the monopoly, but going to that price  
19 incurs the same problem.

20 The quickest answer is look at the cases, the ones  
21 that are cited. There has been a lot of litigation about  
22 what reasonable market value means, and you won't find a  
23 one, unless Mr. Hager and I have both failed in our efforts,  
24 that lets you go to Canada. I don't think you'll find a  
25 one that lets you go to El Paso, but on the other hand, what

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13  
1 does it do? Under the conditions you described earlier and  
2 under the state of the record now, you would have to find --  
3 with respect to Rio Vista; I don't know what the Ryer Island  
4 situation is -- you'd have to find a price higher than a  
5 \$1.37 to find that a \$1.20 paid for Rio Vista was unfair,  
6 and that's it.

7 (Thereupon a brief discussion was held off  
8 the record.)

9 MR. FALLIN: I have to admit that I have done my  
10 best to build this record.

11 MR. McCAUSLAND: Yes, you have.

12 (Laughter.)

13 CHAIRMAN CORY: Increase the size.

14 MR. McCAUSLAND: But I want to say that today I  
15 followed you. As I read through the earlier transcripts,  
16 I found that sometimes I had to go back and reread several  
17 times to make certain that I had understood when you  
18 qualified something you really had qualified it. I think  
19 you were very direct today, and I appreciate that. It's  
20 a complex issue. So, I know why you --

21 MR. FALLIN: Extemporizing the transcript probably  
22 doesn't follow as logically as the statements do.

23 MR. McCAUSLAND: Does PG&E use the maximum of  
24 California produced gas that's available? Do you use a  
25 minimum amount? How do you determine that you're going to

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14  
1 use California gas?

2 MR. FALLIN: That's a subject that is in contention.  
3 You heard a lot of people talk about it earlier.

4 MR. McCAUSLAND: As a quasi-capitalist, it would  
5 be my intent to take the maximum amount of cheapest gas that  
6 I could get into the system.

7 MR. FALLIN: I think you've managed to find your-  
8 self at the point at which Sylvia and I can be severed.

9 MR. GRAVELLE: We'd welcome you to come to one  
10 of our hearings.

11 MR. FALLIN: I don't know the mechanics, to tell  
12 you the truth, of why it works this way or how it works this  
13 way. It's my understanding that the Commission has taken  
14 a position that there is a conservation ethic involved in  
15 use of California gas that involves husbanding it. You  
16 may remember back before Alan got rid of industrial rates,  
17 we were talking about this issue, and the fact that in a  
18 sense they are dedicated to --

19 MR. McCAUSLAND: He's not all bad. He did some  
20 good things for you.

21 MR. FALLIN: I think that writing an opinion for  
22 his client and having to support a position they'd taken and  
23 understood that way, yes. That's my only point about it.

24 MR. McCAUSLAND: But you really don't have an  
25 answer to my question. Your answer to my question regarding

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15  
1 the PUC is that we husband California gas and don't exploit  
2 that low price.

3 MR. FALLIN: If you want to put it another way, that's  
4 another way in which we're not acting like a monopolist.

5 MR. McCAUSLAND: All right. You described to me  
6 during the break a little bit on the arbitration process.  
7 I'm close to the point of believing that all of the burdens  
8 placed upon this Commission in terms of its statutory role  
9 as keeper of resources and generator of cash makes it very  
10 difficult for us to also set ourselves up as a rate-making  
11 body, and I'd like to explore the notion of the fact that you  
12 have cases in arbitration and how that relates to the matter  
13 before us.

14 MR. FALLIN: That's just about your whole problem,  
15 the reason why we talk about this decision reverberating,  
16 because you have to understand the arguments that I've made.  
17 I think the arguments are good ones -- at least they haven't  
18 been answered by anyone so far -- against using Canadian  
19 prices, against the Canadian prices. Those arguments are  
20 largely -- to a point they are conventional. Up to the point  
21 where FERC and Canadian prices break, the arguments are  
22 largely the same. There is just no support for using non-  
23 wellhead, non-market prices.

24 Every case cited by both of us used wellhead prices  
25 except where it was wet gas and you had to get it to dry gas

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16  
1 to sell it. Where we part is in the fact that Canada's  
2 different. It's not just that it's outside the ordinary  
3 scope of law; it's because of the peculiar mechanism used  
4 is hinged automatically to what OPEC does. It is a reflection  
5 of OPEC's prices. When you talk about using that price --

6 CHAIRMAN CORY: When you make that point, will  
7 you help me by telling me how you in good conscience entered  
8 into the Union Island contract in which you used the same  
9 mechanism?

10 MR. FALLIN: Sure. The only point -- well, let  
11 me put it this way. The point at which the mechanism was  
12 used was a special delivery agreement where it's a physical  
13 requirement. If we pull the gas out from there, use it at  
14 their refinery, they have to replace it with LSFO; and they  
15 could argue, whether we felt it was justified, --

16 MR. McCAUSLAND: That's not the only place you  
17 used it. You rejected an extension price because --

18 MR. FALLIN: The quicky argument with respect to  
19 the other place is that it's never used until after the  
20 period you have under consideration. It's never used until  
21 after July of '78 under any circumstances.

22 MR. McCAUSLAND: But the problem that we're  
23 faced with is we view this -- and you can help me define a  
24 word better than value since I'm not an attorney and obviously  
25 none of the attorneys like my use of the term value. We have

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17  
1 a very precious commodity in the Delta which, as a landlord,  
2 we want to husband probably as much as the PUC wants to  
3 husband. Also as a group with fairly broad statewide  
4 interest, we realize the state has a long-term energy need  
5 that you're probably as sensitive, if not more sensitive, to  
6 than we are; and we look at that precious commodity and the  
7 fact that you have already conceptually found an equivalent  
8 value to low sulfur fuel oil indexes. It's very hard for us  
9 as a landlord not to believe that it's incumbent upon us  
10 to look at that same conceptual framework.

11 MR. FALLIN: Well, A, it's not because it doesn't  
12 occur in the time period you're talking about. B --

13 MR. McCAUSLAND: No. That's a fiction.

14 MR. FALLIN: B, it isn't -- we don't think it's  
15 going to occur. To the extent that you are looking at the  
16 thing and you are asking yourself was a bargain struck, as  
17 of right now the answer it was clearly the other way. We  
18 turned it down --

19 CHAIRMAN CORY: But previously you allowed the  
20 other side to unilaterally impose it upon you.

21 MR. FALLIN: It's not been exercised.

22 CHAIRMAN CORY: You contracted away the right to  
23 do that.

24 MR. McCAUSLAND: Let's follow that for just a  
25 second because the difficulty that we have, my difficulty is

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18  
1 that I believe even though we've got sloppy fields that are  
2 falling apart at the seams -- I'm not sure I should stipulate  
3 to that as a landlord.

4 MR. FALLIN: No, it's not quite that bad.

5 MR. McCAUSLAND: It's not quite that bad, but  
6 our fields are extremely valuable to you during peak need  
7 situations. We could probably even help you with some of  
8 that insurance policy you described.

9 MR. FALLIN: Not unless you incur out in front.

10 MR. McCAUSLAND: Not unless we what?

11 MR. FALLIN: Not unless that peaking occurs at  
12 the margin. You're already counted into the equation that  
13 requires us to go out and build this stuff.

14 MR. McCAUSLAND: All right. We really are precious.

15 CHAIRMAN CORY: We really are precious because  
16 we've been had.

17 MR. FALLIN: It's already been contracted for.

18 MR. McCAUSLAND: Preciousness and virginity go  
19 hand in hand. But the fact that you are able to continually  
20 forestall the day of reckoning in terms of not being able  
21 to meet peak demand someday has a lot to do with the fact  
22 that our commodity is available to you when you need it,  
23 and that's to me the exact same terms of an agreement that  
24 you've entered into that runs until 1985, by my reckoning,  
25 that allows you to pull off 50,000 MCF when you need it on

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1 a specified number of days under specific circumstances.

2 MR. FALLIN: Completely ignoring everything else,  
3 that would be a much better peaking contract because it's  
4 total.

5 MR. McCAUSLAND: It's a beautiful contract.

6 MR. FALLIN: You're never obligated to take the  
7 gas when you may not want to have it. It's pure peaking.  
8 The fact is that if you come up with Rio Vista tomorrow  
9 or anything close to it, and in fact you may not fit the  
10 situation so well now because it depends on where our plans  
11 are and whether, as you say, whether you can change them  
12 or not, you get the same premium. That's important because  
13 that's what calls for new gas supplies. You just can't get  
14 it. It's too bad. I guess you can reflect on the fact,  
15 but it is true that the market price for old gas currently  
16 sets a premium at 18 cents, which is what we're paying you.

17 Strictly, it may be a little overpayment because  
18 of the wet well minimum.

19 I don't want to keep ducking this LSFO in the  
20 last year. A, it's hypothetical. If it could occur, you've  
21 got to say, when the bargain was struck a price was thrown  
22 out in the fourth year that was set on a standard. If this  
23 easement said alternate fuels or if we had a series of  
24 contracts that tied gas to oil, fine. It could be done.  
25 It could be done, and you can consider it: and I have no

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20  
1 question that starting in 1978, if they do exercise that  
2 right, that's going to be a big issue. Of course, what  
3 we're going to say, there's a lot of things that the projection  
4 didn't come true. Our fears weren't realized. That's why  
5 we didn't take the option.

6 If that price was a good price to us, we certainly  
7 would have taken it for another three years because that's  
8 a big supply, and with the pipeline built, it's simply gone.

9 MR. McCAUSLAND: I think I can accept the rationale  
10 that was utilized in trying to project the future costs back  
11 to the negotiated --

12 MR. FALLIN: You've got to realize the fact price  
13 that they've given you, you'd have to take out the liquidation.  
14 It's never going to make sense for them to liquidate for  
15 the reasons I mentioned which would take that price back  
16 to a \$1.60 something or other. That's going to have perhaps  
17 a four cent impact on the prevailing rate. It will bring  
18 it up to about a \$1.84.

19 MR. McCAUSLAND: Let me describe for a moment  
20 why I embarked on that dialogue with you. The last time  
21 that we met as a Commission and you made your testimony,  
22 you were quite concerned about the kind of evidence that  
23 was before us at that time; and it struck a sympathetic  
24 chord, and I felt guilty that I hadn't been through the  
25 record. Now that I'm through the record, I feel compelled to

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21  
1 consider evidence that you find totally unacceptable. I  
2 also feel, though, even more uncomfortable with my role as  
3 a ratesetter and am trying to demonstrate to you that I want  
4 to know how arbitration could be any worse than dealing with  
5 me.

6 MR. FALLIN: It's not a pleasant experience. Let's  
7 say I like to see Henry over and over again. The point with  
8 Canada -- this is the kind of thing that I have said before  
9 and I don't think -- I have never said that Canada is  
10 irrelevant. I have never said that oil prices are irrelevant.  
11 If you went to Canada and could see that, God, look at that  
12 price increase they've had over the last two years. You  
13 come to California and you find four percent, five percent.  
14 Inflation. What was inflation, 10, 11 percent? The price  
15 you're now looking at, a \$1.20, was, what, a 60-percent  
16 increase? I think that's right. From 75 to \$1.20 is something  
17 on the order of 60 percent. What we're talking about is  
18 140 percent.

19 There is no question looking at the numbers you  
20 cannot deny that Canadian prices had an influence on that  
21 price. The important point is they didn't dictate it, they  
22 didn't come in just because they were "X" amount of weight  
23 or whatever. They entered into both sides eyeballing of  
24 what the price was and what they could get if they went  
25 to arbitration.

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22  
1 MR. McCAUSLAND: Could you describe to me the  
2 procedures that are utilized in arbitration in terms of  
3 fulfilling the requirements for fact finding and due process  
4 and those things that I am guilty of?

5 MR. FALLIN: If anything they are -- well, it's  
6 all set largely by agreement. If the two sides don't agree  
7 on things, it goes in -- well, literally anything comes  
8 in. There are no restrictions. The arbitrators not only  
9 set all the rules and all decisions, but all proceedings.  
10 That's why it's such a damnably difficult thing to go past.  
11 That's why the judge in San Diego felt he was constrained to  
12 stay with the Occidental arbitration.

13 It can have a downside, it's true. If you came  
14 out and said, we've looked through this thing, and boy,  
15 we're convinced PG&E is paying too much, the stuff is only  
16 worth about 95 cents, and that was cranked into an arbitration  
17 and it was held up, they'd have the same problem. They're  
18 almost impossible to move.

19 MR. McCAUSLAND: Have you had any of those lately?

20 MR. FALLIN: Ninety-five centers?

21 MR. McCAUSLAND: Well --

22 MR. FALLIN: If I had any, I wouldn't be telling  
23 you.

24 CHAIRMAN CORY: You'd have a problem, wouldn't you,  
25 before the PUC if we came up with that in terms of the

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23  
1 bootstrap up? Wouldn't the bootstrap go down in terms of  
2 reasonableness of your position?

3 MR. FALLIN: Probably would. I'll take it.  
4 Sylvia?

5 MS. SIEGEL: I'm listening.

6 MR. McCAUSLAND: All right. Thank you.

7 MS. SMITH: I've read your statement more than  
8 once, as I have the other material. I listened to you all  
9 day today, and I don't have any more questions to ask you  
10 that might cause you to extemporize.

11 (Laughter.)

12 MR. FALLIN: I misspoke on one of the numbers that  
13 I gave you in terms of what the State would have to pay.  
14 It's \$1,219,000. That's to keep this building warm.

15 CHAIRMAN CORY: There is enough hot air in this  
16 building on any day that we don't need any gas.

17 (Laughter.)

18 CHAIRMAN CORY: Mr. Lippitt.

19 MR. LIPPITT: My name is Henry F. Lippitt, II, and  
20 I'm executive secretary of the California Gas Producers  
21 Association. Since my consulting contract with the Commission  
22 has terminated, having completed the work, I'm happy to say  
23 that what I put on the record maybe you can use for part  
24 of your decision.

25 Let me first -- I was asked to put in two statements

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24  
1 by two producers, and they are in the form of letters.  
2 Other than reading them into the record and making an oral  
3 statement, let me deliver the letters to you and just put  
4 them in the record. They are statements on behalf of Buttes  
5 Resources Company and Anacapa Oil Corporation. There are  
6 a number of copies here which the parties can pick up.

7 CHAIRMAN CORY: Does the staff have a copy of  
8 these?

9 MR. LIPPITT: If they don't, they're there if  
10 you'd like to pick them up.

11 CHAIRMAN CORY: Grab them because I can't hang on  
12 to anything.

13 MR. LIPPITT: I understand. The gist of Anacapa's  
14 statement at the bottom is:

15 "Under the circumstances, Anacapa,  
16 as a small producer, felt that it had  
17 no economic alternative to accepting  
18 PG&E's offers."

19 Buttes, in effect, said the same thing. It said:

20 ". . . like other relatively small  
21 producers, did not want to assume the  
22 expense of arbitration which was the  
23 only alternative to accepting PG&E's  
24 offer."

25 In any event, it is somewhat similar to the other

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25  
1 letters which you have received, and I ask that this be made  
2 a part of the record rather than reading it.

3 Let me make a couple of comments first about Canada,  
4 second about Union Island and then third about other contacts  
5 in Northern California, other pricing landmarks.

6 First as to Canada, as Mr. Fallin has said, it  
7 is part of the market in Northern California. That is to  
8 say the delivery of Canadian gas in Northern California is  
9 over one-half of all of the gas which is delivered in Northern  
10 California. It is a fact of the market. It cannot be ignored.

11 The reason it cannot be ignored is not only the  
12 factual basis it cannot be ignored, but Judge Yale, William  
13 A. Yale, in his decision upholding the Occidental arbitration  
14 stated in so many words that it was a factor and that it had  
15 to be considered, or certainly that it could be considered,  
16 and that if it should not be considered, it was a matter for  
17 the Legislature rather than for the arbitration in that  
18 particular case.

19 That's the same situation here. Until there is  
20 legislation, it is a factor. It must be considered. You  
21 cannot disregard an impact of over 55 percent of the Canadian  
22 gas in Northern California.

23 Second, with respect to Union Island, there has  
24 been a good deal of discussion about the fact that the  
25 wells and so forth were more expensive. Let me point out

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26  
1 that this is PG&E's justification for paying the higher price.  
2 The interesting thing is how little this looms in the entire  
3 flow of payments in the Union Island contract. There are  
4 some 14 wells in the field at a cost of \$800,000 apiece.  
5 That's a total of \$11.2 million. The cash flow from that  
6 field at 20 billion feet per year is \$27 million a year,  
7 which means that you amortize the cost of those wells in  
8 less than six months. In other words, if PG&E really feels  
9 that costs should be considered in negotiating these contracts,  
10 they could certainly have asked Union Oil Company whether  
11 or not they felt they would make a fair rate of return, or  
12 more, with respect to the Union Island gas.

13           Obviously, this factor was not considered by  
14 PG&E in its determination, and what they would like to do  
15 is ask all of us smaller producers to cough up all of their  
16 costs; but they have not in their most recent negotiations  
17 used those costs as a factor in determining a price that  
18 they would pay for gas in Northern California.

19           Now then, with respect to peaking, I direct your  
20 attention to Mr. Willard's exhibits and his exhibits three,  
21 four, five and six, which have to do with the peaking  
22 characteristics of the gas that are involved in this case.  
23 You take the largest one, which is the Rio Vista gas unit,  
24 and you take peak day deliveries of 150,000 MCF per day,  
25 and the so-called wet well minimum is 40,000. That is a

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27  
1 peaking factor of over three-to-one, not less than three-to-  
2 one so that, if anything, the Rio Vista gas is more valuable  
3 than a three-to-one contract.

4           The interesting thing is that in addition to needle  
5 peaking, which you can see from the characteristics of the  
6 charts -- and what looks like needles are needles, and that's  
7 why they are called needle peaking -- you also have seasonal  
8 peaking. Take the North River Island unit. It's shut off  
9 completely in March and April and May and June and July. Then  
10 when it's turned on, it's turned on to get the peaking value,  
11 the needle peaking; but in addition to that, from these  
12 fields you also get seasonal peaking.

13           It is a more valuable field if you can get from  
14 it not only needle peaking, which you get from Union Island,  
15 but in addition to that throughout the wintertime generally,  
16 rather than only the very coldest days, you also get seasonal  
17 equation. So, on that basis the Rio Vista gas is more  
18 valuable, not less valuable, than the Union Island gas.

19           Let me also point out that the staff's analysis  
20 of the Union Island gas has only to do with the cost, top  
21 word, cost analysis of the cost of this gas to PG&E. It  
22 does not cover the value of the gas to Union Oil Company.  
23 Of the total deliveries at Union of about 30 billion cubic  
24 feet in the course of three years, 12 billion cubic feet are  
25 exchanged. If you put a value on that exchange gas, and that's

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1 40 percent of the total, you would do it by taking the value  
2 that Union Island, the cost that Union Oil has to pay for  
3 gas at its refinery. That price is presently \$2.29 which  
4 PG&E charges. There is a nine cent per million Btu exchange  
5 fee.

6 So, as far as Union Oil's production department is  
7 concerned, they get a value of over \$2.20 for the gas which  
8 they are delivering today which they have been delivering  
9 for the past three years, or 40 percent of their gas to their  
10 refinery. That has not been taken into account in that  
11 cost analysis. It is an additional value which has to be  
12 considered if you're considering reasonable market values  
13 rather than just costs.

14 Let me refer to you other prices, particularly in  
15 California, and then elsewhere. Before I do, I'll make one  
16 comment, and that is with respect to cost.

17 First off, Mr. Fallin stated that one of the cost  
18 analysis that he had shown that had shown the producers,  
19 in this case the Lathrop field, was making 100 percent rate  
20 of return. Mr. Fallin's study carefully put in the wells  
21 which were drilled in the Lathrop field and a couple of  
22 development dry holes, but he posited that you could  
23 a Lathrop field without drilling any dry holes elsewhere.

24 I will tell you that if the oil and gas business  
25 can be run on that basis, we are entering a new era. The

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1 100 percent figure for a rate of return for a field like  
2 Lathrop, not taking into account anything except development  
3 dry holes in the field after the field is developed, is  
4 certainly worthless for determining the rate of return which  
5 a producer will earn.

6 Mr. Williams referred to ten-to-one --

7 CHAIRMAN CORY: Pardon me. I just want to make  
8 sure I understand the point of that. Are you saying that  
9 the point of your statement is that before you get to  
10 Lathrop --

11 MR. LIPPITT: You drill a lot of dry holes.

12 CHAIRMAN CORY: You had to do something else  
13 to get there unless you're incredibly lucky?

14 MR. LIPPITT: Exactly. For instance, when the Federal  
15 Power Commission --

16 CHAIRMAN CORY: May I ask a question? There is a  
17 gentleman -- I'm sorry. It's getting late.

18 MR. LIPPITT: Mr. Williams?

19 CHAIRMAN CORY: Mr. Williams testified a return  
20 of \$3.00 for \$1.00.

21 MR. LIPPITT: Let me talk to you about that. That's  
22 exactly what he was talking about. In other words, once  
23 you've got a well, if that well will return \$3.00 for \$1.00,  
24 you've got a successful return. If it only returns \$2.00,  
25 you will not get all of your money back because you have to

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1 put additional money besides the actual drilling in the cost  
2 of operation and maintenance and so forth. So, a two-to-one  
3 basis, you sort of maybe you'll make it, maybe you won't.  
4 On a three-to-one basis, you've made it. On a ten-to-one,  
5 obviously you've made it; but that does not include the dry  
6 holes.

7 From the point of view of determining whether  
8 Mr. Williams is earning a fair return or not, you have to  
9 take into account all of his experience with dry holes. In  
10 determining the price generally in Northern California,  
11 you would certainly have to take into account not only  
12 Mr. Williams' dry holes, but the dry holes of the industry.

13 CHAIRMAN CORY: When you say dry hole, are you  
14 talking about the total exploration cost including seismic?

15 MR. LIPPITT: Oh, yes.

16 CHAIRMAN CORY: All the other things you do?

17 MR. LIPPITT: All the other things, yes.

18 CHAIRMAN CORY: And that was not included in  
19 Mr. Williams' three-to-one ratio?

20 MR. LIPPITT: No, it was not.

21 MR. SUMPFF: He didn't state it completely, if  
22 I may interrupt. I'm Mr. Williams' partner. He just omitted  
23 that from his statement. He said profit --

24 CHAIRMAN CORY: I just want to make sure that  
25 Mr. Lippitt is not putting incorrect words into Mr. Williams'

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1 mouth.

2 MR. SUMPFF: We asked Mr. Lippitt to correct that.

3 CHAIRMAN CORY: If there is a correction that needs  
4 to be made, go ahead. I'm sorry.

5 MR. LIPPITT: That's all right. I wanted you to  
6 point out that certainly overall we're not making an unfair  
7 rate of return. You look at the National City Bank rates  
8 of return for oil companies, and their rate of return on the  
9 average is less than manufacturing companies. You make less  
10 rate of return putting your money overall into the oil business  
11 than you do in the radio business.

12 CHAIRMAN CORY: Can more specificity be given to  
13 those numbers?

14 MR. LIPPITT: Well, yes. Put it this way. There is  
15 five volumes about his high that have just been submitted to  
16 FERC in what is called the Biennial Study to show what the  
17 overall costs are of developing gas supplies, and those are  
18 the types of figures which would have to be used to determine  
19 what the costs were. Does that help?

20 CHAIRMAN CORY: I think all sides have been somewhat  
21 guilty of using the generalization and asking us to decide,  
22 and I'm not trying to be argumentative, but one of the  
23 questions which I think may be relative in the long run to  
24 someone who is -- and I'm really not sure that this is our  
25 long-range interest to remain in this field -- but it would

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1 seem to me that I personally could not function as a member  
2 of the PUC if I didn't force people to produce that kind  
3 of hard evidence as to what's happened.

4 MR. LIPPITT: Well, they already have the evidence  
5 with respect to the stuff that's put into the Biennial in  
6 the FEC.

7 CHAIRMAN CORY: Would the producers generally be  
8 willing to produce that sort of data to the PUC? Would  
9 your organization be willing to provide that information to  
10 the PUC?

11 MR. LIPPITT: Some producers would and some  
12 wouldn't. That's all I can say.

13 Mr. Williams is willing to do so. I've had a couple  
14 of others that have volunteered material. I put cost figures  
15 in before the CPUC a couple of times, and it's generally  
16 ignored.

17 CHAIRMAN CORY: That area of the record was sort  
18 of left hanging. I thought we ought to try to pin it down  
19 as best we can.

20 MR. LIPPITT: Some will and some won't. That's  
21 about all I can say.

22 CHAIRMAN CORY: Do you believe that the PUC has  
23 the right to compel that information?

24 MR. LIPPITT: Well, I couldn't tell you. Put it  
25 this way. The answer is that it would be doubtful until they

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33  
1 have jurisdiction over us; and after they have jurisdiction  
2 over us, then there is no question about it. I think the  
3 question of whether they have jurisdiction over us depends  
4 upon, in my estimation, legislation. Whether or not they  
5 can do it as part of an overall legislative proceeding, I'm  
6 not sure. In other words, whether if one of the committees  
7 say, we want a lot of data, I think they can get existing  
8 data; but what is required is putting that existing data  
9 into the form of exhibits and dividing the figures and so  
10 forth. I think you'd have to turn a team of people from  
11 the CPUC, half a dozen people -- oh, it would take more than  
12 that. It would take a dozen of them, and they would have  
13 to work the better part of a year or so.

14 In the Federal Power Commission it took a long time  
15 to develop the figures, and that's what happened and that's  
16 why we are in the trouble we're in. The figures that came  
17 out were so low that we've just gradually lost our gas supply.

18 CHAIRMAN CORY: Go ahead with your point.

19 MR. LIPPITT: In any event, with respect to gas  
20 supplies in California, let me direct your attention to a  
21 couple of things which I just think you ought to have in  
22 mind.

23 First off, in Southern California there has been  
24 a lot of talk about the impact. At the present time today  
25 gas is being sold in Southern California for a \$1.35. That's

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34  
1 100 percent load factor gas per million Btu's. If you add  
2 to that the peaking, which is roughly, the way Mr. Fallin  
3 puts it, 18 percent, 18 cents on a \$1.02 -- it will add  
4 another 25 cents to it. The price of natural gas in Southern  
5 California, which is comparable to the prices we are talking  
6 about today in Northern California for gas of 33-percent  
7 load factor, would be a \$1.60. That price goes up in  
8 accordance with the offer of Southern California Gas Company  
9 to buy another 14 cents on the 1st of July so that the  
10 equivalent price in Southern California generally offered  
11 for gas would be a \$1.85. So, the figures we're talking  
12 about here are sharply lower than those which are presently  
13 being offered for gas supplies in Southern California.

14 MS. SIEGEL: Up till July 1st?

15 MR. LIPPITT: Up to July 1st it's a \$1.35 plus  
16 25 cents peaking, a total of a \$1.60. After July 1st it's  
17 a dollar and a half plus 25 cents peaking, which would be  
18 a \$1.75.

19 Edison Company in Southern California purchases  
20 gas also. Their gas purchases are made at a \$1.98 in million  
21 Btu's. In Northern California the staff has put in the record  
22 the Amstar contract with Chevron. That contract calls for  
23 three price levels: the highest price PG&E pays, or the price  
24 which Amstar has to pay for gas from PG&E or 90 percent of  
25 LSFO prices.

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1           Let me tell you what they are. The price that  
2 PG&E pays in the field is -- presently the highest price is  
3 the Union Island price -- which is maybe a \$1.76 if you take  
4 all the freebies. The price which would be paid by PG&E  
5 is \$2.29, so that would normally set the price; but it shall  
6 be not higher than 90 percent of the LSFO price. The LSFO  
7 price at the present time is \$2.35. Ninety percent of that  
8 is \$2.11. At the present time the gas under this new  
9 Chevron contract with Amstar/Spreckels Sugar is going for  
10 \$2.11.

11           This is just to point out to you that the general  
12 pattern of prices is a good deal higher than those which  
13 have been discussed by PG&E today. With respect to border  
14 prices and what my figures were to provide the staff with  
15 was a calculation of what the weighted average border price  
16 would be for gas. And the reason I did that was that this  
17 is widely adopted in Southern California.

18           Mr. Gravelle has advised the California PUC innumerable  
19 times that it is appropriate to use a border price for  
20 determining the price of gas in Southern California. He has  
21 signed orders which permit that border price to be used in  
22 calculating the cost of gas to Southern California Gas  
23 Company. That policy, that method of doing it, has just  
24 been translated to Northern California. Northern California,  
25 the figures are different, and that's what's been used.

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36

1           In any event, let me just touch a point on Canada.  
2 In Canada the prices have risen even more sharply than they  
3 have here. I was involved in an arbitration case in 1971  
4 at 17 cents, not 30 cents, and the price Mr. Fallin talks  
5 about is a dollar at the present time; but Mr. Fallin does  
6 not tell you that the Canadian producers also get what is  
7 known as the market pool payback price. That is to say,  
8 the Canadian gas prices are equalized because of the difficulties  
9 of delivering gas to Toronto, and they get a higher price  
10 for gas which is physically delivered to the United States;  
11 but in order to equalize the Canadian producer, he gets a  
12 payback from the excess revenues which are generated by  
13 the sales across the international boundaries, and that has  
14 to be taken into account in determining the total. In  
15 California also we've made sales at \$2.25.

16           CHAIRMAN CORY: Mr. Lippitt, could you quantify  
17 what that --

18           MR. LIPPITT: It's about 25 cents.

19           California producers, as Mr. Williams pointed out,  
20 negotiated contracts for \$2.25. We negotiated a number of  
21 them, quite a number of them. I mean a dozen. And we were  
22 ready to make deliveries under those contracts. They would  
23 be made within the state, sold actually to the Natural  
24 Gas Pipeline Company of American which delivers gas in the  
25 Chicago area. What would happen is the additional gas would

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37  
1 be delivered in California. That would mean a smaller request  
2 forecast to come from El Paso, and gas which would otherwise  
3 go to El Paso in West Texas and in the Texas Panhandle would  
4 then be delivered to Chicago.

5 We were ready to do that, and PG&E deliberately,  
6 in my estimation, determined not to permit the exchange to  
7 be made; and as a result of that, we were unable to make  
8 the deliveries. The contracts were signed, an order was  
9 issued out of Washington by Mr. Dunham who was then Chairman  
10 of the Federal Power Commission, requiring PG&E to do it;  
11 but the time finally elapsed and the authority under the  
12 Emergency Act expired.

13 But the answer is, if we are given a chance to  
14 deliver our gas on the fringes, as Mr. Fallin puts it, it's  
15 very clear that we've got a price of \$2.25 which is readily  
16 payable by a number of other purchasers.

17 CHAIRMAN CORY: You would have to deduct from that  
18 some transmission cost.

19 MR. LIPPITT: No, no. In addition to that, the  
20 transmission costs have to be added. In other words, Natural  
21 Gas Pipeline Company of Chicago has to pay an additional  
22 transmission charge for El Paso gas.

23 CHAIRMAN CORY: That is net to the producer in those  
24 contracts?

25 MR. LIPPITT: That's net to the producer.

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38

1           Finally, let me say that Mr. Fallin gave you a  
2 number of prices of gas in other areas that he indicated  
3 were lower than the price of our gas. That is so only  
4 because Mr. Fallin has included controlled prices of those  
5 gas which were controlled by the Federal Power Commission.  
6 In other words, you take all the gas in Arkansas and two-  
7 thirds of it is exported from the state at a price which  
8 has been held down by federal regulation. That's why we've  
9 had all the problems, because holding those prices down  
10 has inhibited the production; and that's why we've had a  
11 natural gas problem.

12           But in any event, you cannot do that here. You  
13 can not take a mix of interstate prices and intrastate  
14 prices and import them into California. You can do it by  
15 taking other states -- Ohio, Michigan, New York -- but  
16 Mr. Fallin was very careful that he didn't give you those  
17 figures.

18           The only one that he gave you of a state which  
19 wholly imports gas and didn't import any intrastate gas was  
20 Illinois, which was 98 cents.

21           In any event, there are other criteria which have  
22 to be considered. Obviously, he talked about the net back  
23 in Canada. The net back in Texas is \$2.00, and this is true  
24 of the gas prices which are available for intrastate gas  
25 in Texas. I may say that that includes not only new

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1 intrastate gas, but generally renegotiated prices for old  
2 intrastate gas.

3           Those are the only points that I thought you  
4 might like to have which would tend to set the record  
5 straight.

6           MS. SIEGEL: Is he subject to cross examination?

7           CHAIRMAN CORY: Do the Commissioners want to ask  
8 any questions?

9           Thank you, Mr. Lippitt.

10          MR. FALLIN: Mr. Cory, I'm afraid because there  
11 are some new things that were brought in there -- it should  
12 be very quick.

13          First --

14          CHAIRMAN CORY: Wait. I would like to know what  
15 the Commissioners want to do. Once we start this, at some  
16 point we've got to come to an end. If the Commissioners  
17 wish to -- but it seems to me if Mr. Fallin is allowed to  
18 do this, then we get into another round --

19          MR. FALLIN: Give me four minutes, and if he wants,  
20 give him two and cut it that way.

21          CHAIRMAN CORY: What about all of the others?  
22 That's why I have trouble with the cross examination thing  
23 trying to deal with it now. What do the Commissioners wish  
24 to do?

25          MR. FALLIN: I'm not asking for cross examination.

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1 CHAIRMAN CORY: You just want more time. If the  
2 other people want more time -- I appreciate your concern.  
3 It's up to what the Commissioners wish to do. How long do  
4 you want to be here and what would you like to do?

5 MR. McCAUSLAND: It's my firm belief, due to our  
6 charge under the statutes and due to our responsibilities  
7 as landlords, that it is inappropriate for us to begin  
8 asserting ourselves into the determination of what the price  
9 of natural gas should be; and I say that because I believe  
10 that we have an extremely strong interest in the outcome of  
11 that, that probably has to be predominantly oriented towards  
12 our role as landlords. I would like my judgment on the  
13 matter of price to be determined by a regulatory body who  
14 has more expertise in that matter and whose primary mission  
15 is to determine fair return so that my fair return is the  
16 same as everybody else's fair return.

17 CHAIRMAN CORY: The question procedurally, though,  
18 is I'm trying to ask --

19 (Thereupon a brief discussion was held  
20 off the record.)

21 CHAIRMAN CORY: Fine. I have the answer from  
22 the Commission. Thank you for your offer, Mr. Fallin.

23 Go ahead, Sid.

24 MR. FALLIN: I'll write you a letter.

25 (Laughter.)

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1 MR. McCAUSLAND: Do you want to talk about my  
2 concern?

3 CHAIRMAN CORY: It's the will of the Commission.  
4 I think that's where we are.

5 MR. McCAUSLAND: I have language which I would like  
6 to propose in the form of a motion as a substitute to the  
7 staff recommendation on this calendar item. I would like  
8 to propose that the reasonable market value ~~of~~ current  
9 market price of the gas produced and sold from the Rio Vista,  
10 Ryer Island, River Island fields for the period in question  
11 shall be those prices that are the result of the pending  
12 arbitration between PG&E and Texaco, Aminoil and Superior,  
13 provided however that should the Public Utilities Commission  
14 determine to regulate the price for California-produced  
15 gas and impose a ceiling on the price that a California  
16 producer may charge, the determination of the State Lands  
17 Commission shall be that ceiling price for all time periods  
18 in question.

19 MS. SMITH: Mr. Chairman, I feel that because of  
20 my interest in the consumer being protected that that motion  
21 probably offers the consumer the most protection that we  
22 can offer them and fulfill our responsibilities as Commissioners  
23 to the State Lands Commission. I find the staff's recommenda-  
24 tion of prices unacceptable, and I find PG&E's position to  
25 be one that I cannot accept at this time. Having listened

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1 to everything that I've listened to all day, I believe that  
2 the motion as worded is acceptable to me and would be  
3 acceptable to Lieutenant Governor Dymally and, therefore,  
4 I second that motion.

5 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, I believe  
6 that Isleton was left out of that.

7 MR. McCAUSLAND: That was an inadvertent error.  
8 The motion should be amended to include Isleton.

9 MS. SMITH: That's fine with me. Second the motion.

10 CHAIRMAN CORY: Is there anything that the  
11 Commissioners wish to discuss, or are we at the point where  
12 the mind cannot cure what the seat cannot endure?

13 Do you wish to put any caveat of limitation as  
14 to a maximum to which the arbitration, if they came in,  
15 should not exceed based upon this record? Do you want the  
16 motion to stand where it is?

17 MR. McCAUSLAND: I made my motion. You can amend  
18 it.

19 CHAIRMAN CORY: We have a motion and seconded.  
20 All those in favor signify by saying aye.

21 (Ayes.)

22 CHAIRMAN CORY: The ayes have it. The motion is  
23 carried. We stand adjourned.

24 (Thereupon the meeting of the State Lands  
25 Commission was adjourned at 8:50 p.m.)

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