

This Calendar Item No. 20
was approved as Minute Item
No. 20 by the State Lands
Commission by a vote of 3
to 0 at its 8/26/76
meeting.

MINUTE ITEM

8/26/76
ADW

20. REQUEST FOR APPROVAL OF GAS SALES AGREEMENT, STANDARD OIL COMPANY OF CALIFORNIA AND PACIFIC GAS AND ELECTRIC; SACRAMENTO, SOLANO, CONTRA COSTA AND SAN JOAQUIN COUNTIES - W 9738.

Commissioner Dymally initially moved that the item be deferred until the next Commission meeting. However, Chairman Kenneth Cory suggested that the Commission should probably first look at what the net effect will be. In addition, since there is an outstanding offer, the Commission should probably rescind that offer so it does not inadvertently end up being trapped in an adverse position.

Mr. D. G. Couvillon, Vice President, Western Operations, Standard Oil Company of California, appeared. He stated that Standard is willing to accept and recognize the right of the State to conduct a continuing review of the reasonable market price for the area. He further stated this price represents a reasonable price under the present conditions. However, Mr. Couvillon stated Chairman Cory has made it clear that the question of future developments for such a period of time is of concern to the Commission.

Commissioner Dymally questioned whether Standard, P.G.&E., or the State would be inconveniencing the consumer by deferring the matter for 30 days. Mr. Couvillon indicated that there would be no inconvenience insofar as the State interest is concerned. He stated, that Standard has made a business decision to accept the subject price and that they are notifying the State of their acceptance. Further, Mr. Couvillon indicated that Standard had no objection to the item being deferred. Commissioner Dymally then asked if Standard would proceed with their contractual arrangements. Mr. Couvillon said that they would subject some minor procedural problems.

Mr. N. Gregory Taylor, Assistant Attorney General, reported that the resolution before the Commission had been changed just prior to the meeting. In addition, the Calendar Item was a reprint of the last meeting and did not reflect recent events which had occurred. Mr. Taylor read into the record clarifying language reflecting those new developments:

"Since the last meeting of the Commission, it is our understanding that the Superior Court in San Diego County has ruled on the Arbitration Award, and sustained it, although the judgment is still in the process of being prepared."

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

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Mr. Taylor stated that based on the above, the situation has changed to not just being an Arbitration Award, but an Arbitration Award which has been approved by the trial court. He also pointed out that the last paragraph of the Calendar Item which states, "The staff does not have any objective data which would support a higher price at this time that the prices contained in the subject contracts." is incorrect. He stated that was a tentative feeling of the staff, and the reason the staff is recommending the item be deferred is that it would appear the gas which was involved in the Arbitration Award appears to be comparable and, in fact, better than the gas involved in the Arbitration Award.

Based on the above, Mr. Taylor stated if Standard signs the contract with P.G. & E. at \$1.20, and the Commission exercises its independent review authority and finds the reasonable market value of the gas was \$1.31 for a year, the difference Standard would be obligated to pay the State would be approximately one half million dollars. In addition, if after the two year period of the contract, under the Arbitration Award, the price of natural gas goes up to \$1.54 or \$1.56, the difference to the State would be another three-quarters of a million dollars which Standard would be obligated to pay. Mr. Taylor explained there would be no problem if Standard would be willing to make that payment. However, Standard should clearly understand if they sign the contract, these monies could be due. He asked Standard to state their position on this.

Mr. Couvillon stated, in principal, Mr. Taylor's information does not change the matter. They recognize that if the State attempted to establish a higher market value as the base of calculating State royalties, Standard would either have to 1) talk the State out of it; 2) agree; or 3) litigate the matter. Mr. Couvillon then requested that a program be arrived at during this meeting whereby the State could be notified that Standard wishes to sign the contract, reserving to the State the right it has on price and then proceed from there.

Mr. John A. Sproul, Vice-President-Gas Supply, representing Pacific Gas and Electric Company, appeared. Mr. Sproul urged the Commission to reach a decision at this meeting. He stated the Occidental Arbitration Award involved a number of prices. He raised the point that the consumers would eventually have to pay for the higher prices. With respect to that comment, Chairman Cory inserted that the Commission has a constitutional and legal responsibility to dispose of the assets of the State at the highest and best price. He stated any responsibility of the State, with respect to the consumer, must be discharged to the Public Utilities Commission. However, for P.G. & E. to have previously entered into an adverse contract and then plead the case of the consumer is unwarranted.

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Mr. Sproul stated it was not an adverse contract and denied pleading poverty. He further stated he wanted to be put on record what the effect would be. Chairman Cory then wanted the record clear that if the consumer would be paying more, it would not be due to the Commission's action, but on previous actions of P.G. & E. Mr. Sproul pointed out that as far as P.G. & E. is concerned, the Occidental Arbitration Award was one Arbitration Award, and that they are prepared to go to arbitration again. He stated P.G. & E. feels that that award was outrageous and wrong.

Commissioner Dymally reminded the Commission he had a motion before it to postpone the matter. Chairman Cory suggested the Commission rescind the outstanding offer, put the matter over and ask the staff to return with details of what the arbitration either is or is not, and then confer with P.G. & E. as to why they think it is bad so that the Commission will have that information to enable them to make comparisons.

Commissioner Dymally then requested that he be given more information on this subject. He also instructed the staff to advise him on what the effect on the consumer will be. Upon receiving this information, he indicated he would be in a better position to reach a decision.

Commission-alternate McCausland expressed the concern of the Department of Finance about the impact on the consumer. He also asked Mr. Sproul if he could give the Commission an idea of what P.G. & E.'s forecast of natural gas prices will be around 1980. Mr. Sproul stated he was reluctant to give precise numbers since they would be entering into negotiations with various producers during that time. However, he did state the prices would go up.

Commission-alternate McCausland then seconded Commissioner Dymally's original motion and offered an amendment that the Commission adopt the staff's recommendation as presented. Commissioner Dymally then seconded that amendment.

At this time, Mr. Taylor clarified for the record that the State Lands Commission did not authorize or give any indication of market value of gas or the approval of Standard entering into the sales contracts and that Standard proceeds at its own risk. In addition, Mr. Taylor put Standard on notice that the Commission has not approved Standard's signing the sales contract with P.G. & E.

Mr. Couvillon stated, in principal, that Standard accepts full reservation on all the points raised by Mr. Taylor.

Upon motion duly made and carried, the following resolution was adopted by a vote of 3-0:

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THE COMMISSION RESCINDS ITS JULY 22, 1976, ACTION ON THIS ITEM TENTATIVELY AUTHORIZING THE APPROVAL OF THE LETTER AGREEMENT MODIFICATIONS AS FURTHER MODIFIED BY THE COMMISSION, AND DIRECTS THE STAFF OF THE STATE LANDS DIVISION TO REPORT TO THE COMMISSION AT ITS NEXT MEETING CONCERNING THE REASONABLE MARKET VALUE OF GAS PRODUCED FROM THE FIELDS WHICH ARE THE SUBJECT OF LEASES AND COMPENSATORY AGREEMENTS BETWEEN THE STATE AND STANDARD OIL COMPANY OF CALIFORNIA.

Attachment:
Calendar Item 20 (3 pages)

REQUEST FOR APPROVAL OF GAS SALES AGREEMENT
STANDARD OIL COMPANY OF CALIFORNIA AND PACIFIC
GAS AND ELECTRIC,
SACRAMENTO, SOLANO, CONTRA COSTA AND SAN JOAQUIN COUNTIES

Standard Oil Company of California has negotiated price increases with Pacific Gas and Electric Company for gas sold to it under contracts with Standard. Some of the contracts cover gas produced from State leases and gas allocated to State land under compensatory agreements. Standard Oil Company has submitted for approval, proposed Letter Agreements, dated June 22, 1976, between Standard and PG&E that will modify the price provisions of the Gas Sales Agreements covering the State leases and agreement. These and corresponding price changes are listed below:

<u>LEASE</u>	<u>FIELD</u>	<u>PG&E CONTRACT DATE</u>	<u>CURRENT PRICE/ MCF</u>	<u>NEW PRICE/ MCF</u>
E 415	Decker Island	6/30/67	77.0¢	\$1.235
PRC 3238	Liberty Island	9/4/68	62.0¢	\$1.005
E 415	Rio Vista and Isleton	1/1/56	78.5¢	\$1.25
E 415	Rio Vista Deep	9/22/67	80.5¢	\$1.285
PRC 714 & PRC 729	River Island	1/1/61	71.0¢	\$1.15
PRC 3743 & PRC 3896	Ryer Island	11/26/68	78.5¢	\$1.255
PRC 2966	West Thornton	7/18/57	72.0¢	\$1.145

The new prices have been adjusted as provided for in the agreements listed above, based on the average heating value of the gas in BTU's per cubic foot and the respective agreement load factors (average daily requirement divided by the maximum daily requirement, as provided for in the contract). The basic price is \$1.20 per Mcf for 33-1/3 percent load factors and gas having a heating value of 1000 Btu. The new contract prices are, in general, considerably in excess of the "border price", i.e., the price paid by California utilities to out-of-state gas suppliers at the California-Nevada-Arizona borders, currently 87.56 cents per Mcf. Estimated increase in income to the State attributable to the price increase will amount to approximately one and one-half million dollars per year.

The motivation for the significantly higher prices offered by PG&E appears to have been the result of the Occidental-PG&E

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Arbitration Award, wherein the reasonable market value for the Occidental gas purchased by PG&E was determined to be \$1.34 per MM Btu. This Arbitration Award is being appealed by PG&E to the Superior Court based on conflict of interest allegations against the arbitrators and failure to follow arbitration agreement guidelines.

The effective date of the proposed modified agreements is July 1, 1976, and covers a two-year period with a price to be mutually agreed upon for each succeeding period, commencing July 1, 1978, as specified in the agreements.

The State leases subject to the sales agreement have been reviewed by the Office of the Attorney General with the following comments:

1. State Lease E 415, which produces in excess of 75% of the gas to be sold pursuant to the subject agreements, does not provide for the State to take its royalty share of the gas in kind.
2. Whatever power the State may have to defer production in anticipation of future rises pursuant to Section 6830 of the Public Resources Code is abridged by the provision of the unit agreement governing E 415 as provided in Section 6832 of the Public Resources Code. Amendment to all leases would be required to defer production of the State's royalty share of the gas.
3. The Commission's approval of the subject sales agreements would not prevent the State from requiring the payment of royalties based upon a higher price, if it were determined that such higher price was the reasonable market value of the gas. The reasonable market value of the gas can be determined by the Commission at any time during the lease.

The staff does not have any objective data which would support a higher price, at this time, than the prices contained in the subject contracts.

IT IS RECOMMENDED THAT THE COMMISSION RESCIND ITS JULY 22, 1976, ACTION ON THIS ITEM TENTATIVELY AUTHORIZING THE APPROVAL OF THE LETTER AGREEMENT MODIFICATIONS AS FURTHER MODIFIED BY THE COMMISSION, AND DIRECTS THE STAFF OF THE STATE LANDS DIVISION TO REPORT TO THE COMMISSION AT ITS NEXT MEETING CONCERNING THE REASONABLE MARKET VALUE OF GAS PRODUCED FROM THE FIELDS WHICH ARE THE SUBJECT OF THE LEASES AND COMPENSATORY AGREEMENTS BETWEEN THE STATE AND STANDARD OIL COMPANY OF CALIFORNIA.

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SHALL NOT BE CONSTRUED TO MODIFY OR TO AFFECT IN ANY MANNER ANY OF THE LEASE TERMS, INCLUDING FULL COMPLIANCE BY THE LESSEE WITH ALL THE TERMS AND CONDITIONS OF THE LEASES AND AGREEMENTS AND THE RULES AND REGULATIONS OF THE STATE LANDS COMMISSION.