MINUTE ITEM 10/24/68

47. CRUDE OIL PRICING PRACTICES - W.O. 5200.203.1.

The attached Calendar Item 46 was presented to the Commission for information only, no Commission action being required.

Attachment
Calendar Item 46 (2 pages)

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46.

CRUDE OIL PRICING PRACTICES

On March 28, 1968, the Commission authorized the execution of a contract for consulting services in order to fully protect the State's economic interest in the Wilmington Oil Field. The services contracted for were analysis, evaluation and recommendations regarding crude oil pricing practices and their effect on State revenues (Minute pages 315, 316). The principal focus of the study was directed to the Wilmington Oil Field because of the increasing proportion in that area of the total tideland oil production and the requirement in the Contractors' Agreement (Article 9(b)) that the price paid for oil deliveries be at least equal to the actual current market price of such oil.

The report by DeGolyer and MacNaughton lists the following conclusions:

1. The pricing of low gravity California crude oils is directly related to the price of residual fuel oil.

2. The price of residual fuel oil for the past 20 years has responded directly with the law of supply and demand, particularly as far as concerns changes in above-ground inventory.

3. Indirectly, excessive inventory of residual fuel is due to the fact that crude oil is being produced in quantities sufficient to satisfy the increasing demand for motor fuel (gasoline and diesel). This unavoidably creates above-ground fuel oil supplies. At the same time, a considerable portion of the increase in demands for fuel to generate electricity, for other industrial uses, and for space heating, once primarily markets for fuel oil, is being satisfied by natural gas and electricity.

4. Directly, the apparent reasons for excessive inventory of residual fuel oil are the successful thermal recovery project in California, and the large increase in production from the Wilmington field.

5. Foreign crude oil and product imports are not major factors in the inventory problem in District V.

6. Any change in posted price for crude oil, especially low gravity crudes, must require approximately the same change in the price of heavy fuel oil.

7. In order that higher crude oil prices may be realized for low gravity crude oils in California, the inventory of residual fuel oil must be drastically reduced.

8. An increase in price of low gravity fuel oil at this time would result in an immediate increase in heavy crude oil production and compound the inventory problem which in turn must result in a major price reduction for crude oil, probably even below the current figure.

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9. Import control imposed by federal regulation has prevented disastrous price declines at least along the seaboard of the United States.

10. Differences do exist in posted prices for crude oil between California and Midcontinent areas of the United States.

11. The stabilized and higher prices paid for crude oil in the Midcontinent area are closely associated with the control of production to meet market demand by those states which are part of the Interstate Oil Compact Commission.

12. An analysis of the difference in crude oil prices and product prices shows that for 1955 and currently the differences are at a 20-year low; that is, there is no reason to believe that refiners are making unreasonable profits.

13. In the long range, energy requirements mainly will be met by the petroleum industry which will require production of low gravity crude oils in California. Higher crude oil prices will be required to meet this energy demand.

From this review it is apparent that the price received heretofore and currently for the Long Beach Unit crude oil production has been substantially equal to the current market price of such oil. These conclusions are also applicable to the price received for crude production from State oil and gas leases producing the same gravity ranges and crude components as the Long Beach Unit.

Another complicating factor was established after completion of the study. On October 18, 1968, the Los Angeles County Board of Supervisors adopted Air Pollution Control Regulation 62.2 which will require power plants to use imported low-sulfur fuel oil whenever natural gas is not available in the five months between November 16 and April 14. Previously the use of high-sulfur fuel oil (as produced from California crude) was permissible during winter periods of gas shortages. This additional restriction will accentuate the problem of excessive inventories of residual fuel oil (Conclusion 3 above).