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MEETING

STATE LANDS COMMISSION

ROOM 2117

STATE CAPITOL

SACRAMENTO, CALIFORNIA

ORIGINAL

TUESDAY, JANUARY 26, 1978

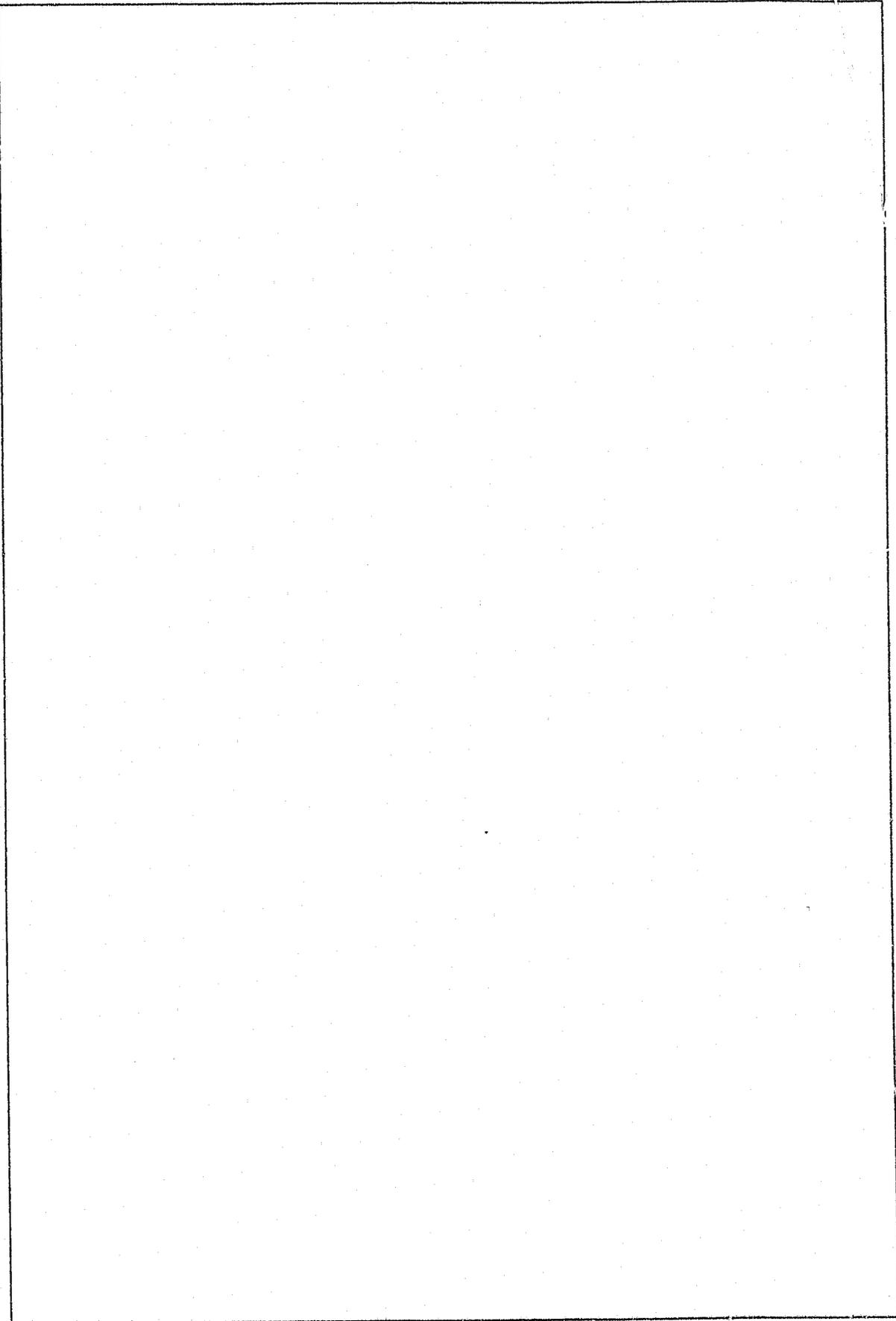
10:00 A.M.

Wendy E. Schiller

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MEMBERS PRESENT

- Hon. Kenneth Cory, Controller, Chairman
- Mr. Sid McCausland
- Ms. Betty Jo Smith

STAFF PRESENT

- William F. Northrop, Executive Officer
- Mr. R. S. Golden
- Mr. James F. Trout
- Mr. Robert C. Hight
- Mr. Don Everitts
- Mr. W. T. Thompson
- Ms. Diane Jones, Secretary

ALSO PRESENT

- Mr. Dennis Eagan
- Mr. Jan Stevens
- Mr. Alan Hager

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P R O C E E D I N G S

--oOo--

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2
3 CHAIRMAN CORY: Call the meeting to order, and
4 we'll take care of some of our housekeeping chores while
5 we await the arrival of Governor Dymally's representative.
6 We have a relatively long agenda today. I do not see how
7 we can possibly complete the agenda before lunch, and
8 acknowledging that fact beforehand might keep everybody in
9 a better frame of mind if in fact they have an opportunity
10 to eat lunch. For that reason, the calendar will be handled
11 in a way, for those of you are here on various items, we
12 will try to get through all of the calendar save the natural
13 gas pricing before lunch.

14 Plan on breaking for a lunch break and coming
15 back -- I don't know -- depending on when we get through,
16 1:30, 2:00, to reconvene to deal with the gas pricing. So,
17 those of you who want to allocate your time accordingly can
18 know that. We will have an executive session on litigation
19 problems. We will do that prior to the Commission itself
20 going to lunch. So, those staff people and people in the
21 audience who are interested in our calendar and how we're
22 going, we now have all of the members here and we will
23 proceed with the agenda, confirmation of minutes.

24 Any corrections or additions?

25 Without objection, the minutes will be confirmed

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1 as presented.

2 Mr. Northrop, do you have reports?

3 EXECUTIVE OFFICER NORTHROP: Yes, Mr. Chairman.

4 In my September 29th, 1977 report to you, I discussed the
5 creation of the Motion Picture Development Council by
6 Government Code Section 14998. The Council was created
7 to promote the making of commercial motion pictures in
8 California, and the Code provides for the Council to issue
9 permits and establish fees to be paid to the Council for
10 the use of State-owned property. The Council collects its
11 fees for reimbursement to the operating departments for
12 the additional costs and the further support of the Council.
13 We will have a recommendation in the form of a calendar
14 item outlining future procedures for your consideration
15 at the Febraury meeting.

16 However, on Tuesday, January 24, the Council
17 requested the Commission's approval for the filming next
18 week of running an automobile from the old Fair Oaks/Sunrise
19 Bridge into the American River. The Film Location Industry
20 Council of Sacramento, whose coordinator is Sharon Shell,
21 is assisting the Council in obtaining the local approvals.
22 The automobile will have no gasoline or motor oil and will
23 be removed by the company making the film. Because of
24 the conditions that will be followed by the filming
25 industry and the --

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1 CHAIRMAN CORY: What will be removed, oil and gas

2 EXECUTIVE OFFICER NORTHROP: The car and all the
3 stuff that falls into the river. And the reason for this
4 calendar item, Mr. Chairman, is because of the short fuse
5 on the notice it becomes impossible to get a Commission
6 meeting for approval. What this report is about is next
7 Commission meeting we were asking approval for this one
8 even though it's --

9 CHAIRMAN CORY: Any objection from the members?

10 MR. McCAUSLAND: No.

11 CHAIRMAN CORY: Do they have anybody? Do they
12 need people in the car that they're going to run off? I
13 have some candidates.

14 EXECUTIVE OFFICER NORTHROP: I have a couple
15 candidates, Mr. Chairman.

16 (Laughter.)

17 EXECUTIVE OFFICER NORTHROP: That concludes with
18 a couple of items. Items C3 and C9 have a new legal
19 description. When you get to that point, we would like to
20 insert them into the record.

21 Items 27, 28 and 43 are off calendar.

22 That completes my report, Mr. Chairman.

23 CHAIRMAN CORY: Okay. If we can interrupt here
24 to accommodate some people's time, I think we have an item
25 before we get to the Assistant Executive Officer's report,

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1 which we will get back to, there is Item 22. We have some
2 people that would like to talk to us on that item.

3 SENATOR BAER: I'm Senator Peter Baer, and I
4 represent a part of the state within which this item falls.
5 With me --

6 CHAIRMAN CORY: Did you bring your assistant?

7 (Laughter.)

8 SENATOR BAER: What happened is this, and the
9 staff recommends that our district, Humboldt Bay Harbor,
10 Recreation and Conservation District, be given some special
11 consideration under special circumstances. The District
12 was required to initiate litigation on State lands because
13 of actually few encroachments on District lands on Samoa
14 Peninsula and needed to do the necessary mapping for the
15 litigation. The estimate from the State Lands Division
16 was \$123,796, and there was a time constraint in getting
17 proper mapping done. So, with the blessing of the Division,
18 the District turned to Winzler and Kelly, which is a well-
19 known surveying and engineering firm in Eureka, which submitted
20 an estimate of \$65,000, and in addition to a firm in Long
21 Beach, Moffatt and Nichols, also very well-known, highly
22 regarded I'm told, assisted Winsler and Kelly.

23 So, the job was done. It was done on time, and
24 the issue here is whether or not in reviewing the work done
25 by these two reputable engineers it may be possible to, under

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1 the circumstances, waive the usual cost, administrative
2 costs, of reviewing the work, which are estimated between
3 10 and \$20,000; and under the circumstances, we are pleased
4 to see that your staff has felt that there is justification
5 for this consideration. I'm here briefly to thank the
6 staff and recommend that the Commission follow its recommenda-
7 tion.

8 CHAIRMAN CORY: Mr. Keene, you are likewise so
9 disposed?

10 ASSEMBLYMAN KEENE: I really have nothing to add
11 that would be other than superfluous. It should be pointed
12 out that in addition to the duplication and additional
13 expenditures, the State's cases and the District's cases
14 in the pending litigation might be jeopardized by any delays.
15 Of course, the public interest might be so jeopardized as
16 well.

17 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, in this
18 calendar item is a recommendation that the Commission support
19 an augmentation of about \$22,000.

20 MS. SMITH: This doesn't set any precedent in terms
21 of review of any other surveys that are done by the District?

22 EXECUTIVE OFFICER NORTHROP: If the Commission
23 would -- I think that's worthwhile stipulating.

24 CHAIRMAN CORY: Stipulating that this is not
25 precedent, this is an individual case based upon the prior

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1 expenditures, litigation and the involvement of that litigation.
2 tion.

3 MR. McCAUSLAND: I think this is extremely unique
4 litigation, and we're cognizant of the burden which we
5 have placed on a very small economic base to support that
6 litigation. We'll be lenient and cooperative in this
7 particular case. It should not be considered a precedent.

8 CHAIRMAN CORY: I would presume that the kind
9 of cooperation will continue on the part of the legislators
10 when we come upstairs with our budget.

11 SENATOR BAER: I presume that and hope it's not
12 a rebuttable presumption.

13 (Laughter.)

14 MS. SMITH: With that stipulation, I have no
15 problems with it.

16 CHAIRMAN CORY: Without objection, then?

17 MR. McCAUSLAND: Well, if it can be rebuttably
18 done without objection.

19 (Laughter.)

20 CHAIRMAN CORY: Item 22 is approved as presented.
21 Thank you for adding dignity to our discussions this morning.

22 MR. McCAUSLAND: I'd like to thank you for
23 complimenting staff, too. Most of the people on today's
24 calendar are not here to compliment staff.

25 SENATOR BAER: Staff is always complimented when

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1 it's moving in your direction in showing that judgment.
2 Thank you very much.

3 (Laughter.)

4 CHAIRMAN CORY: Okay. The Assistant Executive
5 Officer, Mr. Golden.

6 MR. GOLDEN: Due to the length of today's agenda,
7 this report on activities of the Coastal Commission will
8 be brief.

9 The State Coastal Commission is beginning its
10 reviews of the Issue Identification and Work Program phases
11 of the Local Coastal Programs. Permit matters still
12 predominate, however.

13 Greg Taylor and members of your staff met with the
14 North Coast Regional Commission and other interested local
15 jurisdictions in Eureka to work out the proper procedures
16 for dealing with public trust findings under the Coastal Act.

17 Procedures for the proper handling by State Lands
18 Commission of private development projects on public trust
19 lands are yet to be fully defined. This matter is being
20 pursued with the Attorney General's office.

21 That concludes my report, Mr. Chairman.

22 CHAIRMAN CORY: Questions by members?

23 Okay. The executive session will, for mechanical
24 convenience, take place prior to breaking for lunch.

25 The next items are the consent calendar items. You

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1 have some --

2 EXECUTIVE OFFICER NORTHROP: Legal descriptions
3 on C3 and C9. I will give it to Mr. Trout, I believe.

4 MR. TROUT: Mr. Chairman, both C3 and C9 include
5 within the area sole border tidelands commissioner's lots,
6 and the legal description amendment is simply to include
7 within the private or public agency claims of border
8 tidelands commissioner's lots in the lease whatever interest
9 the State Lands Commission may have within those areas.
10 The basic transaction remains identical.

11 CHAIRMAN CORY: Okay. We have now before us,
12 so that those of you in the audience will be aware of what
13 we're about to do, we are going to take all of the consent
14 calendar items, which are designated with the letter "C"
15 in front of the numbers, C1 through C21; and we will take
16 them altogether unless there is anyone in the audience
17 who has particular objection to the proposed action on
18 any of these items.

19 Hearing no objection?

20 MR. McCAUSLAND: No objection.

21 CHAIRMAN CORY: The consent calendar items 1 through
22 21 will be approved as presented with the amendments to
23 the two items on the legal description.

24 Item 22 has been taken care of.

25 Item 23, Mr. Northrop?

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1 EXECUTIVE OFFICER NORTHROP: Item number 23 is
2 an extension and amendment of the lease at Richmond Long
3 Wharf in San Rafael in Contra Costa County for the maintenance
4 of a marine petroleum wharf. This is one of our premier
5 volumetric rentals with a minimum annual rental of \$100,000;
6 however, there is some language that we would -- the
7 difference between the \$100,000 minimum rental and the
8 actual volumetric charge above that amount will go into
9 a suspension account awaiting the outcome of litigation
10 on the ability, I believe, of the Commission to charge
11 volumetric rentals.

12 CHAIRMAN CORY: I thought we were litigating the
13 ability of those infidels to keep us from doing what is
14 right and proper. I thought that that's what we were
15 litigating, but go ahead.

16 EXECUTIVE OFFICER NORTHROP: If the Attorney General
17 would care to comment on it.

18 MR. EAGAN: I have nothing to say really unless
19 the Commission has questions. The existing rental on the
20 lease is approximately \$34,000.

21 EXECUTIVE OFFICER NORTHROP: Would you identify
22 yourself for the record.

23 MR. EAGAN: Dennis Eagan, Deputy Attorney General.
24 With the existing volume which is in the neighbor-
25 hood of 150 million barrels per year, we anticipate that

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1 under the first five years of the newly negotiated renewal
2 the Commission will be receiving approximately 320 to \$345,000
3 per year as opposed to the \$34,000 it constantly receives.

4 CHAIRMAN CORY: And the language with respect
5 to the exemption of same product in, same product out is
6 well-detailed that each side clearly and explicitly under-
7 stands what we're talking about?

8 EXECUTIVE OFFICER NORTHROP: We don't anticipate
9 that problem, and we discussed it with the principals.
10 They seem to be in agreement. There is a member of the firm
11 here.

12 CHAIRMAN CORY: You're happy?

13 MR. EAGAN: I'm happy. The language is different
14 than the one you're referring to, Mr. Chairman.

15 EXECUTIVE OFFICER NORTHROP: Other language wasn't
16 adequate.

17 MS. SMITH: The agenda indicated that the staff
18 had reviewed the primary value system and terminal operation
19 of clean-up contingency plans. How long ago was that
20 review done?

21 MR. TROUT: Don, have you had somebody down there?
22 Have you looked at the Richmond Long Wharf recently, the
23 piping?

24 MR. EVERITTS: Within the last year.

25 CHAIRMAN CORY: Any further questions? Then

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1 Item 23 will be approved as presented.

2 Item 24.

3 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, Item
4 Number 24 is a volumetric rental for Pacific Gas and
5 Electric. It's a 20-year general lease in which we're
6 attempted to consolidate all of the leases that the State
7 Lands Commission has for pipeline corridors with the
8 Pacific Gas and Electric Company into one agreement. It
9 is a volumetric agreement with a minimum rental of \$15,000.

10 We have for the record this statement regarding --
11 all right. I don't have a statement, Mr. Chairman. It
12 has been agreed that the difference between the volumetric
13 rental and the monies generated in excess of the minimum
14 volumetric rental of \$15,000 will similarly go into a
15 suspense account.

16 MS. SMITH: I have one question.

17 CHAIRMAN CORY: Betty?

18 MS. SMITH: I believe this is the calendar item
19 that concerns me. The Executive Officer is asking to have
20 delegation of authority to make minor changes in the agree-
21 ment.

22 EXECUTIVE OFFICER NORTHROP: Yes.

23 MS. SMITH: Is this the type of agreement where
24 you expect there will be a significant number of changes
25 made in the lease? Why was that provision inserted?

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1 EXECUTIVE OFFICER NORTHROP: Miss Smith, I don't
2 expect significant modifications. As a matter of fact,
3 at this time I don't think there are any that we have in
4 mind at the present time.

5 CHAIRMAN CORY: The reason for it was because you
6 are combining all of PG&E's leases into one.

7 EXECUTIVE OFFICER NORTHROP: We're putting 89
8 leases into one package. Some of the nuts and bolts of
9 some of the rather small leases, while they're insignificant,
10 they do have a legal bearing; and we're trying to make the
11 package as neat as possible.

12 MS. SMITH: I notice you're doing the same thing
13 on Calendar Item 25.

14 EXECUTIVE OFFICER NORTHROP: Calendar Item 25,
15 we have some changes that we will bring to the Commission
16 in the next calendar item.

17 MS. SMITH: I didn't see the difference. Since
18 you are combining a system in Calendar Item 24 and in 25 --

19 EXECUTIVE OFFICER NORTHROP: The difference between
20 24 and 25, some of them are existing leases that have
21 already been in effect for 49 years and are still running.
22 We are pulling some of those leases out. PG&E has agreed
23 to put those into the same program. That is not the case
24 in 25 to the degree it is in 24.

25 MS. SMITH: So, then it would be an undue burden

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1 on the Commission to have to come back every time you needed
2 to make a change.

3 EXECUTIVE OFFICER NORTHROP: I think so.

4 MS. SMITH: If they don't anticipate any change,
5 I don't see the need for it. If they anticipate that they're
6 going to need to make substantial changes, then fine if
7 it's going to be an undue burden.

8 MR. HIGHT: Maybe I can clarify the situation.
9 What we're asking for in Calendar Item 24 is the authority
10 for the Executive Officer to make minor environmental changes.
11 In other words, anything that does not require an environmental
12 document he will have the authority to change. If they're
13 going to change a valve or something, a slight minor change
14 in the pipeline, replacement of a pipe, anything that's
15 in the existing right-of-way would be included within this,
16 and anything that did not require environmental documentation.

17 CHAIRMAN CORY: Why would you not want the same
18 right? If that's a valid right, I think the question is
19 why isn't it a valid right in 25 as well.

20 MR. HIGHT: The magnitude of the problem just
21 didn't seem like it was --

22 EXECUTIVE OFFICER NORTHROP: In Item 25 we're
23 dealing less than 20. We doing 19 leases, and it's not
24 something we're going to have to go back and rework. There
25 is a difference in the character of the produce and location

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1 of the lines. Very simply, it's a public utility line and
2 it's under PUC regulation.

3 MR. TROUT: It's a point-to-point line. PG&E is
4 in the gas supply business, and they're always adding lines
5 or relocating lines.

6 EXECUTIVE OFFICER NORTHROP: Every time they
7 want to change, assuming it runs across State lands, we've
8 got to run back in, so what do we gain by lumping it together?

9 CHAIRMAN CORY: The majority of the Commission
10 has come to the conclusion the staff finally now makes sense.
11 Item 24 then, any questions?

12 MR. McCAUSLAND: No objection.

13 CHAIRMAN CORY: Without objection, 24 will be
14 approved as presented.

15 Item 25.

16 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, we
17 indicated 24 and 25, while they are similar in some aspects,
18 have a different application; and Mr. Trout would like to
19 address the Commission on it.

20 MR. TROUT: The concept, as the Commission has
21 noted in the Southern Pacific item, is basically the same.
22 However, the Southern Pacific has two peculiar circumstances
23 not common to most of our volumetric leases. They ask for
24 the normal side letter concerning the amount of volumetric
25 rental above the minimum being put in suspense. They have

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1 asked for two other things in the side letter which we
2 believe are reasonable. They have prepaid a number of
3 leases, and if this goes into effect as proposed in the
4 calendar item, they will not receive the full benefit of
5 those prepayments; and they just want a credit towards
6 those amounts, the amounts remaining in this year. We think
7 that's a reasonable request to be credited against the
8 minimum payment.

9 Second, they have asked for a determination that
10 if the high water/low water suit comes out as to low water,
11 that will be the boundary because we've written a lease
12 to high water. We agree that will be the law. So, there
13 doesn't seem to be any problem with that.

14 CHAIRMAN CORY: So, you agree with all of their --
15 EXECUTIVE OFFICER NORTHROP: We recommend approval.

16 CHAIRMAN CORY: Am I misremembering the briefing
17 I had on this item, or was there another point in that
18 lease that had been dropped?

19 MR. HIGHT: Yes, the other point has been dropped.

20 CHAIRMAN CORY: I have no questions.

21 Without objection Item 25 will be approved as
22 presented.

23 Item 26.

24 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, this
25 is an assignment by Phillips Petroleum to their interest in

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1 Tosco Petro to a consortium of lenders, and Mr. Hight from
2 our legal staff will give you the background and ramifications.

3 CHAIRMAN CORY: This is the dissolution that
4 relates to the anti-trust case, and the federal court says
5 that's not good enough because you're still involved with
6 the company. You have to sever the relations so the lenders
7 are standing in the place of Phillips and, in essence,
8 guaranteeing the lease, right?

9 MR. HIGHT: Correct, Mr. Chairman.

10 MR. McCAUSLAND: No objection.

11 CHAIRMAN CORY: The Attorney General looked at
12 the documents to make sure that the lenders were really
13 on the hook.

14 MR. STEVENS: I don't believe we've had a chance
15 to review these documents.

16 CHAIRMAN CORY: I would like to approve it with
17 the caveat that the AG, if they are dissatisfied with those,
18 bring it back to us. As long as you are happy that you can
19 litigate and that the lenders are in fact hooked deep,
20 hard and solid, go ahead with it. I just don't want some-
21 time later, gee, we can't depend on that because that
22 document wasn't quite right. Get it the way you want it.

23 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, for
24 the record, we will expect a letter from Mr. Stevens
25 indicating his pleasure.

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1 CHAIRMAN CORY: Item 27.

2 EXECUTIVE OFFICER NORTHROP: Mr. Chairman,
3 Items 27 and 28 are off calendar.

4 CHAIRMAN CORY: Okay. Item 29.

5 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, this
6 is an extension of a lease for the agricultural lease on
7 some property that we exchanged for which we gave up some
8 timber property and received this Santa Cruz beachfront
9 property. It's an extension of the existing leases.

10 CHAIRMAN CORY: How long is it extended for?

11 EXECUTIVE OFFICER NORTHROP: One year, Mr. Chairman.

12 MS. SMITH: What do you have to do to make the
13 land ready for future bid?

14 EXECUTIVE OFFICER NORTHROP: I beg your pardon?

15 CHAIRMAN CORY: What are we going to do with the
16 land in the long run?

17 EXECUTIVE OFFICER NORTHROP: The land is next
18 to Scaroni Ranch, which is part of the Parks Department. We
19 felt that it would make a good park site. It's beachfront
20 property.

21 CHAIRMAN CORY: How much land?

22 EXECUTIVE OFFICER NORTHROP: 900-some acres.
23 It's a very large parcel, very prime piece of property on
24 the beachfront.

25 CHAIRMAN CORY: Sometime send me a map. I may when

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1 I'm in the area drop by there.

2 EXECUTIVE OFFICER NORTHROP: Yes, sir.

3 CHAIRMAN CORY: Without objection?

4 MS. SMITH: No objection.

5 CHAIRMAN CORY: Item 29 is approved as presented.

6 Item 30, Mobil Oil Estates (Redwood) Limited.

7 EXECUTIVE OFFICER NORTHROP: Mr. Chairman,

8 Mr. Hight.

9 MR. HIGHT: Mr. Chairman, this is a lease for
10 an existing levee and authorization to make some slight
11 improvements to the levee to Mobil Oil Estates. It also
12 contains the condition that in the event the Commission
13 determines that this land is in fact owned by the State,
14 Mobil Oil will enter into the lease effective the date of
15 the lease. We're still preparing our factual basis in order
16 to make a claim determination, and Mobil Estates needs
17 approval now.

18 CHAIRMAN CORY: Without objection, Item 30 will
19 be approved as presented.

20 Item 31.

21 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, this
22 is an assignment, a sublease from Anza Liquidating Trust to
23 American International Skateboard Park in that area, and
24 it is a volumetric rental rate, Mr. Chairman.

25 CHAIRMAN CORY: Anybody in the audience on this

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1 item? Any questions?

2 MR. McCAUSLAND: Well, I find this a fairly
3 unique arrangement, and I would probably like to be briefed
4 in it in more detail at some point in time. I understand
5 the item before us, and I can move for its adoption. I guess
6 it's an unusual lease.

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

9 MR. McCAUSLAND: Fifty percent of the net income
10 after 1982.

11 MS. SMITH: That's a lot of money.

12 MR. McCAUSLAND: That's almost getting back past
13 the point of reasonable return.

14 CHAIRMAN CORY: Item 31 will be approved as
15 presented.

16 Item 32, Clear Lake Grant. The staff is asking
17 for authorization to hold hearings and make a report to the
18 Legislature on Lake County's administration of the Clear
19 Lake grant. There have been apparently some reported
20 problems of filling Clear Lake.

21 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, it
22 has come to the staff's attention that there are some problems
23 of filling of the lake and some other alleged problems,
24 and what we would like to do is the authorization to conduct
25 some hearings and try to plumb the depths of it to find

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1 out it in fact there is a problem.

2 CHAIRMAN CORY: Whether or not what we do with
3 the Legislature and what recommendation will be brought here
4 so we --

5 EXECUTIVE OFFICER NORTHROP: Right. What we're
6 doing is an administrative hearing in an attempt to find out
7 where that is.

8 MS. SMITH: No objection.

9 CHAIRMAN CORY: Without objection, authorization
10 is granted.

11 Item 33, Ellwood Pier. I would be upset if a
12 year passed that we didn't have Ellwood Pier to talk about.
13 Tell me about Ellwood Pier this year.

14 EXECUTIVE OFFICER NORTHROP: We are attempting
15 to do something definitive about Ellwood Pier. Don Everitts
16 from our Mineral Section has been working with the City of
17 Santa Barbara. You have in front of you a letter from the
18 Santa Barbara Park Department. While you look at that,
19 I'll ask Mr. Everitts to make a presentation on that.
20 Mr. Trout also has a clarification on that.

21 MR. TROUT: Mr. Chairman, Chet Hart of the
22 Wildlife Conservation Board called our attention late last
23 night to one small correction that needs to be made at the
24 bottom of page 114 concerning the role of the Wildlife
25 Conservation Board. In the last paragraph it says the

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1 Board has extended the request for a grant until April 26th.
2 The Board has pointed out that that extension actually
3 applies to a grant requested by the county and was granted
4 by the federal government. The Wildlife Conservation Board
5 is concerned with this project and would consider funding
6 once the arrangements have been worked out. It's just a
7 small technical change, but it does involve that aspect of
8 it.

9 MR. EVERITTS: Just in case you're interested,
10 here's a picture of the pier and other piers about 1950 or
11 '55 we're talking about. This is a more recent picture of
12 the pier as it exists today. It's the last in a series of
13 piers that were built originally in the '30's to service
14 an offshore oil field, and this particular lease has not
15 been producing since about 1972.

16 In 1972 when the production ceased, the company
17 was obligated to tear the pier out if we so chose, or we
18 have the option of taking the pier. About that time, the
19 County of Santa Barbara came to us and asked us whether it
20 would be possible to convert it into a recreational pier.
21 We've been working with them since 1972.

22 We've had a lot of meetings. The problem now is
23 that they've come to us and they've said that it's going
24 to cost \$3.5 million to put the program into effect. They
25 have about \$3 million funding. We think their estimates are

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1 wrong. It probably might be \$4 million.

2 For example, they have \$120,000 in for land
3 acquisition, which was a 1973 estimate. They have never
4 even begun negotiations with the property owners.

5 They have an estimate of \$515,000 for a highway
6 access road, for an access road to be built by the Department
7 of Transportation. That's a 1973 estimate. Furthermore,
8 most of this year the Department of Transportation says
9 it's not in their six-year plan. They have no intent of
10 putting an access road in.

11 We have a letter from Parks and Recreation saying
12 that it would be highly advisable to stay away from the
13 area because the road will cross an archeological site that
14 they feel cannot be cleared, that it would be to better
15 advantage to take an alternate route.

16 We just don't think it's a viable project. That's
17 my advice and suggestion, that we issue this notice to the
18 company to take the pier out and get it out in a hurry
19 because you know that we have problems in that beach area
20 already. We've got this money from the federal government
21 to clean it, clear up what's left, and what's going to
22 happen is we're going to have a nice big storm one of these
23 days. That pier, the outer third of it is unsafe, and
24 we're just doggone lucky it didn't fall to the bottom of
25 the ocean. It's another problem. I think we should get

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1 out of the pier business on this pier anyway.

2 CHAIRMAN CORY: Is there anyone here from Santa
3 Barbara? Santa Barbara's position is they still want to
4 do the project.

5 MR. EVERITTS: They want to do it. They're never
6 going to be able to do it the way they're doing it. They
7 don't have the money, and they don't intend to spend any
8 money. They have \$500,000 of their money to a three and
9 a half to four million dollar project, and that's it.

10 CHAIRMAN CORY: Is there anybody here from Santa
11 Barbara?

12 MR. McCAUSLAND: The reason this calendar item
13 is on today's agenda is that if we don't take action today
14 our handle on Aminoil is lost.

15 EXECUTIVE OFFICER NORTHROP: We gave Aminoil an
16 extension, Mr. McCausland, to the 31st of this month. With-
17 out some action by us and an agreement by them, I wouldn't
18 want to say what the liability is. They may have a question
19 whether they're liable any longer for the demolition of
20 the pier.

21 MR. EVERITTS: We know they were liable five,
22 six years ago, but I don't know how long their liability is
23 going to extend.

24 CHAIRMAN CORY: Okay. Without objection, I think
25 given the circumstances that we should go ahead and protect

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1 our interest. I think we should also let people know if
2 there is any viable change, I guess if somebody wants to
3 fund something and can do so without disturbing archeological
4 sites and be compatible environmentally and they have the
5 funding to make an alternate use of it, I would not want
6 this action to be taken as saying we're rejecting that; but
7 we're not in the position of funding any of the unfunded
8 portions of the project, or I'm not willing to say to hell
9 with the archeological problems, those things. So, if
10 that's where it is, go ahead and issue the order. If they've
11 got something to talk about, we'll be around.

12 Without objection?

13 Item 34.

14 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, this
15 deals with litigation.

16 MR. HIGHT: Yes, Mr. Chairman. This is the
17 settlement of the first lawsuit that the Commission brought
18 relative to trespassers on the Sacramento River. This
19 settlement involves payment of rental of \$450 a year or five
20 percent of the gross and \$2,000 in back rent. The staff
21 feels that this is a very good settlement.

22 CHAIRMAN CORY: Anybody in the audience on 34?
23 Without objection, Item 34 will be approved as
24 presented.

25 Item 35.

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1 MR. HIGHT: Item 35, Mr. Chairman, is the request
2 for authorization for the Lands Commission and/or the
3 Office of the Attorney General to bring a lawsuit on the
4 Smith River for a mineral conversion. The operator there
5 is removing what we estimate to be about \$200,000 a year
6 in minerals and has refused to at this point even discuss
7 the matter with the staff.

8 CHAIRMAN CORY: What kind of minerals?

9 MR. HIGHT: Sand and gravel.

10 MR. McCAUSLAND: No objection.

11 CHAIRMAN CORY: Without objection, Item 35
12 authorization is granted as requested.

13 Item 36. This is our bomb?

14 EXECUTIVE OFFICER NORTHROP: Our bomb problem,
15 Mr. Chairman. Mr. Hight.

16 MR. HIGHT: This is authorization, Mr. Chairman,
17 for the payment of back rent. The federal government condemned
18 this land during World War II, and it's now full of bombs
19 and for practical purposes has no other use than military
20 purposes. The federal government has condemned the five-year
21 leaseholds, and this is the settlement of the last five-year
22 leasehold. We are attempting to negotiate with the federal
23 government to find a better solution for this problem.

24 CHAIRMAN CORY: Anybody in the audience on this
25 item?

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1 Commissioners?

2 MS. SMITH: They are just settling back rent and
3 then they're going to continue negotiations?

4 MR. HIGHT: In addition, Mr. Chairman, the form
5 that is attached at the end of the calendar item is not
6 the identical language, and we would like that stipulated
7 that it will be substantially in the form as indicated.

8 MS. SMITH: Okay.

9 CHAIRMAN CORY: Okay. Without objection, Item 36
10 authorization is granted as requested with the understanding
11 that the agreement will be substantially in the form as the
12 sample, but not exactly.

13 Item 37.

14 MR. McCAUSLAND: I think those values in that
15 form are totally inappropriate.

16 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, Item 37
17 reached you rather late. With that in mind, I'd like to
18 have Mr. Trout go into some detail on that boundary line
19 agreement.

20 MR. TROUT: This stems from a long-standing lawsuit
21 filed by the Wiese's and the Legislature at one time
22 authorized a boundary line in there and an exchange of
23 interest. As a result of work done by Marin County and
24 our staff, the actual location of the last natural high
25 tide line is really impossible to determine. So, instead

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1 of using the statute in the exchange, we're accomplishing
2 the same thing through an agreement as to the location
3 of the boundary; and the County of Marin will be executing
4 this document as the State's trustee and also as the
5 "private upland owner" on a good part of it.

6 We have a sketch. We've got a map over here
7 that just gives you the idea of the boundary agreement.
8 The Gallinas Canal is above the line. The line that the
9 Commission is agreeing to is the green line, and we are
10 getting fill property between the red and green line to
11 the left and between the blue and green line on the right.
12 The blue line is the 1954 mean high tide line. Research
13 has indicated that this was swamp and overflow land that
14 was artificially dredged and has been partially refilled,
15 and we think this is a good solution to a long-standing
16 dispute.

17 The green line is also the same line that was
18 in the legislation.

19 CHAIRMAN CORY: Is there anybody in the audience
20 on Item 37?

21 Without objection, Item 37 will be approved as
22 presented for the green line, right?

23 38, reforestation project.

24 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, this
25 is authorization for six months' trial on the reforestation

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1 of about in excess of 35,000 seedlings. It is part of a
2 federally-funded project initiated by the State Lands staff,
3 and the trees will be grown by State Forestry and the
4 planning will be handled by the CCC.

5 CHAIRMAN CORY: What is this going to cost?

6 EXECUTIVE OFFICER NORTHROP: The total 18-month
7 project is about \$500,000, Mr. Chairman, of federal funds.
8 It will handle reforestation in our area of about 5,000
9 acres. As a result of this, it will be part of, I imagine,
10 the CCC --

11 CHAIRMAN CORY: How do you pick which 90 acres?

12 EXECUTIVE OFFICER NORTHROP: Well, we find that's
13 one of the problems is finding out which 90 acres to plant
14 it on. As an aside, one of the members of our staff owns
15 some property and he's a forester. He put trees on it
16 and not one of them grew. So, we have to select the
17 particular parcel --

18 CHAIRMAN CORY: He put his trees or our trees?

19 (Laughter.)

20 EXECUTIVE OFFICER NORTHROP: The point I'm making
21 is the fact you just can't plant trees anywhere. Even a
22 forester makes mistakes once in a while. What we have done
23 is selected lands that lend themselves to reforestation.

24 CHAIRMAN CORY: Is that same person selecting
25 the sites?

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1 EXECUTIVE OFFICER NORTHROP: In consultation with
2 other foresters.

3 CHAIRMAN CORY: Mr. Green Thumb?

4 (Laughter)

5 (Thereupon a brief discussion was held
6 off the record.)

7 CHAIRMAN CORY: I don't have any problems, I guess,
8 as long as you're sure they're going to grow.

9 EXECUTIVE OFFICER NORTHROP: No warranty is given
10 to their growth, Mr. Chairman. We're just going to put them
11 where they have the best chance.

12 (Thereupon a brief discussion was
13 held off the record.)

14 CHAIRMAN CORY: Okay. Item 38 is approved as
15 presented.

16 Item 39, South San Diego Bay report.

17 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, this
18 is a report that you have, I believe, in front of you as a
19 result of a task force from the Secretary of Resources,
20 and it's a joint report being approved by the State Lands
21 Commission and the Secretary of Resources. It covers the
22 area of South San Diego Bay.

23 CHAIRMAN CORY: Is there anybody in the audience
24 on Item 39?

25 And you want us to approve or just receive this?

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1 EXECUTIVE OFFICER NORTHROP: Receive and approve,
2 Mr. Chairman.

3 MS. SMITH: Has the Secretary of Resources already
4 approved it?

5 EXECUTIVE OFFICER NORTHROP: Yes.

6 MR. McCAUSLAND: We are equal partners.

7 EXECUTIVE OFFICER NORTHROP: We are co-equal
8 partners. We're trying to do it hitting the line at the
9 same time as closely as possible.

10 CHAIRMAN CORY: Okay. Without objection, Item 39
11 is approved as presented.

12 Item 40, Feralta Community College, find out if
13 they have complied with the terms of the grant in Alameda
14 County. It has now been determined that they have?

15 EXECUTIVE OFFICER NORTHROP: Yes, sir.

16 CHAIRMAN CORY: Is there anybody in the audience
17 on Item 40?

18 Any questions?

19 MS. SMITH: No.

20 CHAIRMAN CORY: Without objection, Item 40 will
21 be approved as presented.

22 Item 41. This is a summary of the settlement
23 negotiations with the City of Los Angeles.

24 EXECUTIVE OFFICER NORTHROP: And reporting to the
25 Legislature as required.

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1 CHAIRMAN CORY: And reporting to the Legislature.
2 Is there anybody in the audience on Item 41?

3 (Thereupon a brief discussion was held
4 off the record.)

5 CHAIRMAN CORY: Item 41, the report will go to
6 the Legislature as staff suggests.

7 Item 42, annexation of the City of Stockton,
8 San Joaquin County. Tell us about that one.

9 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, this
10 is an annexation of an area adjacent to Stockton, and staff
11 tells me it's contiguous. If you recall several months
12 ago we had on the calendar a discussion of an item wherein
13 the City of Stockton and a marina operator came in and
14 applied about the same time for a piece of property, and
15 the Commission at that time opted for the city. This annexed
16 that parcel into the City of Stockton.

17 CHAIRMAN CORY: Okay. Anybody in the audience
18 on this item? Problems?

19 MS. SMITH: No.

20 MR. McCAUSLAND: I figured out what the map said
21 that you sent me. Now it's great.

22 CHAIRMAN CORY: Item 42 will be approved as
23 presented.

24 Item 43 is off calendar.

25 Item 44.

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1 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, this is
2 a cutting agreement, and Mr. Trout and our chief forester
3 would like to give you a program of what that is.

4 MR. TROUT: We have a little map as to what's
5 involved here. What Mr. Grimes is showing you here is
6 the oddly-shaped State parcel as a result of early surveys.
7 The area in blue is forested with the merchantable timber.
8 The balance of the parcel is basically scrub.

9 The parcels outlined in green and yellow are
10 privately owned, that being Louisiana Pacific on three
11 sides of us and then the Forest Service has that portion
12 above and the small portion there.

13 We were originally approached on this parcel by
14 Louisiana Pacific. If I have my terms right, they are
15 undertaking a logging program on their property around us.
16 They asked if we would sell them our timber at the same
17 time. At that time the maps we had indicated that the
18 only access to the parcel was across Louisiana Pacific's
19 property exclusively. After we got into it, we found that
20 a small portion of Louisiana Pacific's road is actually
21 on State property.

22 We initially proposed this as a negotiated settle-
23 ment with Louisiana Pacific for the timber in exchange for
24 some reasonable money and a right of way. Now we find
25 that we can exchange mutual interests in the right of way,

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1 and we would like your permission to agree to the exchange
2 of interests on the rights for the easement to the cutting
3 line, which would be an agreement that the State's timber
4 is on one side of the line and LP's on the other. Then we
5 will go on to bid in the marketplace for the timber, and
6 it would be sold to the highest bidder; and that bid, as well
7 as the agreement, would be brought back to the Commission
8 for approval.

9 CHAIRMAN CORY: Anybody in the audience on this
10 item?

11 (Thereupon a brief discussion was held
12 off the record.)

13 CHAIRMAN CORY: Item 44 is approved as presented.
14 (Thereupon a brief discussion was held
15 off the record.)

16 CHAIRMAN CORY: Item 45.

17 EXECUTIVE OFFICER NORTHROP: This is a request by
18 Union Oil Company, Magma Thermal Power for two wells in
19 the "State Ottoboni area, State Lease Number 4596" 38, 39
20 and 25.

21 CHAIRMAN CORY: Anybody in the audience on Item 45?
22 Without objection? Question?

23 MR. McCAUSLAND: I have no problems with the
24 Calendar Item 45, but I think that the development of the
25 geothermal resources has raised some interesting litigation

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1 which I'd like to review with staff at some point in the
2 future in terms of whether or not the level of environmental
3 review that we do on these projects is adequate in terms
4 of laying the groundwork for later consideration. I don't
5 believe in the concept that we should do a full development
6 EIR, but I'd like some staff advice and counsel regarding
7 whether or not the level of environmental review that we do
8 is adequate to point the way for us in terms of what our
9 potential hazards might be at a later date.

10 I'd move approval of 45, but I'd like us to look
11 at that entire issue again.

12 EXECUTIVE OFFICER NORTHROP: I think we understand
13 and are sympathetic to what you're asking. Would you prefer
14 to do it in an open session?

15 MR. McCAUSLAND: We'll just discuss it in our
16 briefings and see if it is something that should be a
17 calendar item.

18 EXECUTIVE OFFICER NORTHROP: We understand what
19 you're saying and are sympathetic to the position.

20 CHAIRMAN CORY: Even if it's not in a calendar
21 item for the Commission, just a detailed show and tell as
22 to what you really do in that environmental report.

23 EXECUTIVE OFFICER NORTHROP: This bears really
24 on a court case that recently held that to do exploration
25 the detail of the environmental impact required was less

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1 than, I believe, what we probably do normally. With that
2 in mind, I think it's a very cogent question to be raised
3 now as to what we're doing in light of that litigation.

4 MS. SMITH: That was a Superior Court decision?

5 EXECUTIVE OFFICER NORTHROP: Yes.

6 MR. STEVENS: There is an appellate decision too
7 bearing on it.

8 EXECUTIVE OFFICER NORTHROP: I think we should
9 review ours both in light of what our policy would be and
10 our legal obligations. I think our legal obligations are
11 considerably less than what we have set up as policy obliga-
12 tions.

13 CHAIRMAN CORY: What I'm saying is rather than
14 just words, it might be a real dog and pony show as to what
15 it is you really do because sometimes these papers lack
16 certain meaning to those of us who sit at the desk most
17 of the time. I speak for myself in that. What is it the
18 people are really looking at and really doing out there
19 in the field? Whether it takes actual slides of what you
20 are doing out there or whether we have to go out to look at
21 it, I'd like some feel for how deep you're going. I'm
22 not sure I understand that.

23 The other Commissioners may fully understand that.
24 I'm not sure I do. I'd like to look at the substantive
25 issues rather than the legal obligations.

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1 EXECUTIVE OFFICER NORTHROP: A main criticism
2 made of the EIR's is that they're nothing more than
3 subsidies for academia and have little real value other
4 than academic substance.

5 MR. McCAUSLAND: I don't think he just made the
6 point that he wanted to make. The point that he wants to
7 make is that the staff of the State Lands Commission goes
8 beyond the use of academia's credentials in fronting for
9 the State Lands Commission and actually looks at some of
10 the issues involved.

11 CHAIRMAN CORY: Where are we? Has 45 been approved
12 or not?

13 EXECUTIVE OFFICER NORTHROP: 45 has not been
14 approved.

15 MS. SMITH: No objection.

16 CHAIRMAN CORY: Without objection, 45 will be
17 approved as presented.

18 Item 46, Moe Sand Company wants a ten-year mineral
19 extraction but they're dredging?

20 EXECUTIVE OFFICER NORTHROP: Mineral extraction
21 of about 50,000 cubic yards at a ten-percent royalty.

22 CHAIRMAN CORY: Ten percent?

23 EXECUTIVE OFFICER NORTHROP: Ten percent of the
24 weighted average sale price.

25 CHAIRMAN CORY: Is there anybody in the audience

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1 on Item 46?

2 MR. McCAUSLAND: No problem.

3 CHAIRMAN CORY: Without objection, Item 46 will
4 be approved.

5 Item 47, American Bridge Division of U.S. Steel
6 wants to dredge, take it out of something and put it back
7 on Alcatraz Island at 15 cents per cubic yard. Is there
8 anybody in the audience on this item?

9 MR. EVERTS: William Everts. I'm just here in
10 case there should be questions, Mr. Chairman.

11 CHAIRMAN CORY: You are with?

12 MR. EVERTS: American Bridge Company.

13 CHAIRMAN CORY: You'd like us to approve it.

14 MR. EVERTS: I would hope so.

15 CHAIRMAN CORY: Anybody else in the audience?
16 Any questions?

17 Without objection, Item 47 will be approved as
18 presented.

19 We get to be informed on Item 48.

20 MR. McCAUSLAND: May I ask him a question as long
21 as he came all the way up here?

22 CHAIRMAN CORY: We have a question for you, sir.

23 MR. McCAUSLAND: If the decision was made to do
24 the disposal in the Pacific Ocean beyond the hundred fathom
25 line, do you have any cost estimate on what the marginal cost

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1 of that disposal would be versus the Alcatraz site?

2 MR. EVERTS: I'm sorry to say I don't have the
3 answer to that.

4 CHAIRMAN CORY: Is that something you may be able
5 to get and send along?

6 MR. EVERTS: Yes, I could.

7 CHAIRMAN CORY: One of the questions I guess Sid
8 has come to, each month we sit here and periodically get
9 these permits to dump things at Alcatraz Island. Every
10 time I'm in the City I wonder where all that stuff is going.

11 MR. EVERTS: I'd be glad to find that out.

12 CHAIRMAN CORY: Item 47 will be approved as
13 presented.

14 Item 48 we are to be informed upon. Owens Lake
15 bid lease.

16 EXECUTIVE OFFICER NORTHROP: Mr Chairman, the
17 Commission left with the Executive Officer the obligation
18 or charge to review the possibility index indicator, and
19 we have come up with the following indicator of 10 percent
20 of the raw material and/or 25 percent of the net profits
21 of the finished material; but in no case will the 25 percent
22 be less than the 10 percent raw material figure.

23 CHAIRMAN CORY: A floor of 10 percent of the gross
24 25 percent of the net, whichever is greater.

25 EXECUTIVE OFFICER NORTHROP: Yes.

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1 CHAIRMAN CORY: Anybody in the audience on this
2 item?

3 We have been informed.

4 49. Inform us again.

5 EXECUTIVE OFFICER NORTHROP: You have a very large
6 tome that was delivered recently to your office entitled,
7 "Power Seeps in California".

8 MR. McCAUSLAND: For those who haven't had the
9 chance to see how thick it is --

10 EXECUTIVE OFFICER NORTHROP: It was done by
11 Mr. Ed Welday whose last work with the staff was to complete
12 that, and we think he did a really fine job on that report.

13 CHAIRMAN CORY: In essence what that document
14 represents is a baseline of existing hydrocarbon seeps
15 along our shoreline.

16 EXECUTIVE OFFICER NORTHROP: Right, and an attempt
17 at some kind of a definitive explanation of some of them.

18 CHAIRMAN CORY: So that will help us in future
19 questions, if a person with a lease is having some activity
20 in somehow one of those in the vicinity of one of those
21 seeps starts to increase its quantity rather substantially
22 we are able to sit down and talk to them on somewhat
23 specific terms.

24 EXECUTIVE OFFICER NORTHROP: In the environmental
25 processing buzz word terminology, this is the benchmark study,

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1 a baseline study, which has been one of the problems we
2 felt in the federal NCS, particularly at the staff level,
3 that there had been too little, if any, real bench work
4 done prior to the development. Unfortunately, this bench mark
5 is a time bench mark and not prior to development, but at
6 least we know what happens, good or bad, from this point
7 forward. It's just a baseline study of this issue.

8 CHAIRMAN CORY: Is there anybody in the
9 audience on Item 49?

10 MR. McCAUSLAND: It's an excellent report.

11 CHAIRMAN CORY: Item 50, the approval of the
12 fourth modification.

13 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, I'd
14 like to ask Mr. Thompson to discuss 50, 51, 52 and 53 with
15 the Commission, if you please.

16 MR. THOMPSON: Calendar Item 50 is a ratification
17 of the Executive Officer's action, and this really is to
18 do some work in the Long Beach unit to produce upper tier
19 oil. We're planning on building two wells and redrilling
20 one well.

21 CHAIRMAN CORY: This is all upper tier?

22 MR. THOMPSON: All upper tier oil, yes.

23 CHAIRMAN CORY: Fine. Approved.

24 MR. THOMPSON: The fifth modification is a little
25 more difficult problem for us to make a staff recommendation

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1 on this. What we think we're doing here is following up
2 on the Commission's policy of augmenting the budget with
3 a portion of any increase from crude oil pricing. We have
4 had problems here in obtaining ceiling price for oil, and
5 this had been blamed on the entitlement program by those
6 companies who oppose it.

7 Effective January 1st, 1978, the Department of
8 Energy changed the entitlements credit for lower tier crude
9 in hopes of getting this ceiling price posting.

10 The first tabulation that you have there actually
11 shows what treatment of oil is under this entitlements
12 program. On the left columns there you'll see the lower
13 tier oil at Wilmington. The very left one is the present
14 posted price, and the one on the right is a ceiling price.
15 You see there is about a 72 cent difference there. We
16 have the potential of getting 72 cents more a barrel for
17 our oil.

18 Now, the posted companies have maintained that
19 under the entitlements program their oil is not worth the
20 ceiling price. You see what happens as you move to the
21 bottom line that the oil that starts at \$4.35, because of
22 its obligation, its penalty, gets up to \$9.20 under this
23 treatment. Without the treatment it would be over \$10.

24 Hopefully under this treatment then you would
25 then have a comparison. Then we would be able to receive

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1 ceiling price for oil so that the cost of refinement under
2 the entitlement program would then be a little over \$10
3 compared to competitor oil of A&S crude or imports of
4 about \$12. Even though those oils initially started out
5 at the selling price of over \$13.

6 We would like to augment the budget here and
7 start some additional development here, but again we are
8 at the crossroads of depending on the Department of Energy
9 to do something in the entitlements program; and then the
10 other part of the action is for posters to increase their
11 price. As of today there has been no increase in the
12 posted prices as a result of this entitlement change on
13 the first of January.

14 Again, the staff has the problem here of giving
15 recommendations, augmenting budgets to do things, and in
16 the past we have been burnt on this. I think at the present
17 time here that the Commission's action back in Washington,
18 especially the Chairman's with the DOE, I think this is
19 possibly a little more favorable environment now than we've
20 had in the past.

21 The second part here actually has a statement by
22 DOE that they want to do everything they can to allow the
23 producers in California to receive ceiling price. This is
24 not a windfall because the price can only go to the ceiling
25 price.

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1 Again, they are going to follow this up with
2 a hearing sometime in the first quarter of 1978, as they
3 say, to see if any adjustments are necessary. This again
4 is the extra page that will be necessary for the DOE to
5 carefully monitor the California market to determine whether
6 in fact the incentive provided was adequate. So, again,
7 we have hopes that if posted prices do not increase as a
8 result of this change, that they will do something in this
9 hearing to do this. Again, we seem to have statements as
10 part of President Carter that he wants to maintain
11 production of California crude at a high level.

12 So, we seem to have a favorable environment to
13 do this, but again you're betting on the company.

14 CHAIRMAN CORY: If we make that bet and for
15 some reason it doesn't come to pass, is it likely that there
16 might be a market for the additional rig and some of the
17 additional things that we've obligated ourselves that we
18 might mitigate our loss by peddling to someone else?

19 MR. THOMPSON: That is a distinct possibility.
20 Delivery time on a drilling rig now is running about 12 to
21 15 months.

22 CHAIRMAN CORY: Part of this is a rig.

23 MR. THOMPSON: There is a limitation in there
24 for \$3.4 million for a drilling rig. So, in effect, we're
25 trying to place an order. With the demand for drilling rigs

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1 right now, I feel fairly confident, yes. If you wanted to
2 cancel out on that rig later on, you could probably get
3 out without any obligation.

4 MS. SMITH: That was my understanding that we
5 would cancel out if the prices didn't increase.

6 EXECUTIVE OFFICER NORTHROP: I think the position
7 has been that we would come back to the Commission and
8 reevaluate our position. It well may be there are mitigating
9 circumstances.

10 CHAIRMAN CORY: We could get out at that point.

11 EXECUTIVE OFFICER NORTHROP: If the Commission
12 felt that that was the thing to do.

13 MR. THOMPSON: Also, any of these expenses you
14 augment for if you want to come back later on and remove
15 them, we can't spend the money instantaneously. There is
16 a period of time to spend these monies. We especially would
17 like to get a commitment for the drilling contract so we
18 can start this rig because these are two locations that
19 we haven't been able to drill from for almost two years.

20 CHAIRMAN CORY: I guess we go along with the
21 understanding that you keep us posted and we should have
22 it in good faith to DOE that we will try to do our part.
23 So, if we go back in and nothing is happening, we can go
24 with clean hands.

25 MR. THOMPSON: All right, and we'll try to

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1 concentrate on upper tier oil, cut the cost of the water
2 injection wells, report back to you in February.

3 CHAIRMAN CORY: Maybe we should assume that
4 they're going to get us what they said they're going to
5 get us, and they're going to continue to monitor it if
6 that doesn't happen. So, if we don't get the additional
7 prices, checking back -- in fact, I'm thinking of doing that
8 next week or the following week -- to keep them posted you
9 are apprised that nothing has changed out here yet and
10 that we are proceeding on the good faith effort, that we're
11 going to take them at their word that they're going to do
12 whatever it takes to increase the penalties on foreign oil
13 or increase our entitlements reduction, continue to give
14 us the price advantage we need to make it happen.

15 MR. THOMPSON: My understanding of this would be
16 that you approve this then --

17 CHAIRMAN CORY: Yes, it's approved.

18 MR. THOMPSON: We'll be able to go ahead and get
19 the drilling contract.

20 CHAIRMAN CORY: Go ahead.

21 MR. THOMPSON: We will then put the order in
22 for the low bidder for the drilling rig; and, if necessary,
23 in the future we will back out.

24 CHAIRMAN CORY: Let's make it clear that we
25 understand that if we back out that we will mitigate our

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1 loss, that we will not end up saying the contract doesn't
2 exist. We realize we're entering into a contractual
3 obligation, but we have an asset there which we could sell
4 as a business judgment.

5 MR. THOMPSON: That, and we will get out of the
6 obligation as soon as possible depending on if it becomes
7 adverse.

8 Calendar Item 52 is merely a reporting of
9 geological hazards, and our staff review of these bench
10 mark elevation changes substantiates that no subsidence
11 in the land surfaces has occurred as a result of the operations
12 in the Long Beach unit.

13 CHAIRMAN CORY: Anybody in the audience on Item 52?
14 Without objection, it will be approved.

15 MR. THOMPSON: Calendar Item 53 is merely
16 closing of a subsidence cost item. This was a land fill
17 project in the harbor section down there and as a result
18 of this will be closed, and there will be an adjustment to
19 the State of a little over \$16,000.

20 CHAIRMAN CORY: Anybody in the audience on 53?
21 Without objection, that will be approved.

22 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, I
23 just received a message that Mr. Loeb from Aminoil is on
24 his way from the airport and would like to speak to the
25 Commission on Item 33. We've already passed the item, so

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1 I will advise the Chair of the problem. It's the Ellwood
2 Pier.

3 CHAIRMAN CORY: Okay. I guess we can listen to
4 him and see what Uncle Ellwood has for us today.

5 Item 54.

6 MR. HIGHT: Yes, Mr. Chairman, this is the
7 settlement of a lawsuit that the Sierra Club brought on
8 the Humboldt Coast.

9 CHAIRMAN CORY: When did they bring suit?

10 MR. STEVENS: About two years ago, I think,
11 Mr. Chairman, two or three years ago.

12 MR. HIGHT: This settlement would remove any
13 implied dedication claims on the property, and the Commission
14 would acquire public access to the beach area through this
15 mechanism.

16 CHAIRMAN CORY: Why is it when we sue up in
17 Humboldt County it takes so long?

18 MR. STEVENS: Because I think here the landowner
19 was willing to settle, Mr. Chairman.

20 CHAIRMAN CORY: I just thought I'd ask. Anybody
21 in the audience on Item 54?

22 Without objection, we will accept the proposal
23 on that.

24 Do you have any questions, Sid, on 54?

25 MR. McCAUSLAND: No, I don't.

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1 CHAIRMAN CORY: Okay. Now we are at that difficult
2 point where we are now ready to go into the executive
3 session, save for the fact that we have gotten a telephone
4 message that somebody from Aminoil would like to come in
5 and speak to us on Item 33, which we have already dealt
6 with, Uncle Ellwood.

7 MR. McCAUSLAND: Do we want to rescind our action?

8 CHAIRMAN CORY: I'm not prepared to rescind our
9 action; although, I think it would probably be appropriate
10 to listen to the gentleman.

11 EXECUTIVE OFFICER NORTHROP: Mr. Chairman, we also
12 have one piece of litigation that probably we should
13 discuss and it can be done in public session, and that is
14 the Berkeley waterfront case.

15 CHAIRMAN CORY: Okay. Let's discuss the Berkeley
16 waterfront case.

17 MR. EAGAN: Dennis Eagan again, Deputy Attorney
18 General.

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

21 MR. EAGAN: As the Commission may know, the
22 Commission is involved as a defendant and cross-complainant
23 in litigation which involves title to approximately 650
24 acres of tide and submerged lands along the Berkeley
25 waterfront of which 80 percent is still under the water of

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1 San Francisco Bay. The action started as an inverse
2 condemnation case brought by some developers and Mr. Murphy
3 and Sante Fe railway, who alleged that they had been denied
4 the right to develop their property by certain zoning
5 decisions by the City of Berkeley.

6 In the course of that inverse condemnation action
7 the claimed title of the private claimants came under
8 question; in view of that our grantee being the City of
9 Berkeley, the State Lands Commission was joined as a party
10 defendant. We brought approximately 600 additional acres
11 into the lawsuit. The other side moved early in the lawsuit
12 for partial summary judgment on the issue of the nature of
13 title which had passed to the tidelands in the 1870's.
14 These were deeds issued by the Board of Tideland Commissioners.

15 There is language in certain cases, both at
16 the Supreme Court level and the Court of Appeal of the
17 State of California, which indicates that these deeds as
18 of their issuance established tidelands trust over these
19 lands. Based on those decisions, the Superior Court granted
20 the partial summary judgment moved for by the opposing
21 parties.

22 The Commission then decided along with the city
23 to seek extraordinary relief, not waiting for entry of
24 final judgment on the other issues in the case. We filed
25 a petition for writ of mandate in the California Superior

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1 Court seeking an order from that court ordering the
2 Superior Court to vacate its prior order. This was back
3 in September of 1977. Without decision, the California
4 Supreme Court transferred the matter for decision to the
5 California Court of Appeals in San Francisco. That court
6 chose not to hear the matter on the merits and issued a
7 one-line decision denying our petition for writ of mandate.

8 We then petitioned for hearing in the California
9 Supreme Court, and last month, the California Supreme Court
10 hearing and ordered the Court of Appeal to hear the matter
11 on the merits.

12 In the perspective of where we had come from
13 in terms of our prior progress in the case, we consider
14 that a major victory. We still don't have a decision on
15 the merits from the Court of Appeals, and it's highly
16 problematical as to what that decision might be. In any
17 case, I think whichever side loses in the Court of Appeals,
18 there will be further activity in the California Supreme
19 Court. The matter is set for oral argument currently in
20 the Court of Appeal on February 16th of next month. Any
21 questions?

22 EXECUTIVE OFFICER NORTHROP: We can now have
23 an executive session because the attorneys are here.

24 CHAIRMAN CORY: Okay. We can now have an
25 executive session because the attorneys are here. I would

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1 guess that what we'll do when we reconvene -- how long
2 will the executive session take?

3 EXECUTIVE OFFICER NORTHROP: Greg, how long?

4 MR. TAYLOR: Forty-five minutes probably.

5 (Thereupon a brief discussion was held
6 off the record.)

7 CHAIRMAN CORY: We will adjourn into executive
8 session. If we could have public and unnecessary staff
9 please leave the room so we can deal with the litigation,
10 I would like somebody of the staff to remain at the door
11 to let people know we will take up the gas pricing item,
12 Item 55, and hear anybody that wishes to talk on Item 37
13 when we reconvene.

14 (Thereupon the morning session of the
15 State Lands Commission was recessed for
16 lunch.)

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AFTERNOON SESSION

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3 CHAIRMAN CORY: The time of 1:30 having arrived
4 there are a couple of housekeeping things I'd like to
5 try to at least commence before we get into the hearing
6 itself.

7 Is the representative from Aminoil here?

8 MR. LOEB: Yes, two representatives, Messrs. Kelly
9 and Loeb.

10 CHAIRMAN CORY: And you would like to talk to
11 us on Item 33. Okay. We will probably wait another five
12 or ten minutes for the remaining members to maximize the
13 probability of whatever it is you wish to do.

14 I want to fill you in that this morning before
15 we got your telephone call we had already acted on the
16 item, and what we are doing now is providing time for you
17 to make your pitch at some point, but an action has been
18 taken. If it's the inappropriate action in your opinion
19 and we should do something else, we're willing to listen,
20 but procedurally where we are we would have to rescind the
21 previous action to take any other. In essence, as I recall.
22 Item 33 is Uncle Ellwood again, and the question that the
23 staff presented to us was that the proposal, as they under-
24 stood it from Santa Barbara, was what they would like to
25 do and that Santa Barbara had half a million dollars toward

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1 that end and that there were some environmental problems
2 with the project to boot; and the Commission did act upon,
3 in essence, terminating the various extensions that had
4 been granted while we tried to figure out something and
5 tried to precipitate an action with the understanding that if
6 anybody in the interim came up with any viable solution
7 we are not predisposed against that. It just seems like
8 we had no reason to keep the thing open. That's where we
9 are.

10 We'll probably sit here for another five or ten
11 minutes. We would prefer to have all the Commission members
12 here to hear you.

13 (Thereupon a brief recess was taken.)

14 CHAIRMAN CORY: We are back in session and would
15 the gentleman from Aminoil come forward. I have explained
16 to him where we are procedurally.

17 Would you identify yourself for the record, please?

18 MR. LOEB: My name is Joe Loeb. I'm an attorney
19 with Aminoil. To my left is Mr. Kelly, who is the Division
20 Production Manager for the west coast of Aminoil USA, Inc.

21 We don't want to prolong the never-ending saga
22 of Ellwood Pier. In fact, your action today is consistent
23 with our ideas, and we are in favor of this decision. We
24 want to point out a few things that almost grow naturally
25 out of the procedures that will now ensue. In order to

1 demolish the pier, which is our directive, we will have to
2 obtain certain equipment; and it is much more efficient to
3 do it at certain times of the year, and we will have to
4 get our permits from the Corps of Engineers and from the
5 Coastal Commission, et cetera.

6 So, there is a built-in time delay. The best time
7 of the year to perform this task is in the latter part of
8 summer, and the particular piece of equipment that is
9 adapted to removing the pier of this size and this length
10 will be available about the same time. Also, as you know
11 probably better than we do, the permitting sometimes gets
12 sticky and that's going to take at least months.

13 So, during this period of time we plan to commence
14 immediately in the permitting procedures, arrange for
15 the equipment and get started on this which now permits
16 us time to examine the other possibilities for this pier.

17 We can see from the viewpoint of the State and
18 the County of Santa Barbara, of course, they are still in
19 the picture. They still evidence their desire to do some-
20 thing with this pier, and some other oil companies who are
21 operating on both State and Federal leases in this area can
22 make use of a portion of the pier, which would be removal
23 of the outboard of the pier which is beyond the boat landing
24 right now. If in this interim which they can see that it's
25 to their advantage, and even through the county or through

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1 the offers of other oil companies -- not Aminoil. We had
2 been approached by other oil companies who have use for
3 this pier, at least the inboard portion to the boat landing.
4 We now have a built-in time life to examine the other
5 possibilities. So, we are prepared and are going to move
6 ahead ultimately to remove the whole thing and prepared
7 to stop at a logical place which would leave a stub of the
8 pier which could be used for recreational purposes and
9 for State employees to examine and inspect the State
10 facilities offshore from this area.

11 This is the only pier, as we know, in the entire
12 area. It would be helpful for emergency procedures in
13 case there were an oil spill. All in all, you can think
14 of, and many people have over the last six or seven years,
15 various possibilities. To sum it all up, we are not
16 obstructing anything. We are in favor of getting people
17 to either move or stop the never-ending story.

18 CHAIRMAN CORY: That's where we are. If anything
19 comes up, we're willing to listen to any reasonable proposal
20 that anybody wishes to put forth. We cannot keep you on
21 the hook any longer. Go ahead with your contractual
22 obligation. Proceed. If something comes up -- any questions?

23 (Thereupon a brief recess was taken.)
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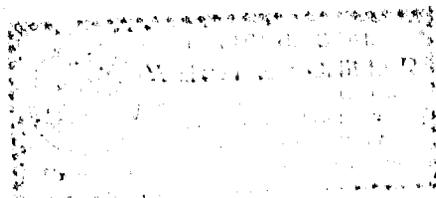
1 STATE OF CALIFORNIA)
2) ss.
3 COUNTY OF SACRAMENTO)

4 I, WENDY E. SCHILLER, a Notary Public in and for
5 the County of Sacramento, State of California, duly
6 appointed and commissioned to administer oaths, do hereby
7 certify:

8 That I am a disintersted person herein; that the
9 foregoing State Lands Commission Meeting was reported in
10 shorthand by me, Wendy E. Schiller, a shorthand reporter
11 of the State of California, and thereafter transcribed into
12 typewriting.

13 I further certify that I am not of counsel or
14 attorney for any of the parties to said meeting nor in
15 any way interested in the outcome of said meeting.

16 IN WITNESS WHEREOF, I have hereunto set my hand
17 and affixed my seal of office this 14th day of February, 1978.



18 Wendy E. Schiller
19 WENDY E. SCHILLER
20 Notary Public in and for the
21 County of Sacramento, State of
22 California

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MEETING
STATE LANDS COMMISSION

State Capitol
Room 2117
Sacramento, California

ORIGINAL

Excerpt of Proceedings

THURSDAY, JANUARY 26, 1978
10:00 A.M.

Wendy E. Schiller

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MEMBERS PRESENT

Hon. Kenneth Cory, Controller, Chairman
Mr. Sid McCausland, representing Roy M. Bell
Ms. Betty Jo Smith, representing Mervyn M. Dymally

MEMBERS ABSENT

Hon. Mervyn M. Dymally, Lieutenant Governor
Hon. Roy M. Bell, Director of Finance

STAFF PRESENT

Mr. William G. Northrop, Executive Officer
Mr. Robert C. Hight, Staff Counsel
Mr. Allen Willard
Mr. Don Everitts

ALSO PRESENT

Mr. Jan Stevens, Attorney General's Office
Mr. Alan Hager, Attorney General's Office

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P R O C E E D I N G S

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3 CHAIRMAN CORY: The next item is Item 55 on calendar,
4 and the question is gas prices on State leases in Northern
5 California. It has been indicated that Mr. Bennett would
6 like to speak to us on this subject, and I think he is
7 most --

8 MR. BENNETT: Mr. Chairman, the group with whom
9 I'm associated has structured their own order of appearance
10 and I'll defer to them. They would prefer that the attorney
11 for the Pacific Gas and Electric Company speak first, then
12 Commission Gravelle, and then I will attempt to clarify any
13 doubts they have planted in your minds and then we'll have
14 a litany of other witnesses who cast light upon this grave
15 question.

16 CHAIRMAN CORY: Before you do that, let me explain
17 as an elected constitutional officer you have certain rights
18 and privileges. Before you give them away, let me explain
19 that after we take care of obligations to our fellow
20 constitutional officers, the Chair may be somewhat arbitrary
21 in how we parcel out the time.

22 MR. BENNETT: That being the case, may I speak
23 first, Mr. Chairman?

24 (Laughter.)

25 CHAIRMAN CORY: I thought that was what you wished

1 to do.

2 MR. BENNETT: Well, Mr. Chairman, Mr. Cory,
3 Mr. McCausland, and Betty Jo Smith, I have no prepared
4 statement, and I have read the material here rather quickly
5 and I'm speaking spontaneously. So, my thoughts may not
6 be in the order I would like or which would have the best
7 appeal to you. But I want to give you my background in
8 the field of regulation, litigation with the oil and gas
9 industry. It's extensive. It has gone on for almost two
10 decades. In my public positions I've had jurisdiction over
11 such matters directly and also before federal regulatory
12 bodies.

13 I understand your responsibility. It's a grave one.
14 You are a public trustee, as am I, and you must derive the
15 best revenue as you see it for the State; but as I read
16 your statute, you are also charged with being concerned with
17 the public interest, and the facts and the prices which are
18 before us are really not in dispute. It's just whether they
19 should be granted.

20 This case represents to me an exercise of the
21 effect of monopoly power of the oil industry upon a state
22 and its people and its elected public officials. Because
23 there is control of market prices in the Middle East and
24 Canada and wherever and because there is an absence of any
25 government control over such prices, either at the federal

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1 level by abdication and neglect of the Nixon years or
2 because of the economic power of the sheiks in the Middle East,
3 we are confronted with the reality of high prices; and you
4 can tell by looking at those prices that they represent
5 windfall profits to the oil companies.

6 For example, the quadrupling of natural gas prices
7 by the negligent Federal Power Commission gave to the oil
8 industry an 18 percent return on equity computed at a 48-
9 percent corporate tax rate, and it's a fact that many, and
10 in some times most oil companies pay little or no corporate
11 tax at that rate. Indeed, sometimes they pay no taxes,
12 and the average is around 16 percent. So, the 18-percent
13 return on common equity is stated on the low side.

14 Coming to California, you're really in an awkward
15 position, not a regulatory body. You don't have a showing
16 of revenues and expenses so you can measure what is being
17 asked for by way of a return. And one thing you should
18 determine, either by voluntary statement or by some witnesses,
19 is what is the return on investment to those producers
20 resulting from the prices asked. That's critical.

21 To price gas produced in California which has no
22 transmission costs with Canadian gas and Middle Eastern prices
23 is not fair to the public nor to the State. To derive a
24 revenue of \$2 million when the effects will be a triggering
25 of gas prices throughout the state and an increase in utility

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1 bills of \$100 million to the people on the face of it seems
2 to be a bad bargain. Two million at a cost of 98 million
3 if my figures be correct.

4 I have no trouble in finding that the public interest
5 calls upon you to reject this. Now, there is a great deal
6 of dialogue from lawyers such as myself and from consultants,
7 but the proof of their case would lie in an exhibit, a
8 witness, something under oath showing that the present prices
9 are inadequate, their investment is being confiscated
10 because of an inadequate return over the years and they're
11 not being made whole. If that's the case, I'll be the first
12 to say increase the prices.

13 I think you can conclude from the absence of such
14 a showing that they can't make it. We should not be companion
15 to this piggy banking operation of a large or a small
16 producer or a group of producers who are benefitting from
17 the exploitation of the world by the oil companies oligopoly
18 or near-monopoly situation. That's what this case is in
19 miniature. You have the power because you have the discretion
20 to deny this, and we don't want any compromise price in
21 between.

22 Now, the last thing I want to say is this: If you
23 would permit me, I would call Mr. Lippitt as a witness,
24 because if I were sitting here as a deputy attorney general --
25 and I was one once for a period of 12 years. I did then

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1 write opinions about conflict of interest. It isn't a
2 question of the competency of Mr. Lippitt or his integrity
3 or his understandable human desire to earn a fee. It has
4 nothing to do with his competence or expertise. It has to
5 do with the fact that he may not and cannot with fairness
6 serve two masters, the public interest and the private
7 interest.

8 As I understand it, he is the attorney and repre-
9 sentative of the producers. He is an advisor to the State
10 on this very matter which is the subject of this hearing,
11 and his testimony should be stricken for that reason. It
12 is a horrendous thing in this day when it's all too common
13 for us to be sitting here as one of the matters which is
14 before you because I'm bringing it before you. Do you think,
15 for example, that the principal attorney for the Pacific Gas
16 and Electric Company should or could, without challenge, be
17 advising the Public Utilities Commission of the State of
18 California as to what rate of return it should receive?

19 I state to you there is no difference between
20 that situation and this situation. So, Mr. Lippitt's testi-
21 mony and his exhibit, if you do not reject it out of hand,
22 I'm personally outraged at a financial arrangement of this
23 kind. It should not be tolerated. It will be considered
24 as an example for others to do the same in the future, and
25 the State should not put out public funds to hire a voice

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1 from the producers of the State of California to advise this
2 important agency upon producer prices. Common law case law
3 dealing with conflict of interest forbids such an arrangement

4 Now, if you do not agree with that which I've
5 said about the conflict here, then I would ask -- and I will
6 call Mr. Lippitt as a witness, and I feel rather certain
7 I could readily establish he is not impartial despite his
8 competence. He has a bias, a proper bias because of the
9 nature of the relationship to his clients, and he should not
10 be a voice which goes into your decision-making process
11 except as an advocate clearly on that side of the table,
12 properly representing his interest, which I consider to be
13 contrary to the public interest.

14 So, I say, gentlemen, in conclusion, do not impose
15 a massive rate increase upon an already overburdened state
16 in terms of utility rate increases because you want to
17 further enrich oil companies. I'll conclude on this note.
18 I would ask Mr. Lippitt to tell this body what the return
19 on investment, on equity, on sales or whatever it may be
20 to the producers involved in this arrangement is.

21 That's something you should know because it may
22 well be that they are having a 50-percent return on equity,
23 a 30-percent on equity, and maybe indeed they're bordering
24 on insolvency. If that's the case, I'll join Mr. Lippitt's
25 cause.

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1 Now, if you have any questions --

2 CHAIRMAN CORY: Bill, there are some areas because
3 of your background that you might be able to explain.
4 Previous hearings on the subject have really not gone a
5 great deal to further fact discovery, unfortunately; but
6 given your posture, there are some questions that go through
7 my mind.

8 Why is there not an involvement of the PUC in
9 this area of controlling prices here within California? It
10 somehow seems like coming in the middle of a movie that I
11 don't necessarily fully understand.

12 MR. BENNETT: There has been criticism of actions
13 of this agency, and improperly so. Let me give you the
14 history of this.

15 It was the Federal Power Commission which, by
16 administrative decision, held that the Natural Gas Act was
17 intended to regulate production and sales of natural gas
18 at the wellhead sustained by the United States Supreme Court
19 in 1954 by the landmark Phillips decision. I argued the
20 second Phillips decision case in the United States Supreme
21 Court further affirming regulation.

22 When I was a member of the California Public
23 Utilities Commission, I wrote a dissenting opinion urging
24 that under Section 216(c) of the Public Utilities Code that
25 the Commission should open investigation leading to the

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1 imposition of regulation upon the producers of the State of
2 California. Because a Texas producer was getting, let us
3 say, 20 cents, the transmission charge was, let's say, 5 cents
4 and it was a border price of 25 cents. California producers
5 were getting border price and they had no transmission
6 charges. There were never enough votes on the Commission,
7 despite a decision of the California Supreme Court known
8 as the Richfield case wherein by way of dicta they suggested
9 they were subject to regulation, there were never enough
10 votes to issue an order leading to the regulation of the
11 producers of the State of California; and I maintain that
12 that should be attempted if only to have the California
13 Supreme Court put the matter to rest.

14 Justice Traynor in his opinion suggests that if
15 the Commission were to proceed in a certain way, there could
16 be imposed regulation at the wellhead. It isn't done, and --

17 CHAIRMAN CORY: Without any statutory changes?

18 MR. BENNETT: It can be done without any statutory
19 changes relying under Section 216(c). The Yucaipa case,
20 as I recall, another case -- this is memory of ten years ago --
21 permitted the Commission to do that with reference to water
22 companies, public utility water corporations. It has never
23 been tried with reference to producers, and the impact upon
24 the State is enormous and the Commission ought to do it.

25 That's why I understand your position. You will be

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1 told not to permit it. At the same time you say, well, what
2 is the Commission doing about this?

3 You're not a rate-setting body. You don't
4 regulate them. You are supposed to give them their prices
5 with the public interest in mind. And I do maintain that
6 you have authority to deny this because of public interest.
7 But I will articulate that today. I say it's high time the
8 California Commission proceeded to regulate the producers
9 of the State of California.

10 CHAIRMAN CORY: The problem I have is the role
11 we're being cast in. It seems to me that I can equate to
12 the public interest responsibility that I have, but what I
13 see happening is that to do what some suggest -- and I think
14 what you are suggesting is putting the State Lands Commission
15 in a role of saying, well, we will deny ourselves what every-
16 body else we know is going to get because the PUC won't
17 deny them. When the PUC commissioners -- we will have one
18 speaking here later -- called me and spoke to me privately
19 on this subject saying, you shouldn't do that. I asked them,
20 why don't you just put a stop to it and declare a public
21 policy. They keep saying they can't do that.

22 MR. BENNETT: I disagree.

23 CHAIRMAN CORY: I have trouble with why it is that
24 we are put in this role of the villain when in fact we have
25 prior cases of secret contracts, if you will, that have been

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1 uncovered in this investigation which it seems to me the PUC
2 should have been aware of and disclosing to the public.
3 If these things are so horrendous, they are the body that is
4 better equipped to deal with that end of it.

5 The end result of what I'm afraid you're suggesting
6 is we won't charge for ours, but we'll give this gas to one
7 private corporation, Standard Oil of California, at a gift
8 price so they can benefit from it, and they will contract
9 secretly or publicly -- I'm not sure which -- with PG&E so
10 another private corporation gets its piece of the action and
11 a profit on the deal; and lo and behold, everybody else is
12 going to get the high prices and we get the green weanie.
13 That's my problem with this whole thing. If you can help in
14 that end of it --

15 MR. BENNETT: Those are problems which must be
16 solved over a period of years because they haven't been
17 squarely addressed perhaps, and they should have been. I
18 will obtain for you a copy of my dissenting opinion. It
19 was 1963, I think. That's how ancient it is.

20 At that time the savings to California consumers,
21 if they only got the same price Texas producers could have
22 gotten, I think it was something like \$50 million annually.

23 Now, in those days one would stop in the street
24 to pick up \$50 million; today you pass it by, as we all know.
25 But I would not be here if this would trigger a \$5 million

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1 increase or whatever.

2 CHAIRMAN CORY: Why, with the power of the PUC,
3 must it trigger the increase?

4 MR. BENNETT: Because the power prices are not
5 regulated, and if they choose to price their gas five times
6 what it is today and PG&E through its monopoly position
7 somehow, despite it, must pay that, then those are the
8 contract prices and those go into the expenses which will
9 be allowed by the Commission.

10 CHAIRMAN CORY: What I'm in essence publicly
11 challenging the PUC to do is flat come out and say these
12 things are not in the public interest. I'm saying to you
13 if you're going to allow the private sector to do this, then
14 the public sector should be entitled to the same that
15 Occidental got from its arbitration or any of these others.

16 MR. BENNETT: And that's why I understand your
17 position.

18 CHAIRMAN CORY: I'm willing at some point to put
19 some price into this and at the same time bounce the ball
20 back into the PUC and say, if you want to use your power to
21 declare these contracts not in the public interest and to
22 come in and regulate them, feel free; but I'm not sure that
23 I have the right, from this vantage point, to exercise that
24 kind of power.

25 It seems to me that the Legislature has given you

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1 the power, the courts in their cases as Bill has indicated
2 them -- and I tend to go along usually with your analysis
3 of legal principles -- that you've got the power --

4 MR. GRAVELLE: I'd like to have a chance --

5 CHAIRMAN CORY: Oh, you'll have your chance, but
6 I want you to know what's coming down the pike. I'm getting
7 a little bit tired of people who I don't think are doing
8 their job to come over here and dump on my head when I don't
9 have your responsibilities.

10 MR. BENNETT: I was in your same position in the fifties
11 and sixties. I would go before the Federal Power Commission
12 and become indignant about Phillips Petroleum wellhead prices,
13 and Chairman Kuykendahl, during the Eisenhower years, would
14 say to me, why doesn't California regulate its producers?
15 They can charge whatever the traffic will bear, and that
16 was the truth.

17 So, I have a real personal interest in trying to
18 get the Commission, of which I was then a member, to regulate
19 producers in California, and there just weren't the votes.

20 The Governor's office at that time was in a state
21 of shock at the mere thought, let alone whisper, let alone
22 articulation of such an idea.

23 I won't comment about whether it's the same today.
24 I don't know.

25 Those are the realities of our political lives.

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1 We know them. I'm a part of that process.

2 You see, the way it could be done would be this:
3 You increase these prices and the PG&E pays them and the
4 Commission could say, those are unreasonable prices. Even
5 though you paid them, we reject them. You should have paid
6 half as much and disallow it. That would be the theory upon
7 which they would proceed. Whether they would be sustained
8 or corrected, I don't know because PG&E would be out of
9 pocket for those. Once you pay it it's very difficult to
10 correct it, as you know.

11 So, there should be an attempt to regulate by the
12 Commission. They should find out if they have the power or
13 not. The statute, to me, gives them the power. 216(c)
14 defines one who sells and then who resales to the public.
15 That's the wholesaler, the retailer. That's 216(c), and they
16 are subject to regulation.

17 I'll conclude, unless you have further questions,
18 again by saying all of us do represent the public, and it
19 is clearly not in the public interest to visit upon this
20 state a \$100 million rate increase, whatever the figure is,
21 for the benefit, the dubious benefit of \$2 million increased
22 revenue to California.

23 I don't have any question that if you deny this
24 it's within your discretion and would be sustained by any
25 reviewing court. It's just a bad bargain.

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1 Now, if we're back here in two years or three years
2 and nothing has been done about controlling producer prices,
3 then I think we can take the position nobody cares, including
4 the Commission, and nobody is going to be in a position to
5 complain to whatever prices you allow. Maybe this should
6 be an action for attempting to get the matter redressed.

7 CHAIRMAN CORY: Bill, that leads me to another
8 question I'd like to ask you. We have been asked at various
9 times to delay this, which I have been willing to do, but at
10 one point the facts seem to indicate that the other non-public
11 parties to these various contracts the market price was
12 somewhere around \$1.34, \$1.38, in that order of magnitude.

13 I had suggested in a private conversation to
14 PG&E that perhaps putting in some accommodation for the
15 consumer and suggested maybe \$1.30, \$1.31 price, allowing
16 them to discount 11 cents per MCF from that for gathering
17 charges. They rejected it as being inappropriate.

18 I think the record should be very clear that that
19 was done, that PG&E did in fact reject that.

20 Subsequently, the facts have come out and prices
21 keep going upward, that we leave this thing in limbo and
22 don't make a decision, all of the facts keep escalating it
23 upward. What I see happening, unless somebody steps in and
24 deals with the public policy issue which we don't have
25 control of, those prices are going to continue to go up.

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1 And waiting I'm not sure is doing the consumer any favor.

2 I ducked the issue. We begged off and left it in
3 limbo in the past, some 15 months ago, something of that
4 order of magnitude; and the facts now seem to indicate that
5 others are getting, marketing and PG&E is agreeing to meet
6 the low sulfur fuel oil prices, pegging gas to those prices
7 and various other things so that we're up in the stratosphere
8 of gas prices. I just wonder whether or not we're really
9 not really serving the public interest by waiting any longer.

10 MR. BENNETT: As a consumer greatly concerned about
11 the willingness to pay the prices in Indonesia and other
12 places, I hope that PG&E is as militant in Canada and other
13 places as it is here. But, you know, you have to accept
14 the reality of life as it is. I'm here on this matter and
15 these prices, and I clearly, as a customer of that utility,
16 don't want \$100 million increase imposed upon me.

17 CHAIRMAN CORY: You're value judgment is that the
18 PUC will pass it on, then?

19 MR. BENNETT: I don't know that. It would depend
20 on the impact upon return. But if it's 100 million it will
21 be passed on. No question about that. They couldn't absorb
22 that. If you deny them this, they'll have more of a
23 financial ability to pay their property taxes.

24 (Laughter.)

25 MR. BENNETT: But the last thing, I want to emphasize

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1 this again. As a matter of law -- which is a narrow ground,
2 but I think it may be correct -- I don't know what evidence
3 is before you of what the producers want or need. If the
4 only evidence is that from Mr. Lippitt, I move to strike that
5 for the reasons I've stated.

6 CHAIRMAN CORY: Mr. Bennett, I don't think -- at
7 least my view is relative to what the producers want or need
8 is irrelevant. I just don't think that's relevant to our
9 scope. It's really a chart of what are Standard Oil and
10 PG&E, what's the marketplace for gas; and the contract says
11 we are to fix the marketplace --

12 MR. BENNETT: But he does have material about the
13 market value.

14 MR. McCAUSLAND: Mr. Bennett, I appreciate your
15 coming today, and I've also appreciated working with you
16 in the past. We had concerns about the advisability of
17 relying on Mr. Lippitt's testimony at our earlier hearing.
18 That resulted in a lot of research and a lot of reading. I
19 can say almost without equivocation that we're in an excellent
20 position to make a decision today with no reference at all
21 to Mr. Lippitt. It may have been advantageous for us to have
22 him do some work for us because it raised a number of issues
23 that I, for one, would never have raised, nor would I have
24 ever gone to the trouble of doing the research to realize
25 that PG&E has already entered into a contract which is in

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1 the best interests of the supplier to proceed with. It's
2 a special delivery agreement which will guarantee the producer
3 110 percent of the low sulfur fuel oil index effective
4 July 1, 1978. If I was the producer, I would make certain
5 that that unbreakable, noncancelable, special delivery
6 agreement for emergency peaking gas is brought into full
7 force and effect.

8 I further contend that virtually all the gas that
9 we're talking about -- no -- clearly the majority of the gas
10 that we're talking about in California is peak gas for the
11 cold winter mornings and the days that PG&E really has to
12 have this supply. I don't see anything contrary in the
13 fact record to the notion that PG&E believes that peak value
14 gas for the days when we really need the extra supply is
15 a very valuable commodity.

16 I will not vote for a proposal which will have
17 an onerous burden on the consumer, but I'm also very tired
18 of being the villain in a charade of many veils which has
19 built a subterfuge that the consumer can't see through, the
20 Commission has had to plow through reams of material to see.
21 I want it on the record that PG&E has a special delivery
22 agreement at 110 percent of whatever the Saudis want or
23 anybody wants, and I'm willing to settle for a whole lot
24 less than that.

25 MR. BENNETT: That's why I'm just on this matter.

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1 You said something, you talked about the value of the gas.
2 That word discloses what is wrong with this whole system of
3 producer sales in California. We should be determining fair
4 prices based upon cost, reasonable costs, expenses, reasonable
5 revenues and a reasonable fair return. Value is subjective,
6 and the reason that oil companies are having their way, they've
7 got the world educated to the proposition that they must
8 get the value for it.

9 Value to them is one thing. Value to me is
10 another. But the costs are reasonably certain, and we've
11 gotten away from that. That's why the Commission should
12 proceed to a critical examination by the regulatory process
13 of their revenue needs and expenses and a reasonable return.
14 That's what this is all about.

15 The last thing I want to say is this: I don't
16 quarrel with whatever material Mr. Lippitt gave you or the
17 fact that you learned something from it. That's not the
18 point. It's not his competence, the eloquence of his state-
19 ments, documents; it's the fact that he's in a position
20 where he cannot represent the producers and the State Lands
21 Commission no matter if his name is Michaelangelo, Onassis,
22 Jacquelyn Kennedy or Henry Lippitt. He's in a position of
23 conflict. That is what's wrong with it.

24 MR. McCAUSLAND: As an individual commissioner,
25 I concur with you wholeheartedly. I am glad that I now have

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1 his testimony in the record along with all of the others.
2 I am not certain whether we could have gone for as much
3 information as he led us towards, but I agree with you.

4 MR. BENNETT: Thank you very much.

5 CHAIRMAN CORY: Thank you, Bill.

6 Okay. Mr. Willard.

7 MR. WILLARD: Mr. Chairman, I'd like to summarize
8 for the Commission the basis for the staff recommendation
9 included in Calendar Item 55.

10 After a detailed study of the Northern California
11 gas marketplace, we are recommending that the reasonable
12 market value for gas produced and sold from the Rio Vista,
13 River Island and Ryer Island fields be established in
14 accordance with the weighted average of the prices paid by
15 PG&E for its purchases in the Northern California gas market.
16 This procedure would utilize the weighted average for the
17 price of PG&E's purchase of El Paso out-of-state gas, the
18 weighted average price of Canadian gas delivered at the
19 California/Oregon border and the weighted average price
20 paid for Northern California-produced gas.

21 Such prices would be adjusted for Btu content and
22 its contract load factor for peaking value, the peaking premium
23 which PG&E pays for having gas available for its peak day
24 needs.

25 The recommended prices are included in your

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1 Calendar Item 55 and have been broken into three periods:
2 that is, January to June of 1977, July through December of
3 1977 and January to June of 1978, with the median or average
4 price being \$1.91 per million Stu's.

5 In the course of the staff's investigation of the
6 reasonable market price, the Commission subpoenaed various
7 documents covering the sale of gas produced from the Union
8 Island field in Northern California. The best summaries that
9 can be made, I think, of these various contracts have been
10 diagrammed on the board. Starting from the far left is a
11 chart which is time-related and pertains to the various
12 decisions that can be made at various time intervals --

13 CHAIRMAN CORY: I must comment on the particular
14 layout and graphic representation of that. It shows a high
15 degree of intellect that I have not generally seen on the
16 part of the staff.

17 (Laughter.)

18 CHAIRMAN CORY: Whoever came up with that specific
19 graphic layout is to be commended, Mr. McCausland.

20 MR. McCAUSLAND: Thank you.

21 (Laughter.)

22 (Thereupon a brief discussion was held off
23 the record.)

24 MR. WILLARD: Well, the basic sales and purchase
25 agreement covers a period from October 1975 through June of

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1 1978, and it is for a basic price of \$1.36 per million
2 Btu's, plus an \$.08 for MCF gathering fee.

3 During the term of this primary contract, PG&E
4 had the option to extend it for a period of three years;
5 however, they have advised us that they have elected not
6 to extend the contract. Then the decision now lies with
7 Phillips and Union, the sellers of the gas in this field,
8 as to an option to extend the primary contract for an
9 additional four-year period. We believe it will be in the
10 best interest to elect to extend this contract and will do
11 so. It's our understanding, however, they have not yet
12 elected to. They have until June of 1978 to make this
13 decision.

14 Following the termination of this fourth year,
15 or indeed the termination of the primary contract in June
16 of '78, the special delivery agreement will go into effect,
17 which commands a price of 110 percent of the low sulfur fuel
18 oil price in California, plus again the \$.08 gathering fee.

19 This special delivery agreement covers the delivery
20 of this needle peaking gas to PG&E. I'll discuss the needle
21 peaking capability of the field in a little later discussion.

22 Staff then made a very careful analysis of the
23 various agreements that were involved in the Union Island
24 field, and commencing with the base contract price of \$1.20
25 per MCF, which when converted to a million Btu basis is

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1 \$1.36, there were numerous additional added considerations
2 included in this carefully concealed document which, when
3 accumulated and carefully analyzed, we came up with a
4 weighted average cost to PG&E throughout the primary term
5 plus the extended fourth year of \$1.76 per million Btu's.

6 This price, we feel, is a very conservative price.
7 In fact, the PUC in their deliberation for their rate base
8 pricing elected only to consider the heat content adjustment
9 and the production payment and came up with an average cost
10 of \$1.66. Had they elected to further analyze these
11 various agreements, I believe that our \$1.76 average price
12 would indeed be a very, very conservative figure. However,
13 using the \$1.76 figure and prorating it over the life or the
14 term of this four-year contract, we have prorated this and
15 come up with values which would be comparable to the period
16 under consideration by the Commission today. That is, from
17 January to June of '77, \$1.70; in the middle period, \$1.82;
18 and from January to June, 1978, \$1.84.

19 We are not advocating that these prices should be
20 used alone to establish reasonable market price for gas in
21 Northern California. They are merely one component of
22 the entire mix of purchases by PG&E in Northern California.
23 However, we certainly think that these prices support the
24 staff's recommendation. They are practically equivalent
25 to our recommendations.

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1 There are a couple of things that I would like to
2 get into the record with respect to the production characteris-
3 tics of the Union Island field as compared to one of the
4 fields being considered by you today, that is, the Rio Vista
5 field. That is, the remaining primary recoverable reserves
6 in the Union Island field is estimated to be about 250 billion
7 cubic feet as compared to the Rio Vista field remaining
8 recoverable reserve in excess of 500 billion cubic feet.
9 The Rio Vista field has twice the remaining reserves that
10 the Union Island field has.

11 CHAIRMAN CORY: I'm dumb. What's the significance
12 of that?

13 MR. WILLARD: The remaining reserves in the Rio
14 Vista field, recoverable, that will be recovered over a
15 period of time, is twice that of the Union Island; therefore,
16 the added value to PG&E is indeed increased, or should be,
17 with Rio Vista.

18 CHAIRMAN CORY: Longer term gas supply for them?

19 MR. WILLARD: Yes, sir. The needle peaking
20 characteristics of the Union Island field are approximately
21 110,000 to 120,000 MCF per day as compared with the peaking
22 characteristics of Rio Vista of in excess 200,000 MCF per
23 day, almost twice again the characteristics of the Union
24 Island field; yet PG&E says that the Rio Vista gas is only
25 worth \$1.20. As compared to our analysis of the Union Island

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1 field, their cost is \$1.76.

2 One of their arguments with respect to that is
3 that the gas in the Union Island field is different than
4 the gas in Rio Vista. That is, the Union Island gas is
5 new gas as compared to Rio Vista gas being old. That is,
6 it has been producing for a long time.

7 We feel that this new and old concept is an
8 arbitrary distinction established by the federal government
9 for the regulation and control of crude oil prices and
10 natural gas prices and should not be used as a basis for
11 determining the reasonable market value of gas in Northern
12 California. The reasonable market value of gas in Northern
13 California is the weighted average price being paid by
14 purchasers in Northern California, including out-of-state
15 gas, and our recommendation contained in the resolution in
16 Calendar Item Number 55 contains those prices.

17 CHAIRMAN CORY: Any questions from members?

18 MR. McCAUSLAND: He answered all my questions.

19 CHAIRMAN CORY: The next person I have on my
20 list is Mr. Robert Paschall.

21 Sir, could you in identifying yourself, give us
22 some indication of your background?

23 MR. PASCHALL: Yes, sir, I'll be glad to do that.
24 My name is Robert Paschall. I am presently Senior Petroleum
25 Appraisal Engineer for the State Board of Equalization, have

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1 been for the past 15 years following about 20 years' experience
2 as a petroleum geologist.

3 I have appraised oil and gas properties for
4 property tax purposes in 15 counties in California, served
5 as advisor to county assessors in this matter. About three
6 years ago I served as a consultant to local government in
7 Alaska estimating the oil and gas reserves of the Prudhoe
8 Bay field and appraising that oil field for tax purposes.

9 Following that, I served as a consultant to the
10 Alaska State Senate on taxation of oil and gas.

11 I'm a registered geologist and registered petroleum
12 engineer in California and a member of several professional
13 societies, all of them that deal specifically with oil, gas
14 and other minerals.

15 MR. McCAUSLAND: Having waded through some of the
16 documents that you have had to wade through, I want to thank
17 you for taking on this difficult assignment. I realize that
18 you did it as an individual. I realize that your work has
19 not been certified by your board, but I really appreciate
20 your bringing your professional expertise to this problem;
21 and I apologize for the abuse that you've taken from a number
22 of individuals who don't happen to agree with the conclusions
23 that you reached. Thank you for stepping into a situation
24 filled with adversity and subjecting yourself to some
25 McCarthy era tactics.

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1 MR. PASCHALL: Thank you, Mr. McCausland. It
2 really didn't concern me too much because the only thing
3 I did in the administrative hearing and which I'll do today
4 is to express my professional opinion. I'm not here as an
5 advocate of either side. If someone mistakenly assumed I was,
6 why that's their problem.

7 Shall I review what I did state at the administra-
8 tive hearing?

9 You will recall that at the time that I came to it,
10 if you've read all the documents, that I brought with me at
11 that time a revised final table which, in essence, does what
12 Mr. Willard's table does up there, that is, give an indication
13 of my estimate of average cost per million Btu the buyer
14 would pay for gas in the Union Island gas field based on
15 my analysis of the contract.

16 The contracts that I employed primarily were the
17 gas fields and purchase contracts and the production payment
18 contract. I didn't concern myself too much with the special
19 delivery contract because it dealt with very small quantities
20 of gas, and I was concerned with the larger volumes that
21 were going to be bought by the buyer from the sellers during
22 the preliminary three-year contract period.

23 CHAIRMAN CORY: May I interrupt you? Just one
24 thing. With your background of having spent a lot of time
25 evaluating oil and gas leases throughout California and

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1 elsewhere, is it normal for a contract for a given field of
2 gas to be broken into so many different agreements and
3 contracts?

4 MR. PASCHALL: I would say that that was not common,
5 Mr. Chairman, yes.

6 CHAIRMAN CORY: Do you have any idea why, what are
7 the advantages to anyone of complicating it with the multi-
8 plicity of documents and contracts rather than just putting
9 it all in one?

10 MR. PASCHALL: I suspect you may be asking a
11 question that calls for a legal answer, and I'm not prepared
12 to give one. I really don't care to speculate on it.

13 MR. McCAUSLAND: As long as we haven't let you
14 really get started yet, in the last hearing following your
15 testimony I assume that several issues were raised which
16 you agree are perhaps factually debatable or questionable
17 because you did an analysis in which you were privy to total
18 facts; but one witness that followed you suggested that
19 your analysis was irrelevant and that it would be more
20 appropriate to consider another economic analogy, and I
21 quote:

22 "If you're going to open up a fast food
23 chain and sell hamburgers for competitive
24 reasons you would look at the price
25 MacDonald charges and Jack-in-the-Box

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1 charges. You'd not go to the Fairmont
2 Hotel and get the menu that shows a
3 \$5 hamburger and say hamburgers are
4 being sold for \$5."

5 I have read that and reread that and tried to
6 apply it to this situation. It looks the biggest red
7 hamburger I've ever seen.

8 (Laughter.)

9 MR. McCAUSLAND: Can you tell me if that has any-
10 thing to do with the issue that you're trying to address?

11 MR. PASCHALL: I didn't try to pursue the analogy,
12 if there is one.

13 Now, the prices that I came up with last time were
14 actually somewhat different. I should say price or cost,
15 one of the two, being equivalent to Mr. Willard's values.
16 I found it necessary to convert the nominal prices into the
17 cost per million Btu's because, unlike most contracts in
18 the area, the contract was based on gas that had a heating
19 content of 885 Btu. Normally a thousand Btu is stipulated,
20 per thousand Btu per MCF.

21 Now, that conversion I think everybody concurs
22 with. I then decided that rather than seek simply the price
23 of gas, because of the complexity of the contracts, I instead
24 determined, as I think I noted on the first page of my
25 report, to estimate or compute the total consideration paid

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1 by the buyer to sellers for 1,000 Btu of gas.

2 Now, going on to that I found that two different
3 sets of prices prevailed for the two sellers, and the reason
4 for that is the difference in the production payments. You
5 gentlemen are probably familiar with it. The timing and
6 the size of production payment in dollar amounts differed
7 for the two different sellers so that there was a different
8 impact upon the true cost of the gas to the buyer in each
9 case.

10 I obtained or was furnished with actual purchases
11 of gas by the buyer and ran out a computation which is quite
12 similar, almost identical, to one that you'd run out in
13 working out a home mortgage. That is, you have an unpaid
14 balance, which in this case consisted of the unliquidated
15 portion of the production payments; a payment which is just
16 like a mortgage payment, the payment being the amount of
17 money paid in a given month by the buyer; and an interest
18 charge on the unpaid balance on the production payments,
19 the balance going to the principal, reducing the principal
20 and so on down month-by-month.

21 In doing that, running it out I found a notably
22 different impact on the price paid, especially in the
23 first year, the effective cost, let me say, to the buyer in
24 the first year relative to the gas furnished by the two
25 different sellers.

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1 For example, Phillips Petroleum's total net cost
2 to the buyer per 1,000 Btu gas for the first three years
3 was \$1.52, \$1.49 and \$1.52. Union Oil's was \$1.85, \$1.57
4 and \$1.52. This is for the primary term of the contract.

5 Since the time that I testified on that and earlier
6 furnished you with that, I was surprised with the fact that
7 the gas gathering fee is being paid in lieu of the buyer's
8 installing a line within the field, as is customarily the
9 case, a line with connections to each wellhead. The sellers
10 themselves furnish the intrafield gas lines so that, at
11 least in part, it appears the gas gathering fee is a payment
12 for the amortization of this line.

13 So, I worked that out recently. I went to the
14 Oil and Gas Journal, the number one trade publication, in
15 their issue on last August 12th on pipeline economics. I
16 got out information on pipeline costs and made my own
17 estimate of the cost of the intrafield pipeline, applied to
18 that an amortization charge, and I found out that actually
19 in terms of the impact on the cost to the buyer, or let's say,
20 the net return to the sellers, the impact to this amortization
21 was quite minor. It was only about three-tenths of a percent
22 per MCF.

23 As a result, I didn't feel it was necessary to
24 adjust my prices. I have a separate report that I'll hand
25 to you on that just for your record, but my original figures

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1 that you received earlier still stand.

2 Incidentally, the matter of the pipeline amortization
3 turned out to be a rather complicated problem. I won't burden
4 you with it fully, but one could ask, for example, whether
5 the pipeline amortization should take place over the life
6 of the field -- which was unknown to me -- over a reasonable
7 period, such as 15 years anyway. Should it be confined to
8 the primary term plus the total amount of the extended term
9 of ten years, or should it be applied only to the three
10 years of the primary term? All kinds of choices to make
11 just on how to work out that amortization cost.

12 I chose to assume that somebody was going to produce
13 and receive the gas over a ten-year term and that therefore
14 the amortization would occur over that time, and the actual
15 cost to the buyer would simply be the annual cost of
16 amortization in the first three years of the total primary
17 and extended term.

18 But in any event, it is a minor amount. I don't
19 know with these figures and my previous submittals, I won't
20 say anything more. Perhaps you have some questions you'd
21 like to ask.

22 CHAIRMAN COFF: Thank you very much. I would like
23 to apologize to you because at the Board of Equalization
24 meeting where I meant to, before the other Board Members,
25 take notice of your professional ability to deal with a

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1 factual situation, sticking to the facts and do a very
2 workman-like job, I had forgotten your name and did not
3 get that into the record over at the Board of Equalization.
4 But I attempted at that point to recognize before the board
5 the quality of work which I thought was very, very good.

6 MR. PASCHALL: Thank you, Mr. Cory.

7 MR. McCAUSLAND: I do have a question, and if
8 you don't believe it to be within the purview of your study,
9 don't try to answer it.

10 Did your study involve any assessment or analysis
11 of what portion of the gas consumed from this area is used
12 primarily for peak need situations?

13 MR. PASCHALL: No. I took no account of the need
14 of the peaking aspect of it.

15 MR. McCAUSLAND: I have no further questions.

16 CHAIRMAN CORY: Mr. Gravelle.

17 MR. GRAVELLE: Mr. Chairman, you indicated you
18 were going to be a little bit arbitrary. Would you prefer
19 to hear from Mr. Fallin of PG&E first or from me?

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

23
24 MR. GRAVELLE: Mr. Chairman and Members of the
25 Commission, my name is Richard Gravelle. I'm a member of

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1 the California Public Utilities Commission and have probably
2 a dual purpose to serve today.

3 One of the first items that I'd like to get out
4 of the way is that I have a statement and a letter addressed
5 to the members of the State Lands Commission from a minority
6 member, minority of one member of the California Public
7 Utilities Commission, Commissioner William Symons, Jr., who
8 supports your staff recommendation for higher prices.

9 I don't know whether that should make you feel
10 comfortable or not. I know it wouldn't make me feel comfortable
11 if I was to go along with it.

12 I would like to thank you, as did Mr. Bennett,
13 for the opportunity to come here. You are a State agency,
14 and I represent a State agency as well. I think we have
15 a common responsibility or common interest, and that is the
16 overall general public interest, and that is what I presume
17 is the goal of each of us in these considerations before you.

18 You are, as I understand it, considering prices
19 for three fields of gas principally. As I have analyzed the
20 material that I have looked over dealing with the problem
21 before you and the position that the Public Utilities Commission
22 has taken -- that is, the position supporting a continuation
23 of the \$1.20 price for the three fields in question -- may
24 be in an oversimplification, but I hope not, I break it down
25 into two bases. They are the legal bases of can you go to

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1 the price recommended by your staff; and, secondly, should
2 you go to that price assuming that you have the ability to
3 do so.

4 We believe as a Commission that the answer to both
5 of those questions is no. In going through the material,
6 particularly the informal opinion supplied by the Attorney
7 General's office, and in looking through the description of
8 the calendar item today, we have a reference throughout to
9 the reasonable market value of the gas in question. The
10 reasonable market value of the gas in question, as I look
11 at the section of the Public Resources Code which I believe
12 governs your action today which is 6827, the reference there
13 is to the current market price and the current price at
14 the well and of any premium or bonus paid on the production
15 removed or sold from the leased land.

16 There is a geographical as well as a quality
17 restriction placed upon you by the Legislature in determining
18 your responsibility. The Attorney General's opinion I
19 respectfully disagree with -- we do, as a commission. It does
20 not cite any cases from California dealing with this subject
21 matter.

22 Now, because of the impact of what we believe to
23 be the adoption or the impact on the public of this state,
24 the ratepayer, the 110 million dollar increase that we believe
25 would be necessitated -- and that comes in line, Mr. Cory,

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1 as to some of the questions you asked Mr. Bennett as to why
2 they would be necessitated. We can get to that in a moment.

3 We feel strongly enough about it, at least I do
4 as one commissioner, that I would recommend to the balance
5 of our Commission that if the price were to go to that level,
6 or indeed go above the \$1.20 level, which we believe to
7 be the constraint placed upon you by the Legislature, that
8 in all fairness to the consumers of this state, the public
9 of this state, that that determination would have to be
10 litigated.

11 You might then have some California law on the
12 subject of how these prices should be determined and what
13 data can and cannot be considered in making the price
14 determinations.

15 CHAIRMAN CORY: Pardon me, sir. Are you aware of
16 the Occidental arbitration?

17 MR. GRAVELLE: I am.

18 CHAIRMAN CORY: It's my understanding that that
19 arbitration, which was affirmed by the various courts, deals
20 with that very point. Is that not the case as you understand
21 it?

22 MR. GRAVELLE: I'm also aware, Mr. Cory, that
23 PG&E negotiated the \$1.20 contracts subsequent to the arbitra-
24 tion entered into with Occidental, and here we are talking
25 about --

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1 CHAIRMAN CORY: That's talking about market gas.
2 You were talking about legal points. I'm trying to ascertain
3 a legal point. If I misunderstand that, it would be very
4 helpful in clarifying the record.

5 It is my understanding that the arbitration awards
6 dealt with a different standard of what reasonable market
7 price was.

8 MR. GRAVELLE: Reasonable market price, correct.
9 What I'm saying is that the only place that reasonable market
10 price appears in the material with which we are dealing are
11 the leases, one lease that you have executed with the producers
12 in the three fields in question. That is a standard that I
13 don't believe you can bootstrap yourself to above the
14 current market price at the well in the leased fields in
15 question, which is the statutory language. Do you follow
16 what I'm saying there?

17 CHAIRMAN CORY: No, I do not.

18 MR. GRAVELLE: The lease, one lease in question,
19 pursuant to the data set forth in the Attorney General's
20 opinion to you which describes the terms in some synopsis,
21 the terms of the leases, makes reference to reasonable
22 market value. The other two make reference to, in general
23 terms, the statutory language, which is the current market
24 price at the well. You, I am saying, are not able to utilize
25 the reasonable market value as a standard in making the

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1 determination of the prices to be paid for gas in question
2 here.

3 CHAIRMAN CORY: We should use the standard of
4 current market price?

5 MR. GRAVELLE: Current market price at the well
6 of the leased lands.

7 CHAIRMAN CORY: Let me make sure I understand it.
8 You're saying that in one of the three contracts we have
9 the right to use reasonable market price.

10 MR. GRAVELLE: No, I'm not saying that. I'm saying
11 that one of the leases utilizes that term. To expand that
12 lease, that lease is governed by your statutory ability.
13 To the extent that the lease would exceed your statutory
14 ability, you cannot utilize that as a bootstrap approach to
15 expand the jurisdiction or the measure for determining value
16 determining the price, rather.

17 CHAIRMAN CORY: The presumption of this colloquy is
18 that there is a distinction between reasonable market price
19 and current market price.

20 MR. GRAVELLE: Reasonable market value.

21 CHAIRMAN CORY: Reasonable market value and current
22 market price. There is a legal distinction between those two
23 terms; is that correct?

24 MR. GRAVELLE: Yes, sir.

25 CHAIRMAN CORY: You have regulations that define

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1 those terms or expand upon them that give them precision?

2 MR. GRAVELLE: I could give you an example,
3 Mr. Chairman, in the practice of public utility law where
4 you do not have willing sellers and willing buyers because
5 of the nature of the property involved. There are condemnation
6 proceedings. The Public Utilities Commission and courts
7 are called upon to determine the reasonable market value of
8 property that is to be condemned, for instance, by a public
9 agency in taking over a public utility's operations.

10 So, there is some body of law which is common to
11 our practice that deals with reasonable market value.
12 Reasonable market value concerns itself with subjective
13 considerations that have to be determined when you do not
14 have market price guidelines to enable the trier of fact
15 to reach a decision.

16 CHAIRMAN CORY: Such as a monopoly; is that correct?

17 MR. GRAVELLE: I beg your pardon?

18 CHAIRMAN CORY: Such as a monopoly. Is that not
19 correct? You started with the concept that in cases where
20 there is a monopoly that exists, you are called upon to
21 determine reasonable market value in some cases.

22 MR. GRAVELLE: Monopoly in the sense that public
23 utility property does not often trade hands. That is the
24 sense of the law. Public utility property, which is a monopoly
25 operation basically, does not often change hands. There is

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1 not a market where water companies, for instance, or PG&E
2 is bought and sold over a period of time.

3 CHAIRMAN CORY: I just want to make sure I
4 understand that in those cases where a monopoly exists there
5 is not a market at which it is really operating; therefore,
6 you are called upon to determine reasonable market price.

7 MR. GRAVELLE: That's correct, but the same
8 criteria, Mr. Chairman, would apply in any situation in
9 which you could not determine from the marketplace what the
10 current market price would be. It is then up to a court or
11 a regulatory body to utilize the other standard, the reasonable
12 market value standard.

13 CHAIRMAN CORY: I think we agree. Go ahead.

14 MR. GRAVELLE: Here we maintain that because of
15 the 180-some odd contracts entered into by PG&E --

16 CHAIRMAN CORY: Which, pardon me, is a monopoly as
17 you said before?

18 MR. GRAVELLE: That's right.

19 CHAIRMAN CORY: Thank you.

20 MR. GRAVELLE: I fail to see the connection.

21 CHAIRMAN CORY: I don't know if there is. Go
22 ahead.

23 MR. GRAVELLE: Now we're talking about buying a
24 product, not a utility. There you have current market prices
25 which come within the standard provided by the statute which

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1 governs your body, and that that is the standard which you
2 must utilize on a legal basis to make the determination of
3 the price to be charged for these fields in question.

4 CHAIRMAN CORY: There is a problem in following
5 your syllogism at that point, sir, but go ahead.

6 MR. GRAVELLE: Would you mind indicating the
7 problem?

8 CHAIRMAN CORY: The only purchaser is the monopoly,
9 PG&E, for those various contracts.

10 MR. GRAVELLE: I fail to see the significance of
11 that.

12 CHAIRMAN CORY: Well, you had escalated yourself
13 to reasonable market value based upon a monopoly situation,
14 and it seems to me that we have a monopoly situation in
15 those various contracts you alluded to to say that we cannot
16 get there because you only have one buyer, PG&E, and the
17 seller is the position of taking it or leaving it. I'm at
18 a loss to see how on the one point one set of standards applies and
19 in this one it doesn't. It seems to me the crux of your
20 argument in terms of your syllogism cannot follow.

21 MR. GRAVELLE: Mr. Cory, the crux of my argument
22 is the statutory limitation placed upon you by the Legislature.
23 That is the crux of the argument, the current market price.

24 CHAIRMAN CORY: So, you're saying that that lease
25 in which another term is used exceeds the statutory authorization;

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1 and, therefore, the lease is null and void?

2 MR. GRAVELLE: I'm saying that the lease may be
3 subject to attack; and if the prices that you set here are
4 based upon your determination of reasonable market value,
5 that you may have exceeded your authority and that that
6 question, I believe, should be litigated.

7 CHAIRMAN CORY: There is a point at which if you
8 had a written contract which you had two people enter into,
9 if there was not a meeting of the minds or the price agree-
10 ment that was agreed to in that contract contravened statutory
11 provisions, it would seem to me that my position in defending
12 the State's and public's viewpoints that the entire contract
13 must fall because there was never a meeting of the minds
14 on a valid price, and that may be probably the best public
15 good that can be served. I'm not opposed to that, but I'm
16 not necessarily willing to say that if we litigate that point
17 the relief should be focused just down to a more limited
18 issue of price because I frankly believe that all three
19 contracts are contrary to public interest.

20 They were entered into prior to my being here.
21 I've got serious problems with them, and if there is some
22 way that they could be eliminated, if we didn't have a meeting
23 of the minds and there wasn't a real agreement, I think we
24 could do a lot better by the public if we had that gas to
25 give directly to the public rather than allow Standard Oil

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1 to profit on it, to allow PG&E to profit on it at the public
2 expense.

3 MR. GRAVELLE: Mr. Cory, as I understand from
4 reading the A.G.'s opinion, there is reference also to the
5 contractual ability of the State Lands Commission to take
6 this gas in kind. If that's your choice, if that is provided
7 in the terms of the leases, I don't see why you shouldn't
8 do that.

9 CHAIRMAN CORY: I'm not so sure we have that right.
10 We do not have that right. That's my concern.

11 MR. GRAVELLE: The statute provides that right.

12 CHAIRMAN CORY: The contract does not.

13 MR. GRAVELLE: The reference in the opinion --

14 CHAIRMAN CORY: I am aware of the reference, and
15 there are some contracts which previous commissions have
16 entered into which allow us do that. The staff has informed
17 me that these particular contracts do not allow us to take
18 the gas in kind. I am perfectly willing, if you can show
19 me how or if your staff can show us how we can take this
20 gap in kind and use it for public benefit, I am perfectly
21 willing to do that. I do not see how we can do that.

22 Let's put that in focus. If you can help us in
23 that regard, I would like to be there; but I don't think we
24 can do it unless the contracts can be voided on some basis
25 of being contrary to the statute.

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1 MR. GRAVELLE: If you would allow me, I'd like
2 to refer to page three of the opinion of November 10, 1977.
3 That's a description of the leases. After a description
4 of the individual leases, the paragraph at the top of the
5 page about a little past halfway down after the quotation
6 then makes reference to:

7 "The leases also provide that the Lessee
8 shall file with the State true and correct
9 copies of all contracts for the sale of
10 gas produced from the leased land and that when
11 the State elects to take its royalty in money
12 rather than in kind, ' the lessee shall not
13 sell or other wise dispose of. . ." et cetera.

14 Certainly the presumption that I got out of reading
15 that was that the State has the ability to take that gas in
16 kind rather in money because otherwise there should be no
17 reference --

18 CHAIRMAN CORY: Alan, can you clarify the factual
19 point of where we are?

20 MR. HAGER: Yes. The big contract here is Rio Vista.
21 That's where most of the gas is. There is no provision in
22 that lease or easement that permits the State to take its
23 royalty share of the gas in kind. In the Ryer Island and
24 River Island contracts, the State may, but that's a very,
25 very small portion of the gas. If I may comment on one thing --

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1 CHAIRMAN CORY: There is one point I think probably
2 should be put on the record in context. You were quoting
3 from the Department of Justice, Attorney General letter of
4 November 10th, '77, page three, first paragraph.

5 MR. GRAVELLE: Yes, sir.

6 CHAIRMAN CORY: Part of the part that was left out,
7 as I recall it, is starting, current market price at the well
8 which shall be determined by the State and shall not be less
9 than the highest price in the nearest field in the State of
10 California. I think that's relevant to put on the record
11 as to what our limitations are as to what we can and can't
12 do.

13 MR. GRAVELLE: That's exactly what I was trying
14 to point out to you. The limitation is in the statute, not
15 in the lease. You cannot bootstrap your statutory limitation
16 by extraneous language.

17 CHAIRMAN CORY: Alan?

18 MR. HAGER: The statute that you quote which is
19 part of what is commonly called the Cunningham-Shell Act,
20 sets forth the requirements that the Commission must follow
21 when they're entering into new leases. One of the leases
22 that is patterned after the statutory scheme are the Ryer
23 Island leases, and that's where they do provide for current
24 market price.

25 The Rio Vista easement antedated the promulgation

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1 of the statutory scheme, and we have a lease agreement with
2 Chevron on this. It says, "reasonable market value". That's
3 the term of the lease.

4 Now, the Legislature, when they passed this statute
5 couldn't alter the term of that contract, and they haven't.

6 MR. GRAVELLE: Are you telling me that the lease
7 predated the legislation?

8 MR. HAGER: Correct, and the legislation refers
9 to leases that are to be entered into by the Commission
10 subsequent to the date of enactment of the statutory scheme,
11 which would be the Ryer Island leases.

12 MR. GRAVELLE: The one lease that uses the
13 terminology of reasonable market value then you say would not
14 be governed by the statutory provision.

15 MR. HAGER: Correct.

16 MR. McCAUSLAND: Let me offer another rebuttable
17 presumption for you to chew on. Since I am not an attorney,
18 today is rebuttable presumption day.

19 The operative phrase is it "shall not be less than"
20 "shall not be less than". I read that as saying let's make
21 sure the State Lands Commission does not sell out to the
22 wrong interest.

23

24 MR. GRAVELLE: Where is the language "shall not
25 be less than"?

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1 CHAIRMAN CORY: Same paragraph you were quoting
2 from.

3 MR. GRAVELLE: That is from the lease. That is
4 the language of the lease. My ability to be clear today
5 apparently is less than --

6 MR. McCAUSLAND: You're getting there.

7 (Laughter.)

8 MR. GRAVELLE: Less than superior.

9 CHAIRMAN CORY: The question, though, the one lease
10 that predates the statute --

11 MR. HAGER: Two leases, in effect. It wasn't a
12 problem, but the River Island leases, which are a small one,
13 predate the statute.

14 CHAIRMAN CORY: Which lease does not go into the
15 normal PG&E distribution system but instead is dealt with
16 on an industrial user contract?

17 MR. GRAVELLE: Ryer Island.

18 CHAIRMAN CORY: Is that the one that is under the
19 statutory?

20 MR. HAGER: Correct.

21 CHAIRMAN CORY: That is the one that has this
22 amount in it, this language that you're suggesting. Okay.
23 That gives me a very clear understanding of why that lease
24 needs that language in it, because the public in no way is
25 going to benefit from it. The only beneficiary is Standard

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1 Oil, who in essence has a transmission agreement, as I
2 understand it, with PG&E. The public never sees that gas.
3 It goes directly from that field to the Standard Oil refinery
4 to be used based upon a transmission charge; is that correct?

5 MR. EVERITTS: Yes.

6 CHAIRMAN CORY: So, the only beneficiary of that
7 gas is Standard Oil of California and PG&E, and since the
8 people aren't participating in that, it seems totally
9 appropriate for somebody to include in a mechanism that we
10 shouldn't be selling out to allow PG&E and Standard Oil to
11 profit by a sweetheart secret private deal. It seems
12 reasonable. It seems like that protects the public interest.
13 Whatever happens to that contract doesn't up or down what
14 happens to the consumer. The other two contracts do in fact
15 predate the statute you wish to base your decision on, and
16 we are at the point where the controlling language is
17 the easement language; and we have apparently arrived at
18 the factual situation which defines our dilemma. I don't
19 particularly like where I am.

20 MR. GRAVELLE: Defines at least the grounds for
21 some judicial determination as to the ability of where we
22 can go.

23 CHAIRMAN CORY: If there is no disagreement in
24 fact, what is there to litigate?

25 MR. GRAVELLE: There are many things to litigate

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1 thereafter, Mr. Chairman.

2 CHAIRMAN CORY: Please go ahead.

3 MR. GRAVELLE: Such things as what should be
4 utilized in determining your reasonable market value. That
5 gets back to the subject that we left where you were concerned
6 that a monopoly was making a purchase from a producer or
7 from a series of producers -- as I understand it, some 180,
8 which account for, I believe, Mr. MacKenzie's previous
9 statement to you of 83 percent of the gas produced in
10 Northern California.

11 There is nothing of which I am aware -- maybe you
12 are -- that would indicate anything but an arm's-length
13 transaction between the producers, large or small, and the
14 monopoly buyer in this case.

15 CHAIRMAN CORY: Of monopoly power.

16 MR. GRAVELLE: If there was, certainly I would
17 anticipate that this Mr. Lippitt's representation of the
18 producers that there would be litigation on that question.

19 MR. McCAUSLAND: I would say that of the supplemental
20 submittals since the hearing in which Mr. MacKenzie partici-
21 pated, perhaps the bulk of those have been from producers,
22 several of whom have advised the Commission through their
23 correspondence that they had negotiated sales agreements
24 with other firms, but since PG&E had the only system
25 available for transmission of that gas and since the producer

1 could not reach agreement with PG&E for the transmission
2 of their gas, those opportunities to sell to others at a
3 higher value were voided. Obviously, they've come in since
4 the last hearing. You can discredit them or someone can
5 attempt to discredit them, but they are now a part of the
6 record.

7 I think we are dealing with a situation where it
8 has been PG&E's gathering system in transmission lines that
9 have allowed them to determine what the price of gas is
10 from field to field and from agreement to agreement. It
11 would be to our advantage to have the PUC involved in that
12 relationship and this Commission not being the body forced
13 to determine whether it's an arm's-length arrangement between
14 the monopoly gathering transmission --

15 MR. GRAVELLE: That gets to the questions that
16 Mr. Cory asked Mr. Bennett, which eventually I hope we can
17 get to, because there are some substantial answers, things
18 that Mr. Bennett was not aware of when he responded to you
19 which made me sit there biting my tongue and waiting for
20 a chance to respond.

21 CHAIRMAN CORY: Go ahead. We'll take as much time
22 as necessary.

23 MR. GRAVELLE: I'd like to get on with this so that
24 we don't take all of your time. I know that you have many
25 other people that you are going to hear from, who at least

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1 would like to address you to make their views known.

2 I would say as an aside, but an important aside,
3 that as Mr. Bennett pointed out the relationship -- and
4 I appreciated your remarks, Mr. McCausland, in response to
5 this -- that the relationship of a State agency, in whatever
6 form, utilizing for purposes of the determinations that you
7 have to make here the services of Mr. Lippitt -- and again
8 I'm not criticizing his ability, as Mr. Bennett remarked --
9 but I think that there is a clear conflict of interest, and
10 I would respectfully suggest that your body seek from the
11 Fair Political Practices Commission an opinion as to the
12 validity of that representation since State funds, I presume,
13 have been paid to Mr. Lippitt.

14 CHAIRMAN CORY: As far as I'm concerned, and I
15 don't know what the other Commissioners think, but they
16 may well agree with me, the question of Mr. Lippitt seems
17 to be a case where people would prefer to pound on the table
18 and talk about personalities and conflicts which appear to
19 me to be irrelevant to getting the facts.

20 I am prepared in reaching any determination I
21 reach to exclude anything Mr. Lippitt had to say. It seems
22 irrelevant to me. We have opened a situation where we have
23 gotten to a whole lot of secret contracts. We've got a lot
24 of evidence of the marketplace, independently derived at.
25 If somebody wants to put a standard of truth of the poisonous

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1 tree, I'm not sure we could sustain that one; but with that
2 caveat, the facts are the facts.

3 They have been independently ascertained through
4 subpoenaing documents and records, and I'm not putting a great
5 deal of reliance on any individual phrasing, testimony of
6 Mr. Lippitt. I don't know where the other Commissioners are,
7 but I just hate to belabor the issue.

8 MR. McCAUSLAND: I'd like to make a statement for
9 the record in that regard. In preparing for today's hearing
10 I reviewed all the submittals and transcripts of the prior
11 deliberations, with the exception of Mr. Lippitt's, because
12 I didn't feel that I wanted to relive the embarrassment that
13 was associated with the dialogue that that generated last
14 time. I think that I can say in all honesty that Mr. Lippitt's
15 participation in this thing has had no bearing on the
16 frame of mind that I bring to this hearing today or the
17 review of the evidence which I have before me; and if it were
18 possible to do so, I would move to strike Mr. Lippitt's
19 testimony from the record.

20 I think that would be a futile act, but Mr. Lippitt's
21 testimony and his participation in these hearings at this
22 point in time have no bearing on my decision in this case
23 because he became the catalyst that opened the barn door,
24 and we have more than we can deal with here.

25 MR. GRAVELLE: I would again, as I say, respectfully

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1 request that your Commission consider that. We have the voice
2 of the people through Proposition 9, which, as we all know,
3 imposed some substantial burdens on us as public officials
4 and on other public employees. That, as I say, was an
5 aside, but I do agree with Mr. Bennett wholeheartedly in
6 his characterization.

7 Finally, getting to the second point, which I hope
8 to make brief and then get to answering some of the questions
9 that were raised earlier, that is not the "can you" but the
10 "should you" adjust the prices in question here for these
11 fields upwards. If the analysis which I provided to the
12 Chairman this morning which was provided to me by our
13 engineering staff is correct, what we are looking at is a
14 net benefit in dollars and cents -- dollars -- to the State
15 of some \$900,000 at a cost to the balance of the state's
16 ratepayers of some \$110 million on an annual basis.

17 Now, the tradeoff that we are talking about in
18 that sense is not complete. It does not, for instance,
19 include any effect on Southern California that might accrue
20 or grow out of the higher prices that may be established by
21 your body. Neither does it take into account additional
22 costs to the State as a consumer of gas to those with whom
23 it contracts because their cost of power and gas has increased.
24 So, it is conceivable -- in fact, the direction is inescapable
25 -- that the \$900,000 figure would be reduced somewhat. To

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1 what extent, I cannot say.

2 It is on that basis alone, the public interest basis,
3 that I would recommend and feel strongly that your body should
4 stay with the conservative estimate of \$1.20 for the contracts
5 in question here because the tradeoff to the public is of
6 such a devastating, as far as I'm concerned, nature.

7 That gets us to some of the questions, and I think
8 probably not taking them in order, Mr. Cory, if you'd like
9 to reiterate them or interrupt me, please do so. But you
10 raised the question as to why would the Public Utilities
11 Commission have to pass on these increases to the public.
12 Why, for instance, if all of these contracts were renegotiated,
13 if PG&E found itself in the posture after a determination
14 by your body that, for instance, a \$1.76 was a reasonable
15 price to be paid for the three fields in question and there-
16 after in negotiations with other producers or in arbitration
17 a \$1.76 figure was adopted, why would the Public Utilities
18 Commission pass that on to the general ratepayer and thereby
19 increase these rates by this horrendous sum of \$110 million?

20 The answer is simply that we each have responsi-
21 bilities. You today are sitting on the hot seat. Should
22 you make the determination and get off the hot seat that
23 a \$1.76 is a reasonable price and the price that you want
24 charged for the lands in question, the gas coming from
25 the lands in question, the buck will then be passed on to the

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1 Public Utilities Commission who will have to make a determina-
2 tion as to the reasonableness of the contracts negotiated
3 between PG&E and the producers. In doing so, we are
4 constrained by a substantial body of law which, as I have
5 gone through the opinion that was provided to you in
6 researching the history of your operations in determining
7 prices, I do not find to be the case with the State Lands
8 Commission. In fact, I may be wrong, but I believe that this
9 is the first time historically that the State Lands Commission
10 has gone through this process to raise the price of natural
11 gas that is sold from the State lands. In the past, I
12 believe they had adopted the negotiated prices that have
13 been arrived at by the producers and PG&E.

14 CHAIRMAN CORY: Let me put that in perspective.
15 I'm troubled by it. One of the things that troubles me
16 most about that is we were told that 90 cents, when we
17 started this thing way back when, was all anybody was paying
18 for gas. Then we were told that \$1.20 was all anybody was
19 paying for gas period. Close to flat ass lying. Close.

20 When you go back and read the transcripts, there
21 are a little few weasel words in there, but what really
22 comes out and what really troubles me is that we have a
23 contractual obligation to get the highest price from proximate
24 fields, and we were led to believe that Standard Oil was
25 negotiating in good faith and that PG&E was negotiating in

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1 good faith; and I assumed that the Public Utilities Commission
2 were monitoring those negotiations and that all the cards
3 were on the table.

4 Then I started hearing rumors around that there
5 are secret deals and secret contracts. When we issued
6 subpoenas for them and we get them, lo and behold, they do
7 exist. Not just a contract. You have to have a road map
8 to ask enough questions to get all the agreements and side
9 agreements and deals to get the full price on the table.

10 What kind of a system is out there in which we're
11 forced to even get into this mess? I mean, I'm troubled
12 by being here. I don't know really what I'd do about it,
13 but here's this whole system of all these side deals, all
14 this secret stuff where you've got to go through 30 minutes
15 of testimony to ascertain that \$1.20 isn't \$1.20, that \$1.20
16 in fact is a \$1.76. That's really the net effect of the
17 deal.

18 I've got some problems with the secrecy of that
19 and the fact that it's really almost a feeling that there's
20 a conspiracy out there to defraud the State of California
21 of its share and that somehow it's okay for Occidental through
22 arbitration to get \$1.36 or \$1.34 and have the record sealed
23 as to why they got that, and somehow everybody comes raining
24 on my parade saying I'm supposed to ignore my contractual
25 obligation to get the highest price on an adjacent field when

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1 adjacent field or very close to adjacent field was the
2 arbitration price. What kind of a system is out there?
3 What kind of shop are you guys running and what kind of a
4 shop is PG&E and Standard Oil running when they enter into,
5 for example, side agreements that if Standard Oil can't get
6 us to accept the \$1.20, PG&E will go ahead and eat all those
7 costs?

8 I've got some problems with all this. It seems
9 like it's a public business, public asset. All the facts
10 ought to be out on the table with everybody just sort of
11 laying them out, looking at it and dealing with it openly
12 rather than all these secret deals.

13 Can you help me with this, and why doesn't this
14 information come out from your shop automatically? Do you
15 allow the guys to enter into secret deals?

16 MR. GRAVELLE: I don't think you can put us in
17 bed -- if there are conspiracies, Mr. Chairman, I don't
18 think it is reasonable to attempt to, nor could you successfully
19 put in bed with interests who have tried to arrange such a
20 conspiracy.

21 CHAIRMAN CORY: No, I'm not suggesting that.

22 MR. GRAVELLE: There may very well be conspiracies.
23 I'm not disputing that, nor am I agreeing with you that that
24 exists because I don't know. I do know, as was testified
25 by the prior witness a few moments ago, that for the Union

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1 Oil field that the Public Utilities Commission determined
2 a price, or it can be claimed that the Public Utilities
3 Commission determined a price of \$1.66 for that field. The
4 witness indicated that the price was more likely \$1.76 which
5 means that for rate-fixing purposes we were below that level.

6 I would also say to you that the decision of
7 the Commission does not spell out that \$1.66 level. That
8 has to be given from the work that was presented by our
9 staff and put into the record in an action in this proceeding.
10 Those kinds of determinations, that is the rate-fixing level
11 of the -- for rate-fixing purposes, the level of the contract
12 prices are listed in the proceedings, in the rate proceedings
13 before the Commission.

14 To the extent that we are able to determine what
15 those contracts provide for and whether or not they were
16 entered into at arm's-length, we are under the constraint
17 of the judicial decisions to allow them as legitimate rate-
18 making expenses.

19 If we can make a determination that there is some
20 imprudence on the part of the utility, that the utility did
21 not act reasonably or that they are dealing with an affiliate
22 for instance, we can and do make substantial disallowances
23 for rate-fixing purposes.

24 CHAIRMAN CORY: But do you have a flat requirement
25 that PG&E disclosed to you all public and private deals

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1 entered into with producers?

2 MR. GRAVELLE: To the extent that they might exceed
3 for instance, the contract?

4 CHAIRMAN CORY: No. Just in terms of the public
5 interest. I have real trouble with, given what I presume
6 your role to be -- and I'm very ignorant in that area. I
7 may be totally wrong about what your role and assignment is.
8 It seems to me that what I thought the PUC was doing was
9 keeping these guys out there honest.

10 It seems to me that the first thing to do is say,
11 all right, guys, you're a monopoly. In exchange for that
12 monopoly right, you have the right to disclose to us what
13 you're doing. If you go out and say that Standard Oil as
14 a producer will go negotiate this price and if you don't
15 get it, we'll eat it, that tends to skew the negotiations
16 rather significantly in the marketplace.

17 Do you require them to disclose those kinds of
18 secret deals of not?

19 MR. GRAVELLE: Our interest, Mr. Cory, is to make
20 sure what is passed through to the ratepayer in the form of
21 regulation -- we're talking about price regulation here;
22 that is the principal interest that we have, that we each
23 have -- is that the utility is not charging the ratepayers
24 or that the Commission is not allowing the utility to charge
25 the ratepayer something that should not be passed through to

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1 it. If the utility takes it upon itself to make payments
2 under the table, for instance -- and I'm not accusing any
3 utility of doing that; although, it may be the case. I'm
4 not an expert in that aspect of the field. If that occurred,
5 our responsibility would be to see that those under-the-table
6 payments were not passed through to the ratepayer. If they
7 were absorbed by the stockholders of that company and its
8 management that is making that choice, then the stockholders
9 are the ones that suffer and the stockholders are the ones
10 that have to bring the action.

11 CHAIRMAN CORY: Is the answer to my question you
12 do not have a general requirement that they disclose all of
13 those deals per se, and if they don't disclose them, they
14 have abridged their responsibility?

15 MR. GRAVELLE: I would say there is not that
16 general requirement, except to the extent that the agreements
17 are going to be passed through to the utility customer.

18 CHAIRMAN CORY: I just commend that to you because
19 in the circumstances, as I understand it, there was in fact
20 a private deal between the producer and PG&E.

21 MR. FALLIN: Chairman Cory, Jack Fallin of PG&E.

22 CHAIRMAN CORY: No. No, sir. You'll have your
23 time.

24 MR. FALLIN: I have a quick point to make.

25 CHAIRMAN CORY: Sir, you are not recognized and

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1 you are out of order. Would you please sit down? Thank you.

2 MR. GRAVELLE: You raised the question "significantly"
3 earlier with Mr. Bennett, that you felt it was the obligation
4 of the Commission to do some regulation of producers.

5 Again, this gets us back hopefully not to
6 personalities, but to Mr. Lippitt as the representative of
7 the producers. There is in fact an Order Instituting
8 Investigation that signed by the Commission which is looking
9 toward the regulation of the California producer. I might
10 expect --

11 CHAIRMAN CORY: When is that happening?

12 MR. GRAVELLE: -- that the cooperation of the gas
13 producer is not readily apparent in that proceeding as it
14 might have been in your proceeding to determine gas prices
15 to be charged here, and that is the case.

16 The current status -- and it is a difficult
17 proceeding because of its very nature -- the current status
18 of that Order Instituting Investigation is in a limbo situa-
19 tion. The reason it is in a limbo situation is because of
20 the Federal Energy Bill which, among other aspects, in some
21 of its forms is looking toward the regulation of intrastate
22 gas prices. If that legislation comes to pass, presumably
23 neither the California Public Utilities Commission nor
24 possibly the State Lands Commission will have anything to
25 say about what the price level is for the intrastate-produced

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1 gas.

2 It would be, in our view, at least on a short-term
3 basis, nonproductive to proceed with that difficult piece
4 of litigation in the face of the hopefully forthcoming
5 federal legislation. One of the problems that one of the
6 cases that Mr. Bennett mentioned to you, the Richfield case,
7 was a prior determination that the Commission did not have
8 the jurisdiction to regulate intrastate gas production at
9 the wellhead. The determination there was that the producer,
10 in that case Richfield, who was selling to the public utility
11 Southern California Edison had not dedicated its gas, and
12 under the very section that Mr. Bennett referred you to,
13 Section 216(c) of the Public Utilities Code, indicated that
14 Richfield was not a public utility, that the Commission had
15 exceeded its jurisdiction in trying to impose public utility
16 status on Richfield and that the solution should be taken
17 up through legislation, which was another part of one of
18 your earlier questions, Mr. Cory.

19 There was a reference, Mr. Bennett was correct,
20 by Justice Traynor as dicta in the case that there might,
21 had other things occurred, there might have been a dedica-
22 tion which would have allowed the Public Utilities Commission
23 to regulate the producer. It's because of that case, for
24 instance -- again for your edification, it was decided by
25 the California Supreme Court in 1960 -- because of the change

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1 in circumstances with regard to energy between 1960 and 1977
2 and because of the change in the makeup of the California
3 Public Utilities Commission, the change in makeup of the
4 court and the inability subsequent to the Richfield decision
5 to get legislation which would give, clearly give the
6 Commission authority to regulate California gas producers,
7 we finally got the three votes that Mr. Bennett was unable
8 to muster his ten years as a commissioner to institute this
9 investigation.

10 If there is no federal regulation of intrastate
11 gas, that proceeding will progress.

12 CHAIRMAN CORY: By when?

13 MR. GRAVELLE: It's going to be a long and
14 litigious ordeal. I would say you would not be able to
15 look for a decision by the California Public Utilities
16 Commission --

17 CHAIRMAN CORY: I understand the decision, but
18 when will you make a decision to either proceed with it,
19 or how long are you going to give the federal government
20 to preempt?

21 MR. GRAVELLE: I would say that the back burner
22 status of that investigation should not remain in that
23 status for more than another month. If the federal govern-
24 ment does not act or if we clearly see that they are going
25 to act one way or another, we can make a determination to

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1 either take it off the back burner and proceed or leave it
2 there and probably discontinue the investigation.

3 I believe that there might have been other
4 questions, Mr. Cory, that you addressed to Mr. Bennett or
5 maybe to me through Mr. Bennett by comment that I don't
6 recall.

7 CHAIRMAN CORY: You believe at this point you do
8 not have the existing statutory authority to proceed to
9 declare some form of regulation of wellhead gas prices.

10 MR. GRAVELLE: I believe personally, one commissioner,
11 that we can make an extremely good case today for the regula-
12 tion of California producers, which is one of the reasons
13 that I supported wholeheartedly the investigation to do so,
14 the attempt to do so. That is where I stand.

15 CHAIRMAN CORY: If we should arrive at some
16 determination of a price today, add to that the caveat that
17 if you, the PUC, would choose to enter the field we would
18 be willing to determine that whatever your price and judgment
19 was would be the appropriate and proper amount, wouldn't that
20 tend to meet the thing, because we have one set of facts
21 and standards, and nobody has gone into this area to regulate
22 the marketplace. Then it's unregulated since. The price
23 has been relatively high.

24 What I am concerned about is the public interest
25 that we might defer and not do something or take some

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1 absurdly low figure and then everybody else in the world
2 get a high price because of the PUC's reluctance to enter
3 this area. If we say, all right, it's a buck fifty, buck
4 ninety-two, whatever the figure is, however, if the PUC
5 wants to come in and provide that the public interest is
6 best served by saying that the price is a dollar twenty or
7 ninety cents, we will, for our side of the contract, be
8 willing to stand aside and say, we are very much for the
9 public interest. We will not exceed that and we will not
10 bind anybody to a contractual obligation that exceeds that.

11 MR. GRAVELLE: I think when we get into the subject
12 matter, this is one of the areas where you are in somewhat
13 of a Catch-22 situation. Our concern is that you will make
14 a determination that a price higher than \$1.20 is reasonable.
15 That is your, depending on whether you are being controlled
16 by the leases or by the statute as it's now clear, apparently
17 clear, that is a determination by a body, a State body.

18 Are we to say thereafter that the State Lands
19 Commission was wrong in its determination that \$1.52 --

20 CHAIRMAN CORY: No. If we decide that if the PUC
21 does not come into the field then in fact the reasonable
22 price is "X"; however, we invite you if we don't have the
23 statutory authority or case law authority to control what
24 other people get, we have a contractual obligation to get
25 at least as high a price as everybody else is getting. We

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1 say to you we think the prices are kind of absurd. The
2 consumer is getting his ox gored. If you wish to come in
3 and say the word, we invite you in, and we will not hang
4 anybody up. What is reasonable is whatever you decide it
5 to be. The ball is in your court, PUC. What happens if we
6 do that?

7 MR. GRAVELLE: That is a very complicated set of
8 circumstances. I think in deference to all of the legal
9 counsel sitting around here, I would not want to try to give
10 you an answer to that now. I would comment that because of
11 the nature of the proceeding that we have instituted to
12 regulate producers, if that is a vehicle that we would be
13 utilizing and, again, because of the appeals that were
14 followed, assuming that the Commission does regulate, make
15 a determination that it has jurisdiction, we are at least
16 a number of years from a final judicial determination because
17 you can bet your boots that that case will go to the U.S.
18 Supreme Court if that determination is made.

19 So, I don't know where we would be down the road.
20 I would like to point out one other Catch-22 situation that
21 we have. That is if it is your desire that a body, be it
22 the Public Utilities Commission or some other regulatory
23 agency, regulate the California producers, then you must
24 make the distinction that was alluded to on a negative basis
25 by a prior witness between the old and new gas, because

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1 what we're talking about here is flowing gas from the Rio
2 Vista field, if I understand correctly, back from 1930.

3 CHAIRMAN CORY: Has the PUC made any distinction
4 within California as to what they consider reasonable for
5 PG&E between old and new gas?

6 MR. GRAVELLE: I think implicitly you can say yes.

7 CHAIRMAN CORY: I have looked for that and haven't
8 been able to find it.

9 MR. GRAVELLE: We've discussed it already today,
10 and that is in the determination to utilize \$1.66 for the
11 Union Island field as opposed to the utilization for the
12 balance of the contracts of \$1.20 for the rate-fixing
13 purposes.

14 CHAIRMAN CORY: Were any of those old contracts
15 at a higher price, but you said, no, we will not give you
16 that rate, or were you just taking that which was actually
17 paid?

18 MR. GRAVELLE: That which was actually paid or
19 which was, to our understanding, was actually paid and would
20 be passed on to the ratepayers aside from the other questions
21 of any other deals that might have been made.

22 I would say to you that as a matter of policy,
23 our Commission would have no objection to the State Lands
24 Commission determining the higher price for newly discovered
25 gas on State lands than for the flowing gas that we are

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1 talking about in the situations before you today. I would
2 not be here making this type of an argument, nor would any
3 of the other commissioners, if that were the situation with
4 which we were dealing.

5 If a body is to regulate at the wellhead, such
6 as is done on the federal level, you cannot have it both
7 ways; that is, no distinction between old and new gas because
8 there is valid reason for giving incentives for newly
9 discovered gas.

10 There is not, as we see it, any valid reason for
11 raising the price of flowing gas, particularly when you
12 are talking about fields that go back to 1930.

13 CHAIRMAN CORY: But when I pursued that question
14 in terms of trying to find a PUC regulation that dealt with
15 that distinction, the staff informed me of a void in that
16 area, that there is no distinction by regulation of the PUC
17 between old and new gas. The distinction only exists at
18 the federal level.

19 MR. GRAVELLE: There is no distinction in regulation
20 because we do not regulate that gas. The distinction has to
21 be determined in an ad hoc basis, case-by-case, and the
22 example is the one which I cited to you of the Union Island
23 field where there is a distinct price differential recognized
24 for rate-making purposes.

25 As a matter of policy, what I am attempting to tell

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1 you today is that the Public Utilities Commission is not
2 adverse to higher prices for newly discovered gas to be
3 determined by this Commission, nor to be determined by
4 producers who go out and put that gas into the dedicated
5 stream for use by the utilities of this state. That, I would
6 say to you, is the general policy consideration, without
7 giving you a determination as to what level that is; but
8 the \$1.20 or the price that you're fixing for flowing gas
9 does put us in a difficult situation when the Commission is
10 involved in attempting to get new sources of gas from wherever
11 -- Mexico, South Alaska, anywhere else that we are dealing
12 with at the same time that the utilities are with other
13 state governments or with foreign countries to be faced
14 with the situation that prices in California are equated
15 to, for instance, the Canadian level.

16 That is one of the reasons that we are so strongly
17 opposed to an increase at this time in the price level.

18 I don't think Mr. Bennett put anybody to sleep.
19 I may have.

20 MS. SMITH: I just have one question for you,
21 and that relates to the cost of gas to the consumer. A number
22 of witnesses have testified that there will be an increased
23 cost, but your testimony indicated a higher cost than any
24 other testimony I've heard. You indicated an increase of
25 110 million. So, I'm curious about the figure that you used

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1 in arriving at this figure and what period of time this
2 increase would be spread over, and also if you do have
3 the information, I'd like to know what would be the impact
4 that would be felt by the consumer on their monthly bill.

5 That sounds like a lot of money if I have to read
6 that in the newspaper. I might get really upset, but I
7 might not be quite as upset if I know in dollar amounts on
8 my monthly bill what that increase is going to be.

9 MR. GRAVELLE: I may not be much of a lawyer, but
10 I'm much less a mathematician. I have a summary which was
11 supplied to Mr. Cory earlier which I would be happy to give
12 you. One hundred ten, zero four two, two four five is an
13 annual figure. It would cover all classes of ratepayers,
14 but only in Northern California because of the rate schedules
15 that we have utilized in taking the gas that goes to the
16 consumer and because of the lifeline which has been adopted
17 by the Commission and has been mandated by the Legislature.
18 There is going to be a varying impact, and I cannot right
19 now break that down to you on an average customer's bill
20 or lifeline customer's quantity bill; but we will, if you're
21 inclined, I would like to have the opportunity to have our
22 staff attempt to develop that and send it to you by letter
23 subsequently if that's acceptable to you.

24 MS. SMITH: Okay. The cost to the consumer will
25 be a factor I will consider in voting on a price. So, I'm

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1 asking these questions because I'd like to know what figure
2 I would have to vote under to prevent a \$110 million increase
3 to the consumers.

4 (Thereupon a brief recess was taken.)
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1 CHAIRMAN CORY: Okay. We're back. We have paper
2 in the machine, and we're ready to go ahead.

3 During the interlude Betty was raising the question
4 that she was not sure that her question was answered as to
5 how that was calculated. Is there anybody that can address
6 themself to that question?

7 MR. GRAVELLE: The calculation I will give you,
8 which you can look at and keep for analysis, the computation
9 is based on an actual 1977 purchases of 128,504,752 MCF,
10 Union Island, 13,177,596 times 2.08, which is the recommen-
11 dation in your staff proposal on the agenda item minus the
12 \$1.35, which comes out to \$9,619,645. The Occidental cost
13 is rolled into that, which is \$4,793,833, and then all of
14 the other contracts which we assume, because of the determi-
15 nation of your body, would establish this new level of price
16 for negotiation purposes, which will be the bulk, or
17 \$9,628,767.

18 MS. SMITH: What price would we be establishing?

19 MR. GRAVELLE: \$2.08. If, for instance, your body
20 established a price of \$1.50, in round figures -- I don't
21 have it calculated here -- we would be talking about an
22 impact on the balance of the ratepayer, other than the
23 State of California, somewhere in the neighborhood of \$35
24 million annually.

25 CHAIRMAN CORY: We have a figure which the staff has

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2
1 prepared which showed after July '77 which is the same.
2 They have one figure before, one after. That would be the
3 new renegotiation period in the major universe. They were
4 using 127 billion cubic feet. You were using 128.5. So,
5 there is a discrepancy, perhaps, there as to how they added
6 a couple of figures.

7 MR. GRAVELLE: If you have it in front, it's
8 estimated --

9 CHAIRMAN CORY: I don't have yours. I have the
10 staff's.

11 MR. GRAVELLE: Ours is estimated annual effect,
12 1978 based on 1977 volumes.

13 MR. EVERITTS: Those are actual volumes?

14 MR. GRAVELLE: Yes.

15 CHAIRMAN CORY: In terms of corresponding figures
16 I'm just trying to get us down to where we are, and using
17 the 127 figure, they have come up with a 150 going to an
18 increase of 279, and one of the differences was they were,
19 I think, assuming that if nothing happened there would be
20 a normal inflation to the \$1.20 which would tend to discount
21 the discrepancy. I think that's what the staff -- am I
22 misreading the staff's analysis of this, that they'd used
23 through the current, the comparative figure being a buck
24 twenty up through July of '78, but they figured that it
25 would go to 1.28 at that point just through the normal things.

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1 So, the combination of the differences in the total base
2 and the eight cent factor, what you're subtracting from,
3 is where reasonable men can differ as to what's going to
4 happen, but it's in that ballpark. So, they use the one
5 fifty, twenty-seven nine or twenty-eight. So, it's somewhere
6 in the twenty-eight to thirty-five.

7 MR. GRAVELLE: That's correct.

8 MS. SMITH: Instead of 100 --

9 CHAIRMAN CORY: Well, that would be -- yes. That
10 would be the buck fifty as opposed to it. They used the --
11 your top figure to get to 210 was 2.08, whereas our top
12 figure was \$2.00, which by comparison came down to 914; but
13 that gives rise to the discrepancy which is concerning the
14 numbers as to what those differences are. Slightly different
15 numbers here and there, but the ballpark figures are, I
16 think, accurate.

17 MR. GRAVELLE: Would you like us to supply you any
18 material?

19 MS. SMITH: Yes, I'd be happy for you to.

20 MR. GRAVELLE: Let me identify what it is precisely.

21 MS. SMITH: Just exactly what the cost impact would
22 be to the ratepayer in terms of their monthly bill over a
23 period of time.

24 MR. GRAVELLE: We do that on the basis of our present
25 rate schedule, depending on the usage.

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1 CHAIRMAN CORY: If you took, for ballpark prices,
2 a factor of seven millimeters industrial and residential,
3 is that about the universe?

4 MS. SIEGEL: 2.6 million for PG&E's service area.

5 CHAIRMAN CORY: Total meters, industrial and
6 residential?

7 MS. SIEGEL: Everything.

8 MR. GRAVELLE: Greville?

9 MR. WAY: I think within the State of California
10 it's about six million, but that includes Southern California.
11 I think that's fairly close.

12 CHAIRMAN CORY: The ballpark per month is 2.75 as
13 I'm doing it quickly in my head per month.

14 MR. WAY: Less than a dollar.

15 MS. SIEGEL: Less than a dollar? That's not true.

16 CHAIRMAN CORY: If you use the figure I just used.
17 Three million, I think slightly less than three dollars, a
18 few cents under three dollars is where I think the figure
19 comes out.

20 MR. McCAUSLAND: I would appreciate the PUC going
21 back to their ivory tower and computing the numbers that go
22 into the background and maybe we can evaluate them.

23 MR. GRAVELLE: If it's agreeable with the members
24 of the Commission, we would give you some spread of the cost
25 to classes of consumers on an annual basis at the figures

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1 recommended by your staff in the agenda item, 2.08, and for
2 comparison purposes, if it would be agreeable to you, we will
3 take \$1.50.

4 MR. McCAUSLAND: We wouldn't even mind some
5 interpolation in between if you want.

6 MR. GRAVELLE: I would reiterate, however, that,
7 please, because we send you that, don't get the impression
8 that we're recommending a \$1.50, because \$1.20 is our number.

9 MR. McCAUSLAND: You can send it to us at a \$1.20.

10 CHAIRMAN CORY: The \$1.50 would have an increase also.

11 MR. GRAVELLE: Would have a zero impact.

12 MR. McCAUSLAND: We would hope that you would find
13 some kind of inflation factor of what you, at least as an
14 in-house estimate, think might be a working number for next
15 year's prices, anyway.

16 MR. GRAVELLE: I would definitely, Mr. McCausland,
17 and respectfully try to avoid doing that because I would not
18 want to be giving signals to the industry as to what the
19 Commission, our Commission, might find acceptable for
20 ratemaking purposes.

21 MR. McCAUSLAND: You got to get into it then, right?

22 CHAIRMAN CORY: Let's back up --

23 MR. GRAVELLE: We each become the ham in the
24 sandwich at some point in time.

25 CHAIRMAN CORY: I'm having some trouble accounting-

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1 wise. If the total universe after July 1, 1978 is 178 with
2 127, 128 billion cubic feet and there is 21 billion cubic
3 feet currently in arbitration and before this body, that
4 appears to be a significant portion of the 128; and, therefore,
5 going from wherever we are to \$1.20, if we go from 90 cents
6 or something, that those items that are still out, if they
7 all go to \$1.20, would there not be a financial impact?

8 MR. GRAVELLE: So what you want --

9 CHAIRMAN CORY: No, I'm just asking a question.
10 You said that there would be a zero impact of going to \$1.20.
11 I'm suggesting that there appears to be BCF that's not in
12 there that is --

13 MR. GRAVELLE: Mr. MacKenzie informs me that you
14 are correct, that there may be an impact at \$1.20. I base
15 that statement on my belief that they are all at \$1.20
16 currently.

17 CHAIRMAN CORY: I think there are some not, but
18 it's not --

19 MR. GRAVELLE: Not substantial.

20 MR. MacKENZIE: We can show you the impact, if
21 there are any that are not, we can assume that there will
22 be certain numbers that would not -- if we went to 1.20 what
23 the impact of going to 1.20 would be using the present
24 rate schedules.

25 CHAIRMAN CORY: Do you have any other questions?

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1 MR. McCAUSLAND: I'd like to ask a couple of
2 questions. We're reluctant partners in a rather difficult
3 area, and it seems that California has an Energy Commission
4 and the Public Utilities Commission and the State Lands
5 Commission. As I have begun to go through the record, it's
6 become fairly evident to me that California's gas is probably
7 the most precious gas that we have because it's available at
8 a time when the system is most in need of peaking capacity
9 in order to meet high demands. I assume that a lot of times
10 when that demand is called upon is when only the priority
11 use customers are actually receiving service.

12 Is the Public Utilities Commission engaged in any
13 active analysis of how we're going to be meeting our gas
14 demands over the next several years and what role California's
15 gas plays in meeting that and what price it's going to take
16 to deliver California gas to be there when PG&E or anybody
17 else needs it?

18 MR. GRAVELLE: The Public Utilities, Mr. McCausland,
19 the Public Utilities Commission is actively engaged in that
20 activity, principally, I would say, through the efforts of the
21 Chairman of the Commission who is, with the Chairman of the
22 Energy Commission and with the Governor, have been for the
23 last two years, plus -- in round figures, the last two years,
24 since he came on the Commission -- I'm speaking now of
25 Mr. Ratinovich -- has been very actively engaged with other

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1 public officials, Commissioner Ross before him, in Canada,
2 in Mexico, in Alaska, with the utilities and without the utilities

3 MR. McCAUSLAND: But what about here in California?
4 My difficulty is that I have also discussed it with
5 Mr. Batinovich and Mr. Ross, and I share your Commission's
6 concern. I think that you have the most thankless task of
7 all, unless it's the one that we have today; but I think
8 you have to address the problem of having gas on line in
9 California when that peak winter day comes. We just went
10 through a drought. What happens when we go through a freeze?

11 MR. GRAVELLE: That is one of the reasons why we're
12 protecting this resource. Mr. Lippitt I think very honestly
13 would accuse us, and maybe eventually so, of being very
14 niggardly in PG&E as they have accused them of being
15 niggardly with the gas in California. You used the term
16 "the value" of gas. Mr. Bennett tried to get you off of that
17 direction. I would also try to get you off of that direction.

18 MR. McCAUSLAND: I substitute the word "precious
19 commodity".

20 MR. GRAVELLE: I would not disagree with that. It
21 is a precious commodity. But on the value concept, for
22 peaking purposes or for any other purposes, it has a
23 substantial value. What we are attempting to do, and we
24 have over a period of years, and I would be less than honest
25 if I tried to be obtuse about meeting the question, is to

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1 retain as much of that gas in the ground for future use and
2 for peaking use as is possible, at the same time allowing
3 the producers reasonable return on their cost and on their
4 investment.

5 CHAIRMAN CORY: Doesn't that take you to a point
6 where low prices to the consumer encourages consumption, and
7 maybe what we really need is for some bold stroke to come
8 in and maybe a heavy tax on it so the government has that
9 profit coming into it rather -- don't you have to price it
10 out of the marketplace? I can't balance the two.

11 MR. GRAVELLE: There are substantial problems,
12 Mr. Cory, because, for instance, we have mandated by the
13 Legislature the concept of lifeline ratemaking for the energy
14 needs of the State of California, which the Legislature has
15 recognized and the Commission has recognized is that we're
16 talking about protection of human life, basically, on that
17 cold winter morning that Mr. McCausland refers to.

18 We do not want to outprice the ability of the poor
19 or the elderly or the parsimonious user to have gas available
20 to them when they truly need it, because this State is so
21 dependent upon the needs, so dependent upon gas as a fuel.
22 We are, to some extent, unique in the United States in that
23 area. So, we have been protecting the commodity that we have
24 at home. We don't believe, contrary to what producers might
25 tell you, that there are huge reserves of natural gas. If

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1 there were, there is an interstate market for it, and the
2 interstate market, to the extent that it exceeds the
3 California prices that are being paid now, would have developed.

4 CHAIRMAN CORY: Is there a pipeline to get it out?

5 MR. GRAVELLE: Where there is a source, there will
6 be a pipeline to get it out. You can see that wherever gas
7 is produced; and if there is no pipeline, there will be
8 schemes to bring gas in by LNG or other means.

9 CHAIRMAN CORY: From my vantage point, let me
10 suggest to you from what I know about the liquid petroleum
11 industry, that does not necessarily follow even though logic
12 would dictate it, given the monopolistic practices of the
13 industry, that there in fact may be gas there to which some
14 people have access but the market doesn't develop because the
15 pipeline isn't there. That's a chicken and egg thing.

16 MR. GRAVELLE: I understand what we're talking about
17 are volumes. We have no doubt that there is gas in Cali-
18 fornia and that there will be gas in California for use
19 sometime in the future. The quantity, the magnitude of that
20 gas is the critical point, and we believe that the magnitude
21 of that gas is not as huge as some would have you believe.
22 The quicker that flowing gas gets repriced at a higher level,
23 the more profit is going to be made on that. The production,
24 the producers tell us all the time, let us take the gas out
25 of the ground, pump it into the system, make PG&E take it,

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1 put it on not as peaking gas but as a main source of supply.

2 That means that the gas fields are going to be
3 depleted. My understanding is, and your staff undoubtedly
4 has informed you of this, that Ryer Island, for instance,
5 is a field that does not look like it's going to be productive
6 for too long a time in the future. I think that they would
7 substantiate that analysis. It's a depleting commodity,
8 and Ryer is very important.

9 CHAIRMAN CORY: Ryer Island is the one that is
10 going to --

11 MR. GRAVELLE: Standard Oil.

12 CHAIRMAN CORY: Standard Oil on transmission which
13 is not a peak loading, but a --

14 MR. GRAVELLE: I share your problem.

15 CHAIRMAN CORY: Go ahead.

16 MR. GRAVELLE: We have been accused of inconsistency,
17 and we were, and rightly, of being inconsistent in that when
18 we are talking about the price of the gas that is going to
19 the utility from the producer, we want to talk cost; and
20 we do, as you heard Mr. Bennett before me iterate.

21 When we talk about gas that goes from the utility
22 to the consumer, we talk about and we fix our rate structure,
23 we do so on a value concept, which does hopefully provide
24 the signal to the users to cut back, to go to alternate
25 sources of fuel and to feel the impact of extravagant use of

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12

1 this precious commodity.

2 The exception there is the lifeline residential
3 customer which, as I again point out, is one which is a
4 very different broad social problem and one that's mandated
5 by legislation.

6 MR. McCAUSLAND: I'd like to ask a question on a
7 slightly different subject, but this also relates, I think,
8 to PG&E and the PUC's relationship. One of my other roles
9 is investing retirement funds for the State, and I watch the
10 ratings of California corporations; and it's very clear that
11 California utilities are not enjoying the most favorable
12 ratings at the national level in the financial community on
13 the basis of return on investment and regulatory outlook.

14 How do we address those kinds of issues in terms
15 of fully pricing the commodity and yet protecting the consumer?
16 How are we going to be sure that we have the capital plant
17 in place to meet California's future needs if it's the
18 perception of others that we're not an attractive place to
19 invest?

20 MR. GRAVELLE: We could be here for several days.
21 Without trying to be corny, I'd like to say, "You're in good
22 hands with Allstate." You're in good hands with the PUC.

23 (Laughter.)

24 MR. McCAUSLAND: That's good enough.

25 MR. GRAVELLE: We understand. We understand that

13

1 problem; and the financial community, believe it or not,
2 spends a good deal of time coming out to California and
3 looking at the Commissioners to see if we have green horns,
4 whether we are what they would call "public ownership nuts",
5 whether we're trying to bankrupt the utilities and things
6 of that nature. We have taken steps to improve the quality
7 of the earnings of the utilities that we regulate, and we do
8 so very often at the substantial criticism of some of the
9 people who will undoubtedly follow me today to testify before
10 you, which is why I say that we all share being the ham in
11 the sandwich at some time.

12 There is a fine balance that we try to make. I
13 would say to you that I believe that the California utilities,
14 as a whole, are very healthy. The perception of the financial
15 community as reflected in the rating of some of the debt
16 issues of our utilities is not as good as it is in other
17 areas of the country under other Commissions; nevertheless,
18 there are substantial other reasons why that is true and
19 why utilities generally have a difficult time financing.

20 We have worked with our utilities, and I don't
21 think when they come in on a case-by-case basis and ask, as
22 Pacific Telephone is going to do, for a 14-percent return
23 on equity and 10-percent rate of return, which equates to
24 \$471 million, these are things that we have to wrestle with.

25 CHAIRMAN CORY: How long have you been on the

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1 Commission?

2 MR. GRAVELLE: Mr. Cory, I've been on the
3 Commission a year today. I was sworn in a year ago today.
4 I've been with the Commission for 18 years, the last two
5 and a half of which before I became a Commissioner was as
6 general counsel.

7 CHAIRMAN CORY: What has been the recent history
8 of rate increases granted by the Commission to PG&E? When
9 was the last one?

10 MR. GRAVELLE: The last rate increase Mrs. Siegel --
11 without looking at her I know she's frothing at the mouth
12 right now. The last rate increase that we might refer to
13 was granted just prior to Christmas 1977, and there may be
14 some significance in that. It was what we categorized as
15 a Rate Stabilization Order which transferred funds from the
16 energy cost adjustment account to the general rate base of
17 the utility, again hopefully to provide a signal to the
18 financial community, among other things, that PG&E is in the
19 process of asking for general rate relief right now, would
20 have the opportunity to earn their authorized rate of return
21 throughout the year 1978. There will probably be --

22 CHAIRMAN CORY: What was the order of magnitude
23 of that?

24 MR. GRAVELLE: That was, I believe, in the
25 neighborhood of \$80 million. The rate of return that was

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1 found reasonable there was equated to the return on equity
2 that has been last found reasonable. It put the rate of
3 return at 9.5 percent.

4 CHAIRMAN CORY: Prior to that when was their last
5 rate increase?

6 MR. GRAVELLE: 1976, I believe. The end of the
7 year 1976. There is a phase. The prior rate case is still
8 going on in one phase, and it has been submitted and is
9 awaiting decision currently. That has to do with the
10 conservation efforts of the utility and the tax problems
11 of the utility, basically.

12 CHAIRMAN CORY: '77 was the basic electric increase
13 of 80 million. In '76 there was a rate increase. Was that
14 the electric and gas?

15 MR. GRAVELLE: That's my recollection, yes.

16 CHAIRMAN CORY: The order of magnitude of that was?

17 MR. GRAVELLE: Sylvia?

18 MS. SIEGEL: It's 170 million for electric and gas
19 in Phase One. The authorized 71 million results in electric
20 for '77 out of the total of 981 million. The balance above
21 the 71 million is attributable to the ECAC adjustment on
22 an annualized basis, plus the increase allowed for the gas
23 department.

24 MR. GRAVELL: If we're talking about ECAC, that is
25 the Energy Cost Adjustment Account.

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1 CHAIRMAN CORY: That was '76.

2 MR. GRAVELLE: The '76 test year.

3 CHAIRMAN CORY: When was the rate increase prior
4 to that?

5 MR. GRAVELLE: I think the increase prior to that
6 was a 1975 decision based on a 1974 test year.

7 CHAIRMAN CORY: What was the order of magnitude
8 of that?

9 MS. SIEGEL: 213 million, December the 16th, 1975.

10 CHAIRMAN CORY: What was that?

11 MS. SIEGEL: Gas and electric.

12 CHAIRMAN CORY: What was the rate increase prior
13 to that? That was '75. When was the one prior to that?

14 MS. SIEGEL: That was a rating commission, and
15 they were coming every 16 weeks then.

16 MR. GRAVELLE: We had procedures previously to
17 offset what was called the fuel costs. We now have procedures
18 to offset what we call energy costs which are based on
19 historical data and roll in all of the various components.

20 CHAIRMAN CORY: I somehow was under the impression
21 that electric rates had been frozen for a long time.

22 MR. GRAVELLE: What has been frozen, Mr. Chairman,
23 was the level of the lifeline rate. If you, as a consumer,
24 have been able to retain your usage at the lifeline quantity,
25 you have not had an increase in your gas or electric rates

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1 for some years. If you have utilized above a lifeline
2 quantity, as a residential user, you have experienced some
3 substantial increases; and if you are a commercial or
4 industrial user of gas, you have had your rates inverted,
5 meaning that instead of a declining block rate, which was
6 the past practice, as your usage goes up your rate goes up,
7 which is, as I say, based on the value concept, something
8 that we do not preach to you for the producers.

9 MS. SMITH: Just one last question, Mr. Gravelle.
10 Has your testimony here today been on behalf of the Public
11 Utilities Commission, or are you testifying in your individual
12 capacity?

13 MR. GRAVELLE: I am happy to say, Miss Smith, that
14 a majority of the Commission support -- and we are a five-
15 member body -- a majority of the Commission support the
16 testimony that I gave today. The lone minority member,
17 Mr. Symons, does not, and he provided a statement to you for
18 your August 11th, 1975 hearing which was part of the trans-
19 mittal which I gave you today.

20 MS. SMITH: So, there was a resolution of your
21 Board or a vote?

22 MR. GRAVELLE: There was a consideration, right.
23 That goes back to August, and it was a touchy situation
24 because we didn't have a full commission at that time. Before
25 coming here today I checked with Commissioner Sturgeon to

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1 find out if I had his support to provide the testimony today,
2 and he would be the third vote necessary. Mrs. Dedrick has
3 not taken a vote on this. She was not present at the time
4 of the first consideration, and I have been unable to
5 contact her between yesterday and today to find out whether
6 she would support it. Commissioner Sturgeon said, as long
7 as you are talking about flowing gas, I'm with you a hundred
8 percent. If you're talking about new gas, we have a
9 different ballgame.

10 CHAIRMAN CORY: To help me understand -- and I
11 guess this is not so much on the factual pattern of gas,
12 but the political realities of the world -- the five-member
13 body of which you are one -- and you impress me very much
14 with where you are philosophically. I have met Commissioner
15 Batinovich. I know where he is philosophically. I have
16 known Claire for some time and have a great deal of admiration
17 and respect for where she is on most issues philosophically.
18 So, if we did something to put the ball back in your court,
19 it would seem to me there would be three votes for the
20 people. Am I misreading your submission?

21 MR. GRAVELLE: I would hope that. I would hope
22 that we would be three votes for the people.

23 CHAIRMAN CORY: As soon as you get to three, it's
24 irrelevant.

25 MR. GRAVELLE: Again, I would reiterate, if you

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1 make a determination of reasonable, it puts our body in a
2 greatly more difficult situation to determine that --

3 CHAIRMAN CORY: But I'm suggesting to you if we're
4 going to continue in an unregulated field, we must recognize,
5 unfortunately, the facts and the realities of what these
6 secret deals have generated; but if in fact the PUC wishes to
7 go in and determine what reasonable is and set the price to
8 which they will not pass on to the consumer above -- which
9 I think would have a great therapeutic effect on secret deals --
10 we are willing to stand by that agreement. That seems to me
11 to put the ball in your court. You seem to have three good
12 votes. The public interest might well be served by people
13 who are in a position to deal with those technical areas
14 where we are mere neophytes and have to worry about definitions
15 and a great deal of other problems.

16 MR. GRAVELLE: I think you deprecate yourself.
17 I think three good people up there could come to a unanimous
18 decision on \$1.20.

19 MS. SMITH: If we do vote to maintain the price at
20 \$1.20 and the rest of the industry remains unregulated, what
21 would the increase to consumers be?

22 CHAIRMAN CORY: You've got other arbitrations.

23 MR. GRAVELLE: That I can't tell you. What we
24 would have to look at would be the arbitrations. What we
25 would have to review later on would be the arbitrations and

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1 the vigor with which PG&E negotiated, not only tried the
2 arbitration proceedings, but negotiated the other contracts
3 that were not subject to arbitration. I would say that I
4 would think it would be of substantial benefit to them if
5 the price was maintained at \$1.20 as a guide to what a
6 State body charged by statute with fixing the price believed
7 to be the reasonable price. It would be substantial
8 evidence to have put before an arbitrator.

9 CHAIRMAN CORY: But you have the other one or two
10 arbitrations at higher figures which have been adjudicated,
11 or the court has refused to interfere.

12 MR. GRAVELLE: That's correct. I don't question
13 that.

14 CHAIRMAN CORY: And you've got another one or two
15 that are in the mill, and the box we're in is if they come
16 back following the previous arbitration and we lock ourselves
17 in contractually, we may be the only consumer that ends up
18 with the low price.

19 MR. GRAVELLE: With regard to the arbitration
20 question and what might happen in the future, based on
21 short conversations that I've had with them today -- I
22 think Mr. Fallin might be able to provide you with much
23 more current information and better opinion on what might
24 transpire there.

25 CHAIRMAN CORY: Any further questions?

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1 MR. GRAVELLE: Thank you very much for your
2 courtesy and the opportunity.

3 CHAIRMAN CORY: Thank you. You've helped us
4 a great deal.

5 Sylvia?

6 MS. SIEGEL: Thank you, Mr. Chairman. I came here
7 prepared to give you a lot of facts, but since you are so
8 generous and gracious and nondiscriminatory inviting a
9 woman to precede all the men who want to follow me, how
10 could I do such a terrible thing?

11 I'm going to be very brief. As far as I'm
12 concerned, this is a clear-cut problem. You raised some
13 marvelous questions, and I wish I had you handy a few years
14 ago when I was cross examining PG&E's witnesses on the very
15 questions you posed.

16 Let me assure you, Mr. Cory and Commissioners,
17 that the four lawyers on our staff who work for the love of
18 it -- they do get somewhat of a salary -- and I, who get no
19 salary, go into all of the information that goes on the
20 record upon which we appeal to the Supreme Court -- and
21 sometimes our writs are accepted -- with the greatest
22 scrutiny. We don't rely on answers in response to our
23 questions that are posed to the utility company. We insist
24 on going to the utility's records and searching the records
25 ourselves, and we come up with some mighty interesting things.

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1 We blew the whistle on the overcollections on
2 fuel cost back in 1975, and I think you recall that very
3 well, Mr. Cory. We try to go into all of the questions of
4 arm's-length bargaining, of proper pricing and so on in great
5 detail. In fact, we're frequently cut off at the pocket
6 from pursuing it, but we go ahead anyway.

7 Now, I hate to be in a position of kissing PG&E
8 on both cheeks and saying, you've done a great job on
9 bargaining. In my heart, I still don't think so, but honestly,
10 I've not been able to uncover anything that shows otherwise.

11 So, if you want to rest on our hard work, so far
12 I haven't been able to uncover anything. Now, for example,
13 in the matter of oil buying, I know the same product purchased
14 by ships as purchased by the oil companies sometimes has
15 discounts, under-the-table discounts, rebates, temporary
16 discounts, and whatever.

17 We did get some of that on the record there. You
18 know more about this than I do. But if there are any such
19 discounts in effect now, I haven't been able to uncover
20 them. If you know them, I'd happily like to know about it.

21 We're going into Edison to do discovery next week.
22 So, if you have any clues, help me. I need your help.

23 On the other hand, let me help you with plain talk.
24 I'm not a lawyer, as you know. I just tell it like it is.

25 The impact on the consumer would be horrendous.

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1 While the Commission from September 16th, 1975 when they
2 graciously accepted our proposal and adopted the beginning
3 of inverted rates, which gives the proper economic signal
4 to conserve, adopted the lifeline amounts as part of a
5 conservation inverted rate structure, there have been no
6 impacts on the lifeline amounts. However, during 1977,
7 because of the horrendous price of gas, gas prices were
8 actually inverted. Now there will be an impact on the
9 lifeline amounts.

10 I'm not sure yet whether I agree with it, but
11 that's what's happened. There will be on electric a
12 stabilization decision that Commissioner Gravelle referred
13 to that we're appealing. It's a terrible decision. I think
14 the PUC is getting politicized.

15 I tell them that to their teeth, and I tell you
16 that. We're going to appeal that decision, and we have
17 appealed other PUC decisions.

18 On the whole I have to tell you the atmosphere
19 in the last two years, or certainly in the first year of
20 this PUC administration, has been far better than it has
21 in the past.

22 Now, with respect to the question under consideration
23 now, the only question you have to decide -- forget about
24 what's going to exist in July '78. You're talking about
25 a contract term that goes from January to June '77, from

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1 July to December '77, from January to June 1978; and
2 clearly the rate is \$1.20. Anything above that, you are
3 throwing a terrible burden on all of California.

4 The 110 million only refers to Northern California,
5 but the rates will be reflected in the Southern California
6 rates as well.

7 As you know, or maybe you don't know, we have a
8 petition with 20 other petitioners in a coalition before
9 FERC, the Federal Energy Regulatory Commission, to hold
10 evidentiary hearings to set a proper national rate. The
11 last rate, the current rate now in effect of \$1.45, as
12 Mr. Bennett suggested, includes phantom taxes which should
13 not be included in there, includes the highest prevailing
14 rate of return, includes a cost of service, includes a
15 component for exploration and development and who knows
16 what else, a lot of which is improper.

17 They never held evidentiary hearings on that rate.
18 We appealed it. The appeal is still in the courts. In the
19 meantime, I am told -- and I get to Washington frequently --
20 they're having a hard time deciding on continued regulation
21 of the gas.

22 We may not have any decision on that. In the
23 absence of a decision, then FERC has to act. FERC will act
24 on our petition. There will be substantial evidence put
25 into the record to show that \$1.45 is far above what is

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1 required. I pass that on for your information. I don't
2 know what else to tell you.

3 I will tell you, I have to level with you. I
4 will tell you, and I don't tell you in the way of threatening
5 or anything else, but to protect the consumer constituents
6 I represent -- that includes the 85,000 Berkeley Co-op
7 members, the Statewide Consumer Federation of California --
8 I'm reciting this for political purposes --

9 (Laughter.)

10 MS. SIEGEL: -- San Francisco Consumer Action,
11 the citizens of a number of cities and counties in
12 California, as well as our own constituents. I have to
13 inform you that I left a lawyer home today with instructions
14 to prepare pleadings. I'm staying overnight. He'll come
15 up here and we'll go to Superior Court or wherever the hell
16 you go, and we're going to file them. We're going to get
17 injunctive relief. I will ask the Governor to intercede
18 because we're not going to stand for an impact of \$110
19 million.

20 I will ask for a legislative investigation of how
21 this Commission functions; and, finally, I will be on the
22 campaign trail informing all of the consumers in the state
23 of how this Commission voted. This is no idle threat. To
24 Michael Warren -- and you can talk to him -- I'm known as
25 Spoiler Siegel.

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1 I urge you, ladies and gentlemen, to do what's
2 right for the broad public interest. I know that you're
3 concerned. I know you want to do the right thing. You
4 have a terrible problem.

5 You are right about regulation. We asked the
6 California Public Utilities Commission three or four years
7 ago to assert jurisdiction under the same Section 216(c)
8 that the others have alluded to. We would have taken it
9 up, but each company is in before that Commission with
10 seven or eight applications at once. So, you can imagine
11 how fast and hard we're working. We don't always have time
12 to appeal, but on this one we will.

13 CHAIRMAN CORY: Let me ask you, what about the
14 concept of if we come to a determination but provide that
15 the PUC can overrule us, because I think they're in a better
16 position if they go ahead and exercise discretionary power
17 under that section which everybody seems to think they have.
18 Doesn't that tend to give them a strong position to do
19 something now and finally get off the dime and start
20 regulating this?

21 MS. SIEGEL: You mean about asserting jurisdiction?
22 Well, I think they can do it right now. They need three
23 votes. That's been the problem.

24 CHAIRMAN CORY: I'm suggesting that there appear
25 to be three votes there.

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1 MS. SIEGEL: Don't be too sure of that, Mr. Cory.
2 I know it appears that there should be three votes. I'll
3 talk to you about it privately.

4 (Laughter.)

5 MS. SIEGEL: In fact, I might talk publicly someday
6 soon.

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

9 CHAIRMAN CORY: It would help me in my deliberations
10 here if I understood, but apparently you choose not to go
11 into that any further at this time and this place because
12 of the forum you're in. But that would be helpful if I
13 understood that because what seems to me to be the case is
14 that the plight I see likely to be coming about is that
15 PG&E was, in essence, offered a net of a buck twenty,
16 \$1.31 less 11 in compression charges some time ago. And as
17 we wait more and more and more facts keep building up
18 elsewhere in the universe because nobody will step in and
19 say, no, we're not going to do this --

20 MS. SIEGEL: Don't worry about the facts that
21 are going to exist beyond July '78. You treat that
22 separately at a later time. All you're concerned with now
23 is the price for the contract that expires in June 30, 1978.
24 That's your only point of consideration.

25 There will be a lot of new factors that you'll

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1 have to consider for the next contract term. Then you
2 consider it. I'll help you if I can. I'll give you all
3 the information I can get for you, but all you're talking
4 about now is the contract period that expires June 30th, 1978.
5 All these new figures are irrelevant.

6 You have to get like comparisons for like products
7 for like periods; and if you do anything else, it's illegal.
8 And I know there are ten reasons on the record right now
9 that all add up to -- you don't mind if I use a legal term --
10 irreparable harm, and we will pursue it. But I don't want
11 to pursue it because I think you want to do the right thing,
12 and I think right today in the public interest you do the
13 right thing and just talk about \$1.20. Come back two months.
14 I'll be happy to spend time and go over all the data I
15 can get for you to show you what will exist for the next
16 contract period. That's a promise.

17 MS. SMITH: Mrs. Siegel, when you say "irreparable
18 harm", what are you referring to? Irreparable harm to the
19 consumer?

20 MS. SIEGEL: To the consumer, yes. I'm concerned
21 as you are about the consumer.

22 MR. McCAUSLAND: I'd like to simply say the last
23 time Mrs. Siegel came I said that her reputation had
24 preceded her. It's grown in the interim, and I appreciate
25 your advice and input and also appreciate the pressure that

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1 you're bringing to bear on us today because as far as I'm
2 concerned, you're the most bona fide representative of the
3 public at large that we're dealing with.

4 MS. SIEGEL: Aren't you sweet.

5 (Laughter.)

6 MR. McCAUSLAND: I wish I could go for \$1.20,
7 but in all honesty, I believe that my responsibilities
8 in this onerous role -- no, that's not the right word.
9 Give me a legal phrase for my role.

10 MS. SIEGEL: I'm not a lawyer, dear.

11 MR. McCAUSLAND: Compel me to vote for more than
12 \$1.20. You've heard my questions to the other people that
13 have testified. If you'd like to comment on any of the
14 questions that I've asked, I'd appreciate your advice.

15 MS. SIEGEL: I think you've asked very good
16 questions and, obviously, you've gone into this record in
17 great detail. I think it's a philosophical point and also
18 a factual point. As far as I'm concerned, Mr. McCausland,
19 the facts are clear. The prevailing rate is \$1.20 for the
20 contract period under discussion that expires June 30th, 1978.

21 In regard to peaking you ask, now, I've been
22 arguing with the Commission that they ought to use California
23 gas. I don't agree with the Commission's stance on LNG.
24 I think the potential for future gas development is
25 substantial in many areas. We're going to get a lot more

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1 gas from Mexico than we counted on. There is gas in
2 Baja California. There are untapped reserves in the Gulf
3 that nobody is talking about. There will be offshore gas.
4 There are large, large tar sand areas that nobody is
5 exploring yet that in ten years will produce more gas than
6 exists in all of Saudi Arabia. I have that from the horse's
7 mouth, the guy who is the oil consultant to the sheiks, a
8 guy who is very big in New York. I can tell you his name
9 privately. Okay?

10 There is going to be all kinds of gas available,
11 and I think banking California gas, in my view, is a
12 mistake. Now, the fact that PG&E chooses to use it for
13 peaking has nothing to do with the pricing of it. The
14 pricing is clear and simple. It's a buck twenty. I don't
15 see how you can arrive at any other figure.

16 At a dollar twenty-one we might not appeal it.
17 At a dollar thirty we will.

18 MR. McCAUSLAND: How about a dollar twenty-two?

19 MS. SIEGEL: No, sir.

20 (Laughter.)

21 MS. SIEGEL: I didn't tell you in past life I'd
22 been a negotiator.

23 MR. McCAUSLAND: Oh, I recognize that.

24 (Laughter.)

25 CHAIRMAN CORY: In your past life?

1 (Laughter.)

2 MS. SIEGEL: This is a reincarnated me. Thank you.

3 MS. SMITH: One more question. There are some
4 individuals who contend that if the Commission were to set
5 the price at a \$1.20 that would constitute a gift of public
6 resources. Can you respond to that? Are you willing to --

7 MS. SIEGEL: No, it's not a gift of public
8 resources; but according to our legal exploration of the
9 question of a gift of public resources, the public entity,
10 particularly a city -- and I'm not sure what the law is
11 in regard to the State; we'll be glad to research it for
12 you -- may do it if it's for a public benefit. Thus it
13 is a number of cities in California contribute to the
14 support of TURN to confer benefits on their constituents
15 which we do.

16 CHAIRMAN CORY: What about, for example, there
17 are three contracts in question. One of them is the
18 Ryer Island in which the public doesn't benefit, as I look
19 at it.

20 MS. SIEGEL: Don't ask me to struggle with that
21 now. I'm too tired at this point.

22 CHAIRMAN CORY: Do you have some problems with
23 it or not?

24 MS. SIEGEL: I'm sorry.

25 CHAIRMAN CORY: This is the gas that goes to

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1 Standard Oil that other consumers don't see. Do you think
2 we should make a distinction in that regard of our largess?
3 If we're going to make the gift and confer benefit, we
4 should confer the benefit on the monopoly as well?

5 MS. SIEGEL: I'm not so hot for Standard Oil,
6 but we're talking about a technical matter of arriving at a
7 prevailing rate in Northern California, and we're talking
8 about setting a rate for this contract term. You have to
9 look at the facts, and those are the facts. Okay? It's
10 \$1.20. I hate to be repetitious, but that's what it is.

11 CHAIRMAN CORY: Any further questions?

12 Thank you very much.

13 We have some logistical problems. Things are
14 going a little longer than we anticipated. We're going to
15 take a five-minute recess so people can retrieve keys to
16 their offices. We will be back here like in five, ten
17 minutes to reconvene.

18 (Thereupon a brief recess was taken.)

19 CHAIRMAN CORY: We will try it again.

20 Mr. Radford? Would you identify yourself for
21 the record?

22 MR. RADFORD: My name is Earl Radford. I'm an
23 attorney for Shell Oil Company, and I'm speaking only with
24 respect to the Ryer Island leases. Shell has a half interest
25 in such leases and not as to the other.

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1 Now, I want to make some comments and repeat
2 some points I've made before. These leases are a contract
3 between Shell as a lessee and the State as a lessor. The
4 State as a contracting party is bound by the terms of their
5 contract; however, this is a little more complicated than
6 that because the State is also bound, or the State Lands
7 Commission is bound, by the statute which gives you authority
8 to lease, the statute under which these particular leases
9 were issued; and these leases use the statutory language
10 that royalty is based on the current market price at the well.

11 Now, in this proceeding, the entire proceeding,
12 and whether you throw Mr. Lippitt's information out or not,
13 you come back to the same point that for Ryer Island or the field
14 nearest Ryer Island, there is only one price. That's \$1.20.

15 You can go to Canada. You can go to Algeria or
16 you can go someplace else and get a different price, but when
17 you stick to the words of our contract and you stick to the
18 words of the statute, you can only go to \$1.20, and the staff
19 has introduced no evidence of any price in excess of \$1.20
20 that affects the Ryer Island leases.

21 Now, insofar as Ryer Island leases are concerned,
22 and the leases say that you are supposed to determine what
23 the highest price is, what the current market price is, in
24 that respect you are conducting a fact-finding operation.
25 As a fact-finding operation, we think that Shell, as an

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1 interested party, has not been granted due process. We
2 were denied the right to cross question your witnesses,
3 and we think that at that point you have a constitutional
4 problem.

5 Also, insofar as the contract is concerned, you
6 have in the past construed the royalty provisions to be the
7 actual price in the Ryer Island field, and you've never before
8 gone to any fictional price arrived at by somebody who has
9 other interests at stake. But we think that the contract,
10 the prior construction of the contract binds you the same as
11 it would bind anyone else.

12 Now, I can understand that it would be an advantage
13 to renegotiate every contract every week if the conditions
14 change, but I don't think you have the power nor the right
15 to do so. Particularly, I don't think you have the power
16 under real old constitutional precepts of violating the terms
17 of a contract because you are a State agency. This was tried
18 in a Dartmouth College case many, many years ago, and I
19 think that pretty well cuts you off at the pocket.

20 Now, one more point that I think I ought to make
21 that I think is important in this hearing, particularly as it
22 affects Shell, is that we feel the State has no power under
23 this contract to determine a price other than the \$1.20 price
24 for any period starting today and going backwards. We've
25 entered no stipulation or no agreement with the State that

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1 they have any retroactive cure of anything. They've made
2 no protest to us. We've entered no agreement with them.
3 So, we think at this stage that any determination of price
4 that you have can only start with production after your
5 decision.

6 I thank you.

7 CHAIRMAN CORY: That relates to Shell. Your last
8 point is that you have half the lease and someone else the
9 other half?

10 MR. RADFORD: Standard Oil has the other half.

11 CHAIRMAN CORY: If they entered into any agreement,
12 it was without your knowledge, blessing and consent?

13 MR. RADFORD: If they entered into an agreement,
14 they entered their agreement.

15 CHAIRMAN CORY: They did not enter into for the
16 entire joint venture.

17 MR. RADFORD: No, not that I'm aware of. I don't
18 know that they've made that assertion.

19 MR. McCAUSLAND: Have we made that assertion?

20 EXECUTIVE OFFICER NORTHROP: I don't know.

21 MR. EVERITTS: They are operators of the lease,
22 but I don't know whether --

23 MR. McCAUSLAND: I haven't read anything in the
24 record that said we have asserted claim over --

25 MR. RADFORD: Well, people start talking about

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1 pricing going back to the beginning of 1977. I was just
2 speaking to that point.

3 MR. McCAUSLAND: It's good to have it in the record
4 because we clearly want to find out whether or not we have
5 in fact asserted and we have some interest in changing your
6 price.

7 CHAIRMAN CORY: In 1977 at a hearing, Standard Oil
8 had indicated they wished to go ahead and enter into the
9 agreement based upon \$1.20, and we said, as I recall the
10 meeting, at the public meeting, you do so at your own peril,
11 that as we read the contract we are unwilling to give you
12 advance blessing that we consider that to be the market price.
13 We don't know what it is, but we're unwilling to give you
14 blessing of that.

15 Standard Oil acknowledged that they were proceeding
16 at their own risk, and it's a question of what "own" referred
17 to in terms of the indirect antecedent vis-a-vis Shell's position,
18 vis-a-vis their position as the operator or not. I think
19 that's an interesting point.

20 MR. RADFORD: And they were not selling Shell's
21 gas under that contract. They, Standard, were not selling
22 Shell's gas under that contract.

23 CHAIRMAN CORY: You get your gas --

24 MR. RADFORD: We handle ours independently.

25 MR. McCAUSLAND: These are two separate contracts.

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1 MR. RADFORD: We have a half interest in the State
2 leases. We have a half interest in the other leases at Ryer
3 Island. We get half the gas from Ryer Island. Standard gets
4 the other half.

5 MR. McCAUSLAND: When was the last time that your
6 half of the lease was before the Commission?

7 MR. RADFORD: As far as I know it's never been before
8 the Commission.

9 CHAIRMAN CORY: It's been the whole lease. That
10 has been the only thing before us, and that's the problem.
11 Your relationship with Standard is a general partnership,
12 a limited partnership, a corporation, a monopoly?

13 MR. RADFORD: Our relationship with Standard is we
14 have half the lease and they have half the lease, and we hire
15 them to run it, to actually go out there and do the physical
16 work.

17 CHAIRMAN CORY: We've got an agent theory going.

18 MR. RADFORD: An agent theory to do the physical
19 work. There is no agency for purposes of selling because
20 that promptly gets you into very serious tax problems.

21 MR. McCAUSLAND: Almost anti-trust.

22 CHAIRMAN CORY: They have so much of that it's
23 irrelevant anyway.

24 Thank you, sir.

25 Mr. Perez?

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1 MR. PEREZ: My name is Ed Perez. I'm Deputy City
2 Attorney representing the City of Los Angeles.

3 I'd like to extend an apology for Burt Pines who
4 intended to be here. He had difficulty with his schedule.

5 Pursuant to the authority of the City Council of
6 the City of Los Angeles, I'm appearing here today to voice
7 our opposition as opposed to any price increase that would
8 exceed \$1.20 per million BTU's. My specific concerns were
9 outlined in a letter dated 12/29/77 to this Commission.

10 I'd like also to thank this Commission for its
11 quick response to the joint letter from the Cities of Los
12 Angeles and San Francisco and San Diego dated December 7th,
13 1977, when we requested a copy of the Attorney General's
14 opinion. It's action like that that reassures at least
15 Los Angeles that this Commission is interested in a fair
16 and open proceeding.

17 Upon receiving that opinion it became clear after
18 I researched the cases contained therein and studied the
19 theories propounded therein as to why that opinion was being
20 held back from public scrutiny. Because if you look at that
21 case, at the cases cited there and the theories, you can
22 quite quickly and readily see that they really support the
23 position of Pacific Gas and Electric Company.

24 I will just outline a few of them for you. The
25 Hugoton case at page 872 states that Oklahoma and Texas gas

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1 prices may be utilized to set the prices in Kansas. That
2 case goes on to say, though, that the gas that they were
3 concerned within the Hugoton embayment transcends the
4 borders of the three states. So, you have an interstate
5 situation much different than we have here, what exists
6 in Northern California.

7 In addition, on page 875 of that case, the court
8 there stressed you should be utilizing the wellhead price.
9 So, no mention of foreign gas prices, no mention of Canadian
10 gas prices, no mention of average weighted border prices.
11 It said wellhead prices. That case clearly can be distinguished
12 from what we have today.

13 In addition, the main issue in that case was an
14 Internal Revenue issue, depletion allowance. They were
15 concerned with the retrospective price setting, not prospective
16 price setting as we are concerned with here.

17 In addition, the Weymouth case cited in the Attorney
18 General's opinion, also an interstate gas case, also
19 retrospective price setting; and the main issue there was a
20 suit for underproduction of gas in Texas being transported
21 out. If I may quote for you on page 95 of that case the
22 rationale, quote:

23 "There is a potential conflict of
24 interest and the opportunity for discrimi-
25 natory preferrment such that the law may

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1 find it necessary to adopt standards
2 to assume fair conduct."

3 What does that mean? Well, what they were concerned
4 with, you have different states, you have different courts.
5 You are going to have different theories on any litigation.
6 You have different conditions, entirely different package
7 than what you have in this case. That case, the Hugoton
8 case and everything else cited in the Attorney General
9 opinion is totally inapplicable.

10 Now, if this issue that we are concerned with today
11 does go into the courts, I'd very seriously consider taking
12 the cases cited in the Attorney General opinion and put
13 them in my voice because they support what we're trying to
14 say. That's an entirely different situation than Texas and
15 Kansas, and the Canadian prices have no relevance to Northern
16 California.

17 I'd like to point out that actually, the Attorney
18 General opinion, if you look at it -- I suggest the Commission
19 read it. You may have already done it, but I suggest you
20 read it yourself, and you don't have to be a lawyer to pick
21 out some of the things that I'm going to highlight.

22 At page nine, and I quote, the author of that opinion
23 says:

24 "Unfortunately, cases we have found in
25 our research, including Hugoton, do not deal

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1 with a gas market like that in Northern
2 California."

3 It goes on to say in the opinion on that page:

4 ". . . Gas sales at the California border...
5 are not strictly comparable to the well-
6 head sales of gas in Northern California."

7 Now, those qualifications some of my analysis of
8 that opinion, and it just doesn't apply; and it's important
9 because several speakers before me have indicated their
10 intention to go into the courts.

11 I submit to this Commission that you will be going
12 into the courts without legal authority whatsoever, and it
13 will be a case actually of first blush for California.

14 The comments on OPEC and Canadian gas prices I think
15 are particularly important for this Commission to consider.
16 That opinion states, number one, the Canadian gas price is
17 totally unrelated to the cost of production; number two,
18 provides huge profits; number three, most importantly, unfair
19 and unjust.

20 Your own counsel has said, as stated in his opinion,
21 it's unfair and unjust. It seems to me the public deserves
22 more consideration than that. Yet, your staff continues to
23 advocate the use of quote unfair and unjust prices.

24 I do want to mention in passing that the City of
25 Los Angeles has been concerned with some of the procedural

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1 problems in the case. I don't want to dwell on that. I
2 will say this: This is a public agency. You have the public
3 interest to be concerned about. Whether or not it's legally
4 permissible or impermissible to cross examine in a fact-finding
5 hearing, I would think you'd want to do that.

6 The people should be really -- they should have the
7 feeling that this Commission is being above and open with
8 everything. I think it's important, the confidence of the
9 people.

10 CHAIRMAN CORY: Tell me how those two statements
11 relate. It seems to me the question of allowing a citizen
12 to use this forum for cross examination which is a fact
13 gathering situation, to allow a person's biases, petty
14 jealousy, competitive advantages, disadvantages, to come in
15 to allow the citizen to use the compulsory power of this
16 proceeding to cross examine, I'm not sure that's really
17 appropriate.

18 MR. PEREZ: I think it's appropriate from the sense
19 that if you have someone who is willing to stand up and
20 advance a position to you, that you should take, for instance,
21 the consultant in this case. That consultant should be
22 willing to withstand cross examination so that this Commission
23 can evaluate his basis and can evaluate whether or not his
24 theories are sound. When you have an absence of cross
25 examination, it's very easy to come up with a logical

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1 argument. If you have cross examination, I think it would
2 deter that.

3 MR. McCAUSLAND: I'd like to comment on this.

4 CHAIRMAN CORY: Sid?

5 MR. McCAUSLAND: I appreciate the comments that
6 you've been making today because I think they have been very
7 constructive. I hope all of the witnesses that follow you
8 will be as constructive in their comments as you have.
9 You have refrained from comments on character and other things
10 which filter through the record and don't please me at all.

11 On the question of due process, though, which is
12 on the fringe of what you are alluding to right now -- I'm
13 not a lawyer. I haven't been to law school, but I understand
14 that the bulk of the classes in law school relate to torts
15 and actually dealing in adversary hearing settings. I am
16 of the opinion that the number of courses in administrative
17 procedure are far less prevalent and far less attractive in
18 appealing to those in law school. My experience with the
19 120 members of the Legislature is that in seven years of
20 working in the environment I've never participated in an
21 adversary fact-finding situation with cross examination there.
22 With every administrative agency with which I deal -- and I
23 deal in a lot more than I would volunteer for if I knew how
24 many it was before I started -- the number of those that use
25 administrative hearing officers as a forum for adversary

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1 exchanges is two.

2 believe the California government is by and large
3 run by administrative procedure which does not generally
4 encompass this thing we call adversary cross examination.
5 It may well be with all the lawyers we have graduating from
6 law school these days that we're not going to be able to do
7 it this way much longer because we'll have to find jobs for
8 them, and adversary cross examination is a good opportunity
9 for them to get employment.

10 But I know a lot of people that come behind you are
11 going to raise the due process issue. If you've got a problem
12 of that due process, take it to the Legislature because they
13 do all their business that way. We do our business to the
14 best of our ability with all the people in California having
15 an opportunity to come here and make their say. If there is
16 cross examination to be done, we're the poor suckers that
17 do it; but I don't want anybody else today to harangue me
18 about due process.

19 Let me conclude by saying I really appreciate your
20 comments. I think they are really to the point that's before
21 us. Thank you for the constructive offerings.

22 MS. SMITH: Just for my clarification, you weren't
23 saying that there was a denial of due process, were you?

24 MR. PEREZ: I think that's a conclusion of law that
25 would have to be reached after it goes to court. I am saying

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1 it is a possibility that exists.

2 One of the facts -- I will move on, Commissioner,
3 because I know you don't want me to dwell on it. One of
4 the facts that's important in the hearing that I attended
5 on, I guess it was the 12th, you had the people conducting
6 a hearing asking questions and cross examining, and those
7 other participants and interested parties were not. I think
8 it's basically unfair, and I don't think the Commission
9 really wants to create that kind of a feeling amongst
10 interested parties in this case. It's just a suggestion to
11 this Commission. Let everything be open. That's my comment
12 in that respect.

13 MR. McCAUSLAND: Let me ask you a question. How
14 many of the decisions of the City of Los Angeles, many of
15 which involve significant fact finding, actually allow for
16 cross examination by the partisan interests?

17 MR. PEREZ: Well, in the ones that I've been involved
18 with -- and that's the only one that I can address -- I'm
19 sure that there are hearings that exist where we don't
20 allow it, and it would be a similar situation. In ones that
21 I have participated, the public utilities and Transportation
22 Department, we always allow it; and I don't think that our
23 charter or an administrative code says we must, but we do
24 it because it's good for the public, good public relations
25 and it's a good way to get the bottom line facts out.

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1 MR. McCAUSLAND: At least that portion of the
2 city's operations are run on that principle.

3 MR. PEREZ: Yes, that's correct.

4 MR. McCAUSLAND: Do you think that is generally
5 true of other departments of the city in their fact-finding
6 operations?

7 MR. PEREZ: It would be speculation. Attorneys
8 I've spoken with, they have always allowed the cross exami-
9 nation.

10 MS. SMITH: Have you had any problem with the
11 orderly administration of your hearings?

12 MR. PEREZ: I have not. I am sure that could be
13 a problem. Yes, that's certainly a consideration, but I
14 think just a few more comments and I'll leave.

15 There has been some mention about the impact in
16 Northern California. Well, I'm here because we feel there
17 is going to be an impact in Southern California. I'm not
18 making work for myself. There is going to be a true impact.
19 There may be some shortages of gas in Southern California
20 in the next three or four years. We might have to borrow
21 from Northern California. It would be a direct impact.
22 When we have smog alerts sometimes we have to borrow from
23 Northern California clean burning gas, and that has a direct
24 impact.

25 More importantly, there are going to be contracts

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1 negotiated in Southern California. I do believe there is
2 going to be a rippling effect, and I think it's going to
3 affect the entire state.

4 MR. McCAUSLAND: You not only get all our water,
5 you're going to get all our gas too.

6 (Laughter.)

7 MR. PEREZ: Well, I won't address that.

8 In conclusion I'd like to say --

9 CHAIRMAN CORY: So much for cross examination.

10 (Laughter.)

11 (Thereupon a brief discussion was held off
12 the record.)

13 MR. PEREZ: In conclusion I'd like to say this
14 Commission has a duty to make sure that the State Lands
15 generate royalties, and it's a problem; but I think it's a
16 paramount duty, as others have said, to consider the public
17 interest. I think this Commission should do that. The
18 price recommendation by PG&E utilizes a historical methodology.
19 There has been no good reason advanced so far to deviate
20 from that.

21 Thank you very much for your time.

22 CHAIRMAN CORY: Thank you.

23 Mr. Peckham?

24 MR. McCAUSLAND: Excuse me, Mr. Perez. If you don't
25 have the answer don't come back up. Are you aware of how

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1 much gas is currently imported into Southern California for
2 use versus the percentage that is domestically produced?

3 MR. PEREZ: No, I do not.

4 MR. McCAUSLAND: Thank you.

5 MR. PECKHAM: My name is Robert Peckham. I
6 represent Chevron USA, Inc., formerly Standard Oil Company
7 of California. I'd merely like to reiterate the statement
8 I made at the last Commission meeting.

9 CHAIRMAN CORY: Pardon me, Mr. Peckham. Do you
10 know why the name was changed?

11 MR. PECKHAM: The name of Standard Oil Company of
12 California was not changed. It still remains the parent
13 corporate entity of the organization. We changed the name
14 of part of our subsidiary operations and, in effect, caused
15 all of our domestic operations -- that is, within the United
16 States -- to be operated under one corporate entity, Chevron
17 USA, Inc. It's a wholly-owned subsidiary of Standard Oil
18 Company of California.

19 CHAIRMAN CORY: I'm trying to square it with what
20 I thought. I thought the first statement was "formerly".
21 It was formerly because it used to be Standard Oil of
22 California, but you took some assets and put them over here

23 MR. PECKHAM: Here in the western part of the
24 United States we operated under this name of Standard Oil
25 Company of California. In other parts of the United States

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1 we operated under other subsidiary corporations that were
2 held by Standard Oil of California. Our leases with the
3 State are now held by Chevron USA, Inc. They formerly
4 were held by Standard Oil Company of California.

5 CHAIRMAN CORY: But it was my understanding that
6 those leases, when you changed the name the same corporation
7 was still the lessee, only the name was changed. And are
8 you telling me that in fact now we have a wholly-owned
9 subsidiary which we may not have the full access to the whole
10 corporation standing behind those leases?

11 MR. PECKHAM: No. The interests under the lease
12 were assigned to Chevron USA by Standard Oil Company of
13 California. However, I think the form of the assignment
14 Standard Oil Company of California -- I think the language
15 was in the form of an assignment that kept Standard Oil
16 Company of California as, in effect, a guarantor.

17 CHAIRMAN CORY: Fine. I'm sorry to interrupt.

18 MR. PECKHAM: Surely. I would like simply, as I
19 said before, to reiterate the statement I made at the last
20 Commission meeting, that Chevron objects to the recommended
21 schedule of natural gas values appearing in this calendar
22 Item Number 55 for the reason heretofore expressed by Chevron
23 in its testimony presented during the tendency of the staff's
24 hearings. My statement is made simply to complete the
25 administrative record.

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1 I might shed a little light on the gas sales
2 situation. We do at Ryer Island sell our share of the gas,
3 or have a contract to sell it and or use it at our option
4 with PG&E; and our submittal for the approval of the change
5 in the contract price was made by us on our behalf along
6 with all of the other state lease gas sales contract
7 amendments that we submitted at the time shortly after July,
8 1976 that caused this entire hearing to evolve.

9 CHAIRMAN CORY: Are you suggesting it was only on
10 that half that you were not operating as a joint venturer --

11 MR. PECKHAM: We're operating as a joint venturer
12 with respect to the operations, but we're each required to
13 take and dispose of our own respective shares of the gas
14 production in the field. We cannot presume under the
15 circumstances to sell Shell's share of the gas or to dispose
16 of it on their behalf.

17 CHAIRMAN CORY: I just want to make the record very
18 clear. You're opting to be in a position, as I perceive
19 it, and it may be factually accurate to maximize Shell's
20 position to duck out. That may be factually accurate --

21 MR. PECKHAM: I'm not attempting to help Shell duck
22 out or not. I'm just simply trying to clarify the record
23 with regard to how the gas is handled, and we, Chevron, do
24 not disclose or handle Shell's share of the gas.

25 CHAIRMAN CORY: When the person from your corporation

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1 or one of the subsidiaries was before this Commission and
2 was informed that if they entered into any agreements they
3 were proceeding at their own risk, can you tell me whether
4 they were speaking for both parties to that joint venture
5 or only one, or do you know?

6 MR. PECKHAM: We were negotiating only on our own
7 behalf with PG&E, and that was the contract that we entered
8 into at our own risk.

9 CHAIRMAN CORY: I want you to take it to the highest
10 corporate level in your organization that henceforth on
11 every joint venture that you come before this Commission,
12 you had better have in writing an explanation of who you
13 represent and who you do not represent because there appears
14 to be an error. I don't know where that's going to settle
15 out in court, but I also want the representative from Shell
16 the record will please indicate he is still here -- I would
17 like for them to be aware that I have a relatively long
18 memory, and there are some slogans around this building
19 which I try to adhere to. I try to deal with people in good
20 faith. I presume you tried to deal with me in good faith,
21 but we seem to have a communication difficulty; and we are
22 going to eliminate that communication difficulty as we deal
23 in the future. That may be somewhat cumbersome upon you,
24 but for us to discharge our duties to the people, I think
25 we have to know for whom it is you speak and that you do

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1 have authority to commit or not commit so we know how we are
2 proceeding.

3 MR. PECKHAM: Might I say --

4 CHAIRMAN CORY: No animosity. It is just a fact
5 situation. We've got to clear it up.

6 MR. PECKHAM: If there has been any mistake with
7 regard to this matter, it's unintentional on our part I can
8 assure you.

9 CHAIRMAN CORY: Okay.

10 MR. PECKHAM: May I say something more? Perhaps
11 it grows out of the Commission's lack of knowledge of how
12 the gas in any area now is handled with regard to co-venturers.
13 Years ago gas was usually sold by an operator in a field for
14 all of the participants in the field. Then some tax problems
15 did evolve with that. As a result of that, that was changed
16 and each party handles their own share.

17 We brought, as we were required to do, any amendments
18 to our gas sales contracts for the Commission. Our gas sales
19 contract only operates with respect to our share of gas.
20 It's clearly defined in the sales contract, and the contract
21 was approved originally by the Commission.

22 CHAIRMAN CORY: I understand the fact situation.
23 I just want to correct it as we go forward so that all parties,
24 including this staff, is aware of what we need so we know
25 where we're at.

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1 MR. McCAUSLAND: I don't understand the facts.
2 If I understood Mr. Radford's testimony earlier, I believe
3 he said that his half of the lease had never been brought
4 up before this Commission as a separate item, that it was
5 part of one master relationship with the State. Is that
6 a fair characterization?

7 MR. RADFORD: No. That may be what you've interpreted.
8 The actual facts are that Shell's gas goes into the Shell-
9 owned pipeline system and is not sold.

10 MR. McCAUSLAND: Okay. I did understand that part
11 of your testimony. Has this Commission ever approved a
12 contract with Shell in the Ryer Island field?

13 MR. RADFORD: Not that I'm aware. It's possible
14 that you have because --

15 MR. McCAUSLAND: That's what I thought. Under what
16 terms are you taking gas out then? Under the lease that's
17 held by Standard Oil?

18 MR. RADFORD: No, under the lease held by Shell.
19 There is an assignment approved by your Commission of a
20 half interest in the lease to Shell.

21 MR. PECKHAM: It's held jointly.

22 MR. RADFORD: It's held jointly.

23 CHAIRMAN CORY: This is going to be an esoteric
24 argument that I'm sure we'll know how many angels can dance
25 on the head of a pin when we get through with that one. I

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1 I just want the staff to clearly understand that in the
2 future we should define with whom we're dealing. That
3 apparently is going to be a somewhat cumbersome process.
4 Whatever regulations you need you should bring before us.
5 We ought to get them in writing, signed up, sealed and
6 delivered as to who it is we are dealing with because there
7 is too much money on the table to allow the bets to be made
8 and the people to skate when they don't like the results.

9 I don't think that happened, but if they allow our
10 sloppy terminology to deal with it, I'll have to say that
11 I kind of think that if that was a deal cut at the Petroleum
12 Club between one of the sisters or two of the sisters they
13 would find an accommodation because there is, at least in
14 that realm, that gentlemen's agreement among thieves that
15 work -- among gentlemen, pardon me; I'm getting tired --
16 that those kinds of misunderstandings don't happen there.
17 But we had better get them in writing. Okay.

18 Go ahead, sir.

19 MR. PECKHAM: I have nothing more to submit.

20 CHAIRMAN CORY: Okay. Thank you, sir.

21 (Thereupon a brief discussion was held
22 off the record.)

23 CHAIRMAN CORY: Mr. Snaider.

24 MR. SNAIDER: Mr. Chairman, Acting Commissioners,
25 my name is Leonard Snaider. I'm a Deputy City Attorney of

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1 the City and County of San Francisco. I'm here representing
2 the City Attorney, George Agnost. I also have a very short
3 statement on behalf of the City Attorney of San Diego.

4 Let me get that first. The City Attorney of San
5 Diego wrote you on October 20th expressing a position on
6 this matter. Basically, they wanted me to reaffirm to you
7 that their position is that you should act in accordance with
8 the recommendations of the California Public Utilities
9 Commission, the \$1.20 recommendation. That is also my
10 recommendation.

11 I'm going to try and be brief for the main reason
12 that the majority of the case will be most coherently set
13 out by Mr. Fallin, and I hope not to have repetition.

14 I do want to address certain points that have been
15 raised by the three of you. Let me just list some of them
16 that I want to discuss. Your point, Ms. Smith, raised about
17 the possibility of a problem of a gift of public resources;
18 the Chairman's concern that the State may somehow be short-
19 changed. I think the phrase he used was the State may be
20 getting the green end of the weinie, but I think that was
21 the concept he was interested in.

22 CHAIRMAN CORY: Like most of your statements, slightly
23 inaccurate, but go ahead.

24 MR. SNAIDER: Better slightly.

25 I wish to address the hamburger analogy that

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1 Mr. McCausland raised. I intended to discuss due process,
2 but I will follow Mr. McCausland's advice and not discuss
3 it in this forum at this time. I will discuss slightly the
4 informal advice that the assigned Attorney General provided
5 to the staff of the State Lands Commission, the letter of
6 November 10th. I also wish to discuss the possible role
7 that the PUC may have on this issue.

8 I was going to get into another issue, and I would
9 like some clarification if this is even relevant now; and
10 that is the question of the Canadian price. Since
11 Mr. Lippitt, if I understood the prior discussion that you
12 would not be considering Mr. Lippitt's presentation --

13 MR. McCAUSLAND: That was only my recommendation.

14 MR. SNAIDER: Well, then I better get into Canada,
15 although only Mr. Lippitt brought that out.

16 Let me start with the idea of the gift of public
17 resources. I assume that Miss Smith was concerned with the
18 concept if you sold the gas too low you are somehow giving
19 away something that the State was entitled to.

20 MS. SMITH: Before you assume too much, I didn't
21 state an opinion one way or another on the issue. I merely
22 stated that it was an issue that had been raised.

23 MR. SNAIDER: That's correct.

24 MS. SMITH: If you'd like to address it and give
25 your opinion of it, that's quite acceptable.

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1 MR. SNAIDER: I think if there was a methodology
2 used by PG&E as a gift of public resources, then you have
3 done this in the past and you have acted illegally in the
4 past. I asked very specifically and suggested very specifically
5 to the Attorney General that they advise you if there was
6 anything wrong with the way you had acted in the past.
7 Again, I think one of you -- I can't ask questions of these
8 people -- but one of you should ask them if there were to
9 be anything wrong if you did adopt the \$1.20, whether there
10 would be anything legally wrong. The informal advice that
11 you were given by the Assistant Attorney General that
12 represents the -- excuse me, I promoted you -- Deputy Attorney
13 General that represents the State Lands Commission was that
14 you may, m-a-y, do certain things, not must.

15 I think you should ask if you may charge \$1.20,
16 if there is any problem with that. I'm convinced the clear
17 answer is that there would be no problem. The reason is
18 really quite simple, and this goes to the possible discrimi-
19 nation to the State.

20 You have this wonderful showing up here of one PG&E
21 contract in California. I think looking at California
22 certainly is right. As a matter of fact, that's all you
23 really should look at.

24 Mr. Northrop in the transcript of the September 29th
25 hearing, I think made the statement that whether, quote,

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1 "The \$1.20 price was not consistent with gas prices being
2 received by other producers in the State."

3 That's what you should be interested in, other
4 producers in the State. Now, there are two ways you can
5 look at that contract. Your staff says that you look at
6 that contract as part of a rated average. If it's relevant
7 and you look at it as part of a rated average, the dollar
8 impacts shown there are really lost in the total.

9 The point I made before -- and we'll get to
10 hamburgers now -- is that this is not relevant. Your staff
11 man didn't seem to be too concerned about the new gas/old gas
12 distinction. It's a major distinction.

13 Mr. Fallin has set it out quite well. I'm not
14 going to go into it at any length, but there are significant
15 reasons why that contract is in no way comparable to these
16 others.

17 If you wanted to look for comparability, you should
18 have given the employee from the Board of Equalization who
19 looked at that contract the 183 contracts in Exhibit B and
20 found out if they were comparable to your contract.

21 I think you would have found that those contracts
22 were completely comparable and that the State getting \$1.20
23 would be getting the same at every other old gas producer,
24 all 183 contracts. That is the criteria.

25 Mrs. Siegel was quite right. Looking to the future,

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1 you can change it. There will be change July 1st, but
2 looking up to July 1st, the \$1.20 will give the State the
3 same thing everyone else is. If you go higher, the State
4 will be earning far more than others in the same negotiated
5 area; and the real problem is not the few dollars extra that
6 the State gets, but the 50-to-1 ratio of excess profit
7 that you're giving to these other producers. And I get the
8 50-to-1 from the \$2 million to the State yield, somewhat
9 in excess of a hundred million.

10 MS. SMITH: A question. Are you saying that if we
11 set the price at a \$1.20 now that in July of 1978 there will
12 be facts that will be so different that we will not be faced
13 with the same argument that we're being faced with today?

14 MR. SNAIDER: Yes, because you're faced with these
15 contracts that are fait accompli that will be renegotiated
16 effective July 1st, '78. When they are renegotiated, it will
17 be those new renegotiated prices that you will look to.

18 MS. SMITH: But they'll still be our contracts.

19 MR. SNAIDER: I'm talking about these 183 that are
20 the rest of the independent contracts that are already out.
21 In other words, the \$1.20 relates to them and the termination
22 or renegotiation is July 1st. So, the concern that was
23 raised was that somehow these contracts would get higher and
24 you'd be left sitting with \$1.20. That is not a basis for
25 concern. You can get more later if the facts change to

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1 justify it.

2 MS. SMITH: You would not be arguing that because
3 we set the \$1.20 for our own contracts that we not remain
4 at that figure in 1978?

5 MR. SNAIDER: I think you can change it when the
6 facts change. If the facts changed in these contracts and
7 these producers were getting \$1.50, a \$1.50 would be all
8 right. I'm not saying a \$1.50 is right, but I think what
9 you look to for possibility is what the other producers in
10 these independent transactions are getting, and they're
11 getting a \$1.20, and they will be through July 1st, '78.
12 When those facts change, you should be free to change yours
13 also.

14 MS. SMITH: To whatever figure they are selling for?

15 MR. SNAIDER: Be comparable, yes.

16 With regard to the question of Canada -- and I'm
17 not going to dwell on the entire informal advice that was
18 given to you -- there were two aspects really that were
19 looked at. One was market value and then the adjective that
20 went before market value, reasonable market value. Your
21 attorney, I think, really gave you all the reasons -- pages
22 9, 11, 12 -- why Canada's prices are not reasonable by any
23 criteria. He explained the cartel-like setting, the OPEC
24 tie.

25 He did not say you must use Canada. He said the

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1 weight to be given Canadian gas prices is a matter resting in
2 the discretion of the State Lands Commission. I think
3 the weight based on the evidence must be zero, and that is
4 all that Canada is worth.

5 Now, for the possible Public Utilities Commission
6 role in ratemaking -- let me digress back to Canada for
7 one minute. I was in agreement with one other point that
8 Mr. Hager made, and that was the point that wellhead pricings
9 were the proper area of comparison. You have no evidence
10 with regard to Canada of wellhead pricing. You have a
11 border price. It's not a wellhead price.

12 You have no evidence of wellhead pricing in Texas,
13 interstate. You have the border price, not the wellhead
14 price. If you're going to look to wellhead prices, you're
15 going to look to Canada and other areas that aren't comparable
16 and aren't meaningful. Then the evidence that Mr. Lippitt
17 has put in, either directly or through members of your staff
18 is simply not wellhead pricing.

19 I do have something favorable to say, at least if
20 I interpret it correctly, from one of the suggestions that
21 was broken out here today. It would be reasonable for the
22 State Lands Commission to leave the question of what is a
23 reasonable price for this gas to the determination of the
24 Public Utilities Commission. The Public Utilities Commission
25 makes this determination right now to the extent that if

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1 they find a price unreasonable, they will not grant it for
2 ratemaking purposes. So, the question should be deferred
3 to the PUC, and the reasonable level could be set. I think
4 that would have a salutary effect in many ways. It was
5 already brought out before that this might be a strong signal
6 to the rest of the market.

7 With regard to the question of regulating intrastate
8 rates, I think Mr. Bennett's point was that the problem of
9 lack of regulation of intrastate rates was that the prices
10 were now all too high, that with regulation the \$1.20 would
11 not be here. We look to the actual earnings of Mr. Lippitt's
12 various clients.

13 If the regulation was involved, that could well
14 even work against your narrow interest as a landowner because
15 probably the prices would be well below the \$1.20; but it is
16 an admirable attempt by the PUC if they go through with
17 intrastate regulation.

18 Assigning them the role to determine the reasona-
19 bleness and then setting fair prices on that basis would be
20 a resolution of this particular problem that you find
21 yourselves faced with at the present time.

22 I thank you for your courtesy, your attention;
23 and it's been a pleasure being here.

24 MR. McCAUSLAND: Don't leave.

25 MR. CNAIDER: Oh, cross examination. Excuse me.

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1 (Laughter.)

2 MR. McCAUSLAND: I want to thank you for being
3 constructive today. I really appreciate it.

4 You made reference early in your testimony to
5 Mr. Fallin's presentation. Have you pretty carefully read
6 his words in each of his preceding presentations to this
7 Commission?

8 MR. SNAIDER: I have.

9 MR. McCAUSLAND: Are you able to stipulate that
10 they seem to you from your reading to represent a pretty
11 clear factual analysis of this situation so that a person
12 from a casual reading can interpret what he means by what
13 he says?

14 MR. SNAIDER: It all depends on who the person is
15 and how casual the reading.

16 MR. McCAUSLAND: I'm not reading them casually.
17 I found that the words are perfect if you understand the
18 16 or 17 qualifiers and how they relate to other words.
19 Since you were saying that he was going to set forth the
20 better part of your case for you, I want to find out if you
21 would stipulate that it would probably come across the way
22 you wanted it to or there might be some question about
23 interpretation.

24 MR. SNAIDER: I will say that in his presentations
25 here, in my discussions with him, I found Mr. Fallin to be

1 extremely expert, extremely straightforward, extremely
2 honest; and I think that on the whole I agree with what he
3 says and would expect that I would agree with what he says.
4 I don't hold this as a general rule with PG&E presentations.
5 I am usually engaged in challenging PG&E's --

6 MR. McCAUSLAND: This is awkward, isn't it?

7 MR. SNAIDER: No, it isn't. It is not awkward.
8 This is the key point. The real strange part of this entire
9 proceeding is the people that are here on the same side as
10 PG&E. You have Bill Bennett, who has fought the utilities
11 in various courts. You have the three cities, and we're
12 fighting these rate cases continually before the California
13 Supreme Court. We've won major victories there. We are
14 very active in this role.

15 You have Sylvia Siegel, who has done an excellent
16 job. You have the California Commission. You've got Shell
17 Oil, Chevron. I may have left someone out. It's unintentional,
18 but you have a very mixed group of people, all of us who are
19 very, very concerned that your actions, through possibly
20 the best intention to get a little bit of extra money for
21 the State, may cause a massive, massive windfall, undeserved,
22 for these producers and really a detriment in the state;
23 and that's why we're all here. I'm not uncomfortable with
24 being with Mr. Fallin in this case. I think PG&E has done
25 an excellent job protecting the consumers; but, quite frankly,

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1 if they hadn't come to this Commission and this thing had
2 rolled through the way it was originally proposed, they
3 would have been challenged before the PUC as being imprudent
4 for letting such a result happen, and that would have been
5 a basis to reduce the price.

6 The problem comes about that they have fought and
7 they have presented the case in an excellent manner. If
8 you do this, and assuming the appeals lose -- which I don't
9 think they would -- but there would be no real basis to
10 deny them the rates whatever you give them. The only way a
11 commission could deny their rates is to make a finding that
12 you were unreasonable and did something so bad, and also
13 that would have to be overturned by a court, because PG&E
14 prudently did everything in their power.

15 So, I'm happy to be on the same side with PG&E in
16 this case. PG&E in this case is representing the consumers'
17 interest against the gas producers.

18 MR. McCAUSLAND: Can you clarify for me or perhaps
19 elaborate on the phrase "great detriment" to the State so
20 that I understand that?

21 MR. SNAIDER: Yes. The detriment to the State
22 comes at many levels. One level is the State looking at the
23 sum of the people in the state, the citizens. But the State
24 just from the most narrow view, there are various offsets
25 to this \$2 million dollar bonus you see. One offset is the

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1 immediate offset the \$1.3 million higher gas rates that the
2 State would pay. The other is what might be described as
3 a ripple effect. The state purchases many products, goods,
4 services also take into account utility rates, far more
5 difficult to calculate than the direct rate; but this is an
6 additional dollar impact to the state.

7 The precedent that you might set and the financial
8 detriment it might set could be enormous. That was the intent.

9 CHAIRMAN CORY: As I understand your position, it's
10 that the City of San Francisco does a great deal to aid the
11 consumer, particularly the utility consumer in the City of
12 San Francisco; is that correct?

13 MR. SNAIDER: What I said was that we have been
14 active before the California Public Utilities Commission to
15 assure that there are not excessive rates charged to the
16 city as a consumer of utilities services and to the city's
17 citizens, consumers of utility services. That was what I
18 said, Mr. Chariman.

19 CHAIRMAN CORY: I was trying to square that with
20 recollection of some historical facts in San Francisco and
21 the obligation of the city to assume the electrical distri-
22 bution under the federal thing; and why is it the City of
23 San Francisco hasn't met that rather clear obligation that
24 has been sitting there for some 30 years to take over the
25 distribution of electrical power to the City of San Francisco

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1 on projects that were put in by federal money to which PG&E
2 continues to reap the profits? Have you done anything about
3 that in terms of going to court?

4 MR. SNAIDER: Quite frankly, sir, I'm here on a
5 matter involving natural gas, which is of relevance to
6 this Commission, and I have discussed that matter. I am
7 not here to discuss past history and --

8 CHAIRMAN CORY: Thank you.

9 MR. SNAIDER: -- I'm interested in -- can I
10 finish my answer?

11 CHAIRMAN CORY: Sure.

12 MR. SNAIDER: What I'm interested in, what we all
13 should be interested in is that nothing you do will hurt the
14 consumer today.

15 CHAIRMAN CORY: Thank you.

16 MR. McCAUSLAND: I would like the record to reflect
17 that I am a consumer, the three of us are consumers, and it
18 is the unfortunate fact of reality that the three of us
19 occupy positions which require us to look beyond the interests
20 of the consumer in this particular case to the best use of
21 the State's resources and the State's return on its resources.

22 CHAIRMAN CORY: For a change of pace, Mr. Leineke.

23 MR. LEINEKE: My name is Ronald Leineke, and I'm
24 appearing before you as a director of the California
25 Independent Producers Association. We're 450 members strong.

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1 We are relatively new in the state. We are finally trying
2 to organize.

3 We are independents. No major oil companies are
4 among our members. We're operators and producers of natural
5 gas. We're the guys that go out there and look for it and
6 find it. We have dry holes, but we're the people providing
7 the peaking gas to the state and whatever else we can find.

8 I'd like to start to disclaim any relationship to
9 Mr. Lippitt. He does not work for us. He is not our counsel.
10 He receives no fees from CIPA. Our organization, I think,
11 represents quite a few more people than his does. Not to
12 argue with anything he's presented. We think he's a very
13 knowledgeable guy.

14 On the 12th we entered some testimony to the effect
15 that the current \$1.20 price was not determined in the free
16 marketplace. PG&E has shown, I think, some 200 or so contracts
17 that are at a \$1.20. Boiling those down, they are signed
18 by about 90 different entities. I think about ten of them
19 are dead, they're estates so they're really not in the oil
20 or gas exploration business. Forty of them, or the balance
21 of the 80, are members of CIPA. There are a couple other
22 exploration companies.

23 We feel that we're speaking for a majority of the
24 companies who have signed this \$1.20 price, and we want to
25 again say that it was not done at arm's-length negotiation.

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1 We had no choice. That was the only one offered.

2 Well, we had a choice -- either go to arbitration
3 which is beyond most of the means of our members. We
4 prohibited from negotiation en masse because of anti-trust
5 so we can't pool our resources to negotiate for a price.
6 So, it's kind of divide and conquer. That's so much
7 \$1.20.

8 We did before ask that you consider all prices.
9 The gas all burns the same. It's like food on the table.
10 let's not ask how it got there; what does it cost to get
11 there. We feel that we ought to get the same price
12 as anyone else. It costs us to produce it and find it.
13 incidentally, it takes quite a large carrot to keep
14 of us to go out and risk a drill on a dry hole.

15 We're constantly subjected to a little dance
16 it comes to contract negotiations. We call it the tug-of-war.
17 PG&E tells us, well, we can't talk about anything higher
18 than the price we're offering you because the CPUC will
19 allow, probably will not allow them to be passed through.

20 We go down to the PUC, and we've talked on
21 to several of the Commission members there. They say
22 talk to PG&E. We do not set the prices. You're going to
23 have to talk with them.

24 So, it's back and forth with Catch-22, and
25 comes down to is we have a price unilaterally determined.

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1 PG&E. It always has been so and it is today.

2 So, we just want to make that point so whatever
3 weight you are giving to it in your deliberations we hope
4 you consider this fact. That seems to be really the published
5 reason for being here and holding these hearings, but there
6 has been a lot of testimony entered about the consumer and
7 should any higher price determined by this Commission trigger
8 a statewide increase should this happen.

9 It's very possible it would. I think I'm probably
10 the only one that's going to say this, but that's good for
11 the consumer. That's the best thing that could happen because
12 this is going to assure additional development and develop
13 additional gas supplies in the state where we do have control
14 of them and we have the peaking ability when we need it.
15 It will be here.

16 It's going to cost the consumer less for that gas
17 in many ways than going to foreign sources through LNG or
18 whatever. We're looking at much higher prices. You hear a
19 \$110 million talked about that the consumer is liable to get
20 stuck with. It's peanuts to what LNG prices are going to be,
21 and that's coming. No question about it. The machinery
22 is already at work and contracts are signed, and the money
23 that the consumer is paying for that will be several times
24 this; and most of that money is going overseas, will not
25 benefit the California economy except for a relatively small

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1 handful of California families that control some of the
2 distribution of that LNG.

3 But any higher prices that we as producers here in
4 the state receive, it's going to go into the well. We heard
5 talk about unjust profits. No such thing. These fellows
6 ought to take a good look at our balance sheets if they want
7 to make these unfounded charges.

8 I can say this for the independent driller: We like
9 to explore for gas. Every time we make another dollar, it
10 goes out in the ground. First of all, we have got income
11 taxes to contend with. If we don't spend it, we have
12 tremendous erosion; but that aside, we like to look for gas.
13 It's exciting. The thrill of exploration is what got people
14 into the business and, hopefully, to make their fortune.
15 What can you do about that? I think that's what built this
16 country.

17 I'd like to point out that we're really talking
18 about 16 percent, roughly, of the gas supply at any possible
19 higher prices. Already the balance of the 84 percent is a
20 much higher price. I just can't believe that the overall
21 effect on the consumer, on the utility bill, is going to be
22 that difficult to assume. Christ, everything else has been
23 going up, so is this.

24 So, inflation is here, and what's new? We do put
25 the money back in the ground. I think approximately 85

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1 percent of Sacramento Valley is under lease. These lease
2 rentals of three to \$25 per acre per year go to the property
3 owners in the state. They go into the economy.

4 The drilling, the rig to drill. My estimate is
5 something like \$80 million is spent every year drilling here
6 in Northern California. This goes into the local economy.
7 This employs Californians. I wish all the money we're
8 sending to Canada could be spent here. That's not a reality
9 of life; nevertheless, what's happening here is the money
10 that's spent with us goes right back into our economy.

11 To be very brief, it's getting late, I'd say that
12 we would like to see whatever price you determine, be it the
13 \$1.20 or better than that. Hopefully, it's better because
14 our costs are going up, and we think a \$1.20 is unreasonable.

15 Whatever it is, we're not going to threaten you
16 with any litigation, or I personally am not whatever price
17 you find. Hell, I can't even afford to go to arbitration
18 now, but I want to thank you very much.

19 CHAIRMAN CORY: What does arbitration cost?

20 MR. LEINEKE: Well, I understand from companies
21 that have gone into it in the past that their costs have
22 been upwards of \$100,000. Each company, each arbitor, each
23 side of the table.

24 CHAIRMAN CORY: And that is -- I'm just trying to
25 quantify that so I understand what you are telling me. You

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1 are telling me that your choice, as a businessman, is to
2 accept what the monopoly offers or you can go to arbitration.

3 MR. LEINEKE: Or we can not sell the gas. This is
4 on new wells. On existing wells, we have two choices,
5 either go to arbitration or to accept the price. If we find
6 a new pool of gas and we go to negotiate a contract, there's
7 really only one viable buyer, and that's PG&E. They have
8 pipelines all over the Valley. We've had offers from other
9 companies, but previous testimony has alluded to that. We
10 couldn't make a deal because of pipelines. Those, I might
11 say, were \$2.25. That's interesting but illusory at best.

12 MR. McCAUSLAND: Are you aware of any arbitrations
13 that are currently pending in the Delta area?

14 MR. LEINEKE: Yes, I am. I am not personally
15 involved in them, but I believe there is arbitration going
16 on between PG&E on the one side and Signal, Aminoil, Honeycut
17 and Camp and a couple other producers involved in that. As
18 I understand, they each have individual contracts, but they
19 have been lumped together for purposes of arbitrating it.

20 MR. McCAUSLAND: Do you have any idea how long those
21 arbitrations have been pending?

22 MR. LEINEKE: Well, since July 1st of 1976. That's
23 on the current price.

24 MR. McCAUSLAND: Do you have any idea how much of
25 the natural gas consumed in Southern California is domestic,

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1 i.e., intra-California gas?

2 MR. LEINEKE: No, I do not.

3 CHAIRMAN CORY: Thank you very much, Mr. Lieneke.

4 MR. McCAUSLAND: Let me ask one more question. Do
5 you have any idea what the values being debated in the
6 arbitration are?

7 MR. LEINEKE: They're really closemouthed about
8 that on all sides.

9 MS. SMITH: One other question. Assuming that we
10 did set a price that was higher than the 1.20 and the rate
11 increase to the consumer would be the 110 million as quoted
12 earlier, your companies would benefit substantially; but
13 how much more of an increase would there be in the amount of
14 money that you spend on exploration?

15 MR. LEINEKE: First of all, I don't really believe
16 that the rates are going to go up 110 million. There are so
17 many variables involved in that number. PG&E may or may not
18 give us a larger price based on what happens here, but should
19 that be the case, I would say something like 90 percent is
20 going to go right back into additional exploration.

21 I'm speaking in terms of small independent producers.
22 This is all they do is drill. They do not pay dividends to
23 a lot of stockholders --

24 MS. SMITH: People who are members of your
25 organization?

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1 CHAIRMAN CORY: Why would you put 90 percent back?
2 That seems like that's a lot of bucks to put back. Don't
3 you want some spending money?

4 MR. LEINEKE: Well, I'll speak for my own company.
5 I'm trying to grow.

6 CHAIRMAN CORY: Why don't you put another dog in
7 training?

8 MR. LEINEKE: I like to drill wells. It's just
9 in the blood. Now, tax, number one, let's talk about that.
10 You got 48-percent federal corporate rate. You got nine
11 percent State rate. Right there, if you go drill more wells,
12 commit to more leases and try to maintain any forward thrust
13 to our companies, it takes tremendous capital to go ahead.

14 I drill about eight wells a year. I'd love to
15 drill 20 or 30 wells. At two or three hundred thousand a
16 crack, it takes a lot of money to go in there and drill.
17 We're looking for cash. We're looking for more exploration
18 dollars all the time.

19 If it comes from higher gas prices, that's where
20 we put it, right back in the ground. I don't see any of
21 these companies taking it out and investing in other businesses
22 as we hear this criticism of some of the majors that they've
23 been diversifying their portfolios. The independents drill,
24 and that takes quite an investment to maintain that drilling
25 schedule.

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1 MS. SMITH: If you were investing 90 percent of
2 your profits from the increase, do you have any idea what
3 effect that would have on the unemployment rate, like how
4 many people would you be employing?

5 MR. LEINEKE: Well, I would say it would probably
6 double what we're employing now. I think it would double
7 the drilling activity here in Northern California. There
8 have been several others --

9 MS. SMITH: They're all coming from Alaska.

10 (Laughter.)

11 MR. LEINEKE: There are some of our producers
12 that our doing a small amount of drilling, and they're more
13 active in other states. They would rather do it here, but
14 there's a bigger carrot out there. They're drilling in
15 areas where the gas is going for two and a quarter, a dollar
16 eighty-five or whatever. As the price goes up, the drilling
17 activity goes up.

18 This is well-established in Texas where about three
19 years ago when the price was released and it soared up to
20 well over \$2.30 for some of the contracts. Drilling activity
21 followed it up just right up like that. Then the price
22 leveled off as they found a lot of gas, and pretty soon there
23 was more gas than there was a market for and the price went
24 right back down, and it leveled out at a lower price. This
25 is in relation to the additional prices. More drilling

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1 activity, more reserves were found.

2 CHAIRMAN CORY: Any further questions?

3 Thank you Mr. Leinekø.

4 Mr. Doris?

5 MR. DORIS: My name is Monte Doris. I'm employed
6 by a small independent oil company here in Sacramento. I
7 am not speaking for them. I'm speaking for myself as a
8 geologist, as a consumer of the state.

9 I did not come here with a prepared statement.
10 I came here as a salaried employee hoping to hear things
11 that would guarantee my employment in the future.
12 Unfortunately, I haven't heard those things.

13 I hope that I don't speak beyond my means as some
14 people have, and I hope that I don't ramble as others have.

15 I have read the documents, the transcripts, the
16 evidence presented prior to today, and I have been here all
17 day. I don't believe I have heard any facts addressing the
18 issue. As I understand it from the material, the purpose
19 of these hearings is to determine a reasonable market value
20 for natural gas in Northern California. I don't think any-
21 body has addressed the issue of market value.

22 The term market value has been interlaced and
23 mixed back and forth rather carelessly with something that
24 I think is more appropriately a market price. In fact, no
25 evidence, no numbers, nothing has been presented which

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1 would give this Commission any idea of what the true market
2 value of natural gas in Northern California would be.

3 I could sit here and talk to you about specifics,
4 attempt to address issues like Ron Leineke did.

5 MR. McCAUSLAND: Perhaps you'd prefer to respond
6 to questions.

7 MR. DORIS: I can't speak as an operator. I am
8 strictly -- I'm a geologist. I am a salaried employee.
9 I've got nothing to gain by increased prices, and addressing
10 that issue would not -- I don't believe my testimony would
11 have any credibility with this Commission. I don't believe
12 I should do that.

13 But as an interested citizen and an employee of
14 the industry, I don't believe the facts -- and this is
15 supposed to be a fact-finding hearing -- I don't believe
16 that the issue has been addressed at all.

17 CHAIRMAN CORY: How would you define the issue?

18 MR. DORIS: Well, as I understand it -- and not
19 being a lawyer I could not --

20 CHAIRMAN CORY: That may be an advantage.

21 (Laughter.)

22 MR. DORIS: I could not attempt to -- well, I
23 could not say whether or not this Commission has the legal
24 right to determine --

25 CHAIRMAN CORY: But as a citizen just tell us

1 in your own words what you think the issue is that we should
2 be looking at.

3 MR. DORIS: In the transcripts that I have read
4 on the cover it says, "In the Matter of: Reasonable Market
5 Value for Natural Gas in Northern California."

6 What I started to say is I cannot address the
7 legal issues, whether or not this Commission can determine
8 that; but assuming that you can address that issue, I don't
9 believe you have in fact done that. Market value, as I
10 would interpret it, is a price that buyers and sellers are
11 willing to do business at the marketplace. Well, essentially
12 in California there is no marketplace. A \$1.20 is not
13 negotiable. To use words that lawyers have used here, a
14 \$1.20 is the price that 183 of us are getting.

15 That is in fact the truth, that a \$1.20 that has
16 been quote accepted by those producers is in fact a market
17 price, not a market value at all. Nothing here has been
18 submitted to determine the market value. There has been no
19 evidence submitted to determine the market value of natural gas.

20 MR. McCAUSLAND: You have read the transcripts,
21 but have you seen the documentation that was submitted in
22 addition to the transcripts, the staff reports and written
23 testimony, things of that nature? Because there are a lot
24 of numbers in our record. I think we probably have sufficient
25 data as to what people are paying for gas, both California-

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1 produced and gas which comes across our borders, to make a
2 finding on what market value should be.

3 The thing that we're grappling with is how do we
4 want to define market value. Is it going to be right there
5 in that one field, or is it going to be what it takes for
6 PG&E to provide gas to the people of California if and when
7 they need it some winter morning? And are there marginal
8 values that you pay for different kinds of gas? Is the
9 \$1.20 artificially suppressed when 84 percent of the gas is
10 paying a lot more?

11 Those are the issues that we've framed. I think
12 we've already gathered enough information to suggest a \$1.20
13 is a little bit light in this day and age.

14 MP. DORIS: Apparently your interpretation of what
15 the word "value" means --

16 MR. McCAUSLAND: They don't like the way I use
17 that word, do they?

18 MR. DORIS: I think you've gathered all the numbers
19 and all the facts about the price that is paid. I don't
20 think you've addressed the issue as to what it is worth.
21 If you did, then you've got the even harder problem of
22 determining how much of that is reasonable; and that is
23 something I don't think that has been addressed by anyone.

24 MS. SMITH: Well, as a consumer, what is your
25 opinion? Do you feel that it's reasonable for us to charge

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1 more than a \$1.20?

2 MR. DORIS: I have a tie to the industry that
3 I cannot deny. I believe that makes me more knowledgeable
4 than the average consumer. As far as my own bill is concerned
5 I cannot help but believe in the end run it will be lower
6 if local producers are encouraged to find and produce natural
7 gas within the state and that it has always been and will
8 always be the cheapest gas that PG&E can buy.

9 MS. SMITH: Are you saying that we should raise
10 the price?

11 MR. DORIS: As an incentive for development for
12 development of natural gas in California, yes.

13 My purpose in coming here without a prepared
14 statement was that I listened to everything that has been
15 said, and so much has been said through this microphone that
16 did not make sense that I wondered if it was the microphone.

17 (Laughter.)

18 MR. McCAUSLAND: Our microphones work the same way
19 those do.

20 I appreciate your testimony because I think you
21 have in fact helped focus the issue for us, and we have in
22 fact been listening to everyone's thoughts on the matter
23 today in anticipation of the presentation which will be
24 made later this evening by PG&E in which they will suggest
25 whatever they will suggest about the staff proposal and the

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1 ways that we could reasonably act; and sometime before dawn
2 I assume we may find the courage to make a decision that
3 hopefully will balance off the interests of the State as a
4 producer of gas, the State as a owner of the land, the State
5 as an association of over 21 million individuals, most of
6 whom are consumers. And the three of us get to figure out
7 how to reach that balance.

8 MR. DORIS: The bottom line in my coming up here
9 is that I don't know why -- well, first of all, there is
10 a major difference between independent oil companies and
11 major oil companies, and I don't think the public is aware
12 of what the difference is.

13 MR. McCAUSLAND: This Commission is.

14 MR. DORIS: That is good. By no means do not
15 interpret that as a statement against major oil companies
16 because it is not. We live and operate by a completely
17 different set of bounds, and I am not so sure that people
18 realize that.

19 Independent operators do a lot of drilling. We
20 find a lot of gas in this state. Unless we are encouraged
21 to continue to do so, we will not be able to do so; and I
22 don't believe that anybody has addressed the independent
23 operators in this state, any government agency, whether it
24 be this one, that you see, whoever. I don't think anyone
25 has come to us and explored, found out what our costs are,

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1 what it costs us to operate, how much money we make.

2 You hear people up here make complaints about
3 windfall profits. Where are the numbers? Show me the wind-
4 fall profits that the independents have made. No one has done
5 that.

6 MR. McCAUSLAND: That's correct.

7 CHAIRMAN CORY: You're correct.

8 MR. GRAVELLE: It wasn't asked for.

9 CHAIRMAN CORY: I don't think we're putting too
10 much weight on that. I don't think you need to fear any
11 decision based upon that weakness in the record.

12 MR. McCAUSLAND: Why don't you listen to the balance
13 of the testimony and then perhaps you will feel that you
14 might want to contribute some more.

15 MR. DORIS: Well, I had hoped to speak much later.
16 I had hoped to hear PG&E's testimony, but I believe I know
17 what it is going to be.

18 MS. SMITH: We will allow you to come back and
19 testify again.

20 MR. DORIS: I don't think it will change my
21 statement, but if it does, I will. Like I say, I'm up here
22 as a concerned citizen and an employee of the industry and
23 as a consumer of the state. Thank you.

24 CHAIRMAN CORY: Thank you.

25 Mr. Williams?

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1 MR. WILLIAMS: My name is Stanwood I. Williams.
2 I am a director of CIPA, but I do not represent them in this
3 testimony. My testimony is given for my own company which
4 is called the Sumpf, S-u-m-p-f-Williams of which I'm co-owner.

5 I've been kicking around in this business for about
6 40 years as a geologist, as a major independent oil company
7 employee, as a drilling contractor and as the company owner
8 now of a small oil and gas producing company, exploration
9 company. My testimony is primarily written with a thrust
10 toward the price of gas and how it affects the independent
11 producer.

12 I understand from some of the remarks that have
13 been made by the Commission that that is not the thing that
14 you're interested in hearing; however, I wish to discuss my
15 testimony from that standpoint because the price with respect
16 to the independent producer is all important when it comes
17 to the major problem that no one has touched on to any great
18 extent here today to my knowledge and that is the problem
19 of development of additional reserves.

20 That is not strange at all. I've spent a little
21 time in Washington lately, and we have the same problem in
22 Washington. The President's energy program devoted nothing
23 whatsoever to the development of additional reserves, and
24 the new Department of Energy, which has been passed now and
25 it is in by Congress and is now in operation, as you all

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1 know, does not add one iota to the development of natural
2 reserves.

3 It adds a price of \$3.50 a barrel, as a matter of
4 fact, to every barrel produced in the United States with
5 it's \$10.6 billion budget, which is just a starter.

6 So, it is not strange that we aren't talking about
7 the development of additional reserves here today, but I
8 want to address that to some degree. We are one of the
9 companies on a list that was named by PG&E as having signed
10 a contract at a \$1.20. We have produced gas in the Sacramento
11 Valley since 1974 and have never had a contract with PG&E
12 until November, 1977, in which instance they were our only
13 outlet for one well. This contract was negotiable to a
14 degree, but not at all as to price, which is insufficient
15 to afford an ongoing development program when stacked up
16 against today's cost.

17 We have made numerous attempts to develop other
18 markets for gas wherein the price would be commensurate with
19 exploration, development and operating costs, including
20 mineral right taxes and the new costs engendered by the highly
21 detailed new federal reporting procedure. In such attempts
22 we have been only partially successful.

23 We sell a good part of our gas to PG&E on a spot
24 basis without sales contract, and the balance goes to Dow
25 Chemical under a negotiated contract more favorable than the

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1 PG&E contract; and we received a \$1.20 per mmBtu from
2 PG&E and a \$1.35 from Dow.

3 Also under the Federal Gas Emergency Act we signed
4 a contract for our uncommitted gas with the National Gas
5 Pipeline Company of America, Houston at the instigation
6 of and with the full approval of the FPC. The price was
7 \$2.25. This would have involved wheeling through PG&E lines,
8 but before shipments could commence, the deal was called off
9 without explanation or reason.

10 Because the price is controlled at a \$1.20 by
11 PG&E, even though most of our production is taken at a
12 slightly higher figure by Dow, we currently are drilling
13 only wells that are contractually required in order to hold
14 our leases. New exploratory drilling ventures are not
15 fundable under these price conditions insofar as the
16 independent producer is concerned.

17 So much for the specifics of our PG&E experience.
18 Even with complete deregulation at the federal level, the
19 price in California will still be controlled by PG&E and
20 Southern California gas company in tune with the rulings of
21 the CPUC.

22 The price is currently controlled to the extreme
23 disadvantage of California producers who supply only 15
24 percent of the total consumption, while at the same time
25 far higher prices are paid for the remaining 85 percent of

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1 the PG&E consumption. The price is held so low that public
2 consumption remains extremely high, and no one can afford to
3 search for more supply within the state.

4 In conclusion, I must conclude that to pay the
5 State the price paid today for California-produced gas is
6 unfair because it is the price paid for a small portion only
7 of the total purchases. It is inadequate to do the job of
8 keeping the independent producer alive. It is determined
9 under almost completely monopolistic practices, and it
10 promotes consumption without allowing for replacement and
11 therefore is not in the interest of the consumer of California.

12 Also in closing, I would like to add a remark with
13 respect to the independent producer. In this country, we
14 have a very fantastic situation. We have 10,000 independent
15 producing oil and gas companies. No other country in the
16 world has a thing like this to offer to its country. We
17 used to have 20, but controls cut that down to today's
18 figure of 10. Controls have been the bane of the existence
19 of the independent producer in attempting to develop reserves.

20 The independent producer stands ready and financed
21 with adequate and very able staff to go out and drill and
22 find more reserves, but he is hampered at every step of the
23 way by controls, price controls being number one.

24 The reasonable value, the reasonable market value
25 for gas, which is what we're gathered about here today to

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1 discuss, has got to be something higher than the independent
2 producer and the rest of the producers are receiving now in
3 the Sacramento Valley. Otherwise, the producer is going out
4 of business as he has in the past in the rest of the country
5 and in the State of California because of the fact that he's
6 been unable to get his price that will keep him in business
7 for both oil and gas.

8 In the State of Texas, as Mr. Leineke has just
9 related to you, the prices have been kept high for natural
10 gas. There is a great scurrying around and a lot of drilling
11 in the State of Texas. They'll never run short in that
12 state.

13 The same thing is true in the country of Australia,
14 as an example. The price of their oil has been kept high,
15 and now that they're finding oil in great quantities --
16 much larger than they anticipated after their first discovery --
17 they're going to be self sufficient because they have the
18 money to drill in the deeper places, in the more remote places
19 and in the areas where exotic methods of extraction are
20 necessary. That's why the price has to go up if we want
21 reserves.

22 Thank you.

23 CHAIRMAN CORY: Thank you very much.

24 MR. McCAUSLAND: Would you care to suggest the
25 price?

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1 Let me ask a question that precedes that
2 and you don't have to answer it if you don't want to.
3 Are you willing to tell this body what your return on
4 invested capital is?

5 MR. WILLIAMS: Return on investment capital.

6 MR. McCAUSLAND: Or some other number that you
7 would --

8 MR. WILLIAMS: I can't give return on invested
9 capital per se in dollars and cents, but I can tell you
10 this, that in Northern California in the Sacramento Valley
11 the return on investment of the independent producer
12 runs somewhere in the neighborhood of three for one up to
13 as high as ten for one. That is over a ten to a twenty-
14 year period, and that includes the drilling of dry holes.

15 CHAIRMAN CORY: What do you mean by three to one?

16 MR. WILLIAMS: I believe if you invest a dollar,
17 ten years from now you get three back. The risk however
18 is on the order --

19 CHAIRMAN CORY: Does that three to one ratio
20 take into account the dry-hole capitalization?

21 MR. WILLIAMS: That takes in the dry holes, but
22 does not take in dry holes of those who are not successful.
23 I'm talking about the people that are in the business
24 still today. The average wildcat that is successful in
25 the San Joaquin Valley per operator is on the order of one

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1 out of twenty.

2 MS. SIEGEL: Are you selling stock? Can we buy
3 some?

4 MR. WILLIAMS: We'd love to sell some stock.

5 MR. McCAUSLAND: My second question is: Would you
6 care to suggest the price that you believe would encourage
7 the industry to increase its exploration activity, at
8 least its field development activity?

9 MR. WILLIAMS: Yes, I would suggest a price
10 that would be equivalent of a barrel of fuel oil in Btu content.

11 MR. McCAUSLAND: Someone else suggested that once
12 before. I can't remember whether it was Union or Phillips.

13 MR. WILLIAMS: That's the only basis it can ever
14 really be straight on down the line, in my opinion, for
15 comparison purposes.

16 CHAIRMAN CORY: I think we have, according to
17 my indications, two people left to testify -- that is
18 Mr. Fallin and Mr. Lippitt. Is there anyone else here
19 that wishes to testify?

20 Now, it's 6:30. It's a question of what the
21 wish of the majority of the Commission is in terms of whether
22 or not we eat dinner and come back for those two, whether we
23 continue on. Do you wish to get a resolution of this problem
24 tonight? Do you wish to put it over and punt again?

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

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1 CHAIRMAN CORY: All right. Mr. Fallin.

2 MR. FALLIN: I feel like the bridesmaid who almost
3 didn't make it.

4 MR. Mc CAUSLAND: But you've been patient today.

5 MR. FALLIN: I was telling somebody yesterday I
6 can remember the day when we began the first hearing. I
7 think there were about three of us in the room who were
8 interested and an audience of one or two. It's grown.

9 My name, I think, has been mentioned before. Jack
10 Fallin. I testified before you three months ago, I guess,
11 now.

12 I do have a more or less -- well, it is something
13 I worked up to speak about, but I'm going to do what I guess
14 most people fear to see me do because like me they don't
15 know where I'm going to turn. I'm going to extemporize for
16 a few minutes.

17 What's happened here, I think, is this hearing has
18 brought out -- I might say flushed out, but I don't think
19 that's accurate -- it's brought out testimony. It's brought
20 out evidence that wasn't in the record book before. We've
21 finally got two people who were really interested in seeing
22 the new prices, the gas producers, the people who will
23 benefit.

24 Now, I'm not casting that now as a bad thing. I
25 think it's factual. I think they should have been in and

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1 around all along because those are the people who stand
2 to benefit by what you're going to do.

3 The question was asked, and Chairman Cory stopped
4 it a little while ago, by the next to the last speaker. I
5 guess I'm to the point now where I can call him a young man.
6 He protested the statements that had been made in the proceeding
7 about producer return, about windfall profits, about recovery
8 over cost; and he said there isn't anything in the record
9 at all, I think inferring that if it were in the evidence
10 and in the record, those documents would support a claim that
11 in fact profits aren't reasonably being earned.

12 Mr. Williams then came on and, I think in honesty
13 to me, it sounded certainly forthrightly, made a statement
14 that he wasn't loath to disclose his costs and that he
15 thought that his costs would demonstrate a need for increased
16 price levels.

17 Now, the question that was slipped, and the reason
18 I may have spoken from the audience, is that I asked, not
19 orally, but I wrote a letter to this Commission staff
20 referring to this issue because my position, the PG&E's
21 position, has been all along -- and I can't speak for the
22 CPUC on this -- that if the producers can come in and show
23 to you --

24 CHAIRMAN CORY: The CPUC?

25 MR. FALLIN: Yes, California Public Utilities

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1 Commission.

2 CHAIRMAN CORY: Are there some others where you
3 do you speak for them? You said you cannot speak for them.
4 I just want --

5 MR. FALLIN: I'm not going to answer that, Chairman
6 Cory.

7 MR. MACKENZIE: He doesn't represent them in any
8 way.

9 MR. FALLIN: Well, I guess I can say I haven't
10 discussed this with them.

11 CHAIRMAN CORY: That's what I wanted to know.

12 MR. FALLIN: My statement was, before I was
13 stopped there, we have always taken the position that if it
14 can be shown that in fact the prices received are insufficient
15 to return adequate return to those producers, the very term
16 you're talking about, reasonable market value, permits you
17 to consider that and requires you to consider that even if
18 it's to our detriment.

19 What I'm saying is that the term was designed to
20 say what it does say. It says "market value." It then says
21 that market value must be reasonable.

22 I do not have an objection, I have not had an
23 objection -- and I've said this repeatedly -- to that line.

24 I think I should ask, and I will ask, why is it
25 that the staff chose not to explore this avenue which I asked

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1 them to explore and which the producers now indicate was
2 open to exploration, because obviously this is an important
3 issue.

4 MR. McCAUSLAND: Would the staff be willing to
5 respond to that question?

6 EXECUTIVE OFFICER NORTHROP: I was doing a house-
7 keeping chore. Would you mind restating the question,
8 Mr. Fallin?

9 MR. FALLIN: The question is that we've now had
10 people at this hearing -- which was to be oral comments and
11 no more evidence -- which indicate that the people that
12 most directly stand to benefit from a proposed increase,
13 the gas producers, do contend, as I think Mr. Lippitt was
14 quoted as saying, that higher price levels are required to
15 return to them a reasonable profit over their cost.

16 Now, it is true that throughout this proceeding
17 PG&E has said that if that can be shown, if the costs require
18 further profits, that should be cranked into the analysis.
19 Now, I asked that the Commission explore this, and after,
20 I think, having subpoenaed PG&E twice and a couple of other
21 fellows a couple of times, that you use that power or whatever
22 other inquiry you have to find out if in fact that's so,
23 if the costs do require a higher level of profit; and I
24 never got a reply to that request.

25 EXECUTIVE OFFICER NORTHROP: That's a very long

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1 question, and I have a very short memory at this time. Let
2 me try to answer what I think you're asking me.

3 What you're asking me, as I recall, is, it seems
4 to me, why didn't we go to the producers and say, what do
5 you need to produce gas. Is that what you're asking me?

6 MR. FALLIN: Uh-huh.

7 EXECUTIVE OFFICER NORTHROP: As I took the charge
8 from the Attorney General, the charge was to find out what
9 the fair market value of gas is, and we proceeded along
10 those lines.

11 CHAIRMAN CORY: So, your definition of fair market
12 value says that that's really irrelevant.

13 EXECUTIVE OFFICER NORTHROP: What's the market
14 get? What's really the market value of gas?

15 CHAIRMAN CORY: Whatever willing buyers and sellers
16 you can locate arrive at rather than a cost basis.

17 EXECUTIVE OFFICER NORTHROP: I don't think that's
18 anywhere called for in the charge.

19 MR. McCAUSLAND: Let me ask a question. If this
20 matter was submitted to the California Public Utilities
21 Commission, it would be incumbent upon them under their
22 powers to consider the fair return aspects of the price.

23 MR. MACKENZIE: Yes, providing that information
24 were adduced on a record. The Commission would have to make
25 a determination of whether that was tantamount to a reasonable --

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1 whether it was a reasonable expense or a reasonable item
2 to put in the rate base.

3 MR. McCAUSLAND: If this Commission chose to defer
4 the question of fair return to the PJC and, in fact, we have
5 built no record that would demonstrate whether or not the
6 prices that have been discussed here relate to fair return
7 or not, you would then be able to deal with the situation
8 de novo in terms of building your record?

9 MR. MacKENZIE: We would be required to whenever
10 the applicant or utility chose to file an application, which
11 is totally within their discretion to seek a rate increase.
12 That would include the component of the factors that would
13 go into these costs that they would then be absorbing.
14 The determination would then have to be made as to whether
15 or not that was reasonable. So, we're talking about possibly
16 years for all utilities that will be faced with these increased
17 costs to come before the Commission and have these long,
18 elaborate hearings that are required in order for the
19 Commission to make those findings of reasonableness.

20 MR. McCAUSLAND: But in fact your professional
21 staff and its procedures have been geared to make those kinds
22 of findings for many years.

23 MR. MacKENZIE: Yes, and they make them sometimes
24 as short as six months. It usually takes longer than that,
25 as I understand, to make those findings.

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1 MR. WAY: I'm Grev Way, and I'm with the Commission
2 staff. You've got a few legal problems, and I'm no lawyer;
3 but what we can get from PGE&, PG&E really cannot deny us.
4 But about three or four years ago the Commission staff
5 attempted to pursue what it cost to produce gas in California.
6 We pursued this through PG&E, and we also wrote letters
7 to a number of producers; and we got back a number of
8 derogatory letters. We got back one letter that didn't
9 even seem to be relevant, but it gave us some cost figures;
10 and it's really a matter of what are the producers willing
11 to provide along this line.

12 That may be a major problem because I don't think
13 the Commission has authority, maybe we do.

14 MR. FALLIN: Chairman Cory, I don't make this
15 sort of thing for effect only. I'm saying that --

16 MR. McCAUSLAND: I respect you quite a bit. I've
17 read a lot of your words.

18 MR. FALLIN: You have in front of you an issue
19 that's important for resolution to us as much as it is for
20 you.

21 We've said, and I think it's true, that the
22 standard doesn't just say market value and it doesn't say
23 fair market value. It says reasonable market value. The
24 position we've always taken is that if it can be shown that
25 the value that the market creates -- and I'll talk about that --

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1 is the value of the market that you're to deal with. It
2 shows up a \$1.20.

3 If there's evidence to show that that \$1.20 is
4 unreasonable, then that evidence ought to be in and perhaps
5 it should be given effect. To the extent that now at least
6 one member, Mr. Lippitt, is excluded to the extent that
7 Canada still floats in the chamber, the issue of Canadian
8 prices or FERC prices, those only are reasonableness.

9 The point I'm making is that if in fact the
10 producers are willing now to come forward and to show you
11 the numbers that indicate that this is not enough to give
12 them a fair return, then that ought to be in the record;
13 and the reason I'm asking it here is that we didn't get it.

14 The CPUC has had a lot of trouble trying to get
15 it. Your staff has demonstrated an ability to pull documents
16 out of oil companies that seems to be unparalleled.

17 MR. McCAUSLAND: I understand we're getting better
18 at it, too. Once we finish what we're working at right
19 now --

20 MR. FALLIN: What I'm saying comes back to the
21 pragmatic points that these witnesses have made. They can't
22 be belittled. The odd thing is that they are new points,
23 and they are points that I tried to raise and everybody said,
24 oh, yeah, you're great. You'd help them out if they could
25 show they needed it. It's not a posture. If it was in the

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1 record, then we could consider it.

2 Another point that I think has to be made -- and
3 I'll talk about it a little while down the road. The point
4 has been made that it's important to explore for gas in
5 California, that it's important to bring in gas supplies.
6 In that very statement that you've heard repeated several
7 times lies a distinction between Union Island and the flowing
8 gas contracts we're dealing with here.

9 It's not just because the FPC uses the term. That
10 contract was designed -- and I'll discuss it with you -- to
11 provide both compensation for unusual value to PG&E because
12 of its timing and size and also to provide an element of
13 incentive for new gas finds in this state.

14 That has to be done very carefully. Perhaps you
15 ask yourselves, well, why is that? You're looking at it.
16 You're looking at it.

17 The reason why we have to be very darn careful of
18 that new gas incentives is because somebody is going to turn
19 around and try to club the consumers with those prices for
20 flowing gas. Mr. Williams I think very accurately described
21 the situation with respect to new gas finds in that, to a
22 certain extent, they are negotiable, but not with price.

23 We have tried to work some recognition into new
24 gas pricing having to do with exactly when the prices are
25 paid, even though the wells aren't connected and everything

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10 1 else without creating the price effect that we see coming
2 back to haunt us in proceedings like this, in proceedings
3 like the arbitration you've talked about.

4 There is no fight from this side, and perhaps not
5 from the other side, about the notion that new high costs
6 for new gas may be justified because you encourage exploration.
7 There is no question about it. That's not what we're
8 dealing with here, and the fact is that the prices you're
9 talking about, there is no guarantee.

10 We tried on a tentative basis to have contracts
11 signed by the producers which down at the bottom one paragraph
12 said, it is agreed that the increases hereinabove provided
13 will be devoted to exploration activity in California. We
14 got a resounding lack of interest in that sentence.

15 Again, if the producers can come forward and tell
16 you that they are willing to devote every cent of these
17 increases on flowing gas supplies into exploration for
18 new gas, that changes a lot of things; but that's not the
19 case. As you say, we don't have a record on their costs,
20 we don't have a record on these things.

21 In the state of the record you've got right now,
22 you'd have to assume that the cost increases can't be cost
23 justified. You have to assume it because I've asked for it
24 time and time again, and there is no evidence in the record
25 that indicates that they are. We just don't know. The state

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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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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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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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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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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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1 There is no page 187 due to numbering error
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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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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