MINUTE ITEM

This Calendar Item No. 23 was approved as Minute Item No. 23 by the State Lands Commission by a vote of 2 to 0 at its 7/24/86 meeting.

CALENDAR ITEM

23

A 4, 10, 11, 26

S 2, 5, 7

07/24/86
LSE E-415
PRC 714
PRC 729
PRC 2966
PRC 3743
PRC 3896
PRC 6498
Willard
Gonzalez

APPROVAL OF NEW GAS SALES CONTRACTS
AND AMENDMENTS TO GAS SALES CONTRACTS,
STATE OIL AND GAS LEASES
LSE E-415, PRC'S 714, 729, 2966, 3743, 3896 AND 6498
CONTRA COSTA, SACRAMENTO, SAN JOAQUIN AND SOLANO COUNTIES

LESSEE: Chevron U.S.A., Inc.
P. O. Box 5050
San Ramon, California 94583

LEASE INFORMATION, AREA AND TYPE OF LAND:
Summarized in Exhibit "B".

APPROVALS REQUESTED:
Approval of new gas sales agreements and amendment of existing sales agreements as listed in Exhibit "A" for subject leases.

BACKGROUND: Chevron as operator of State leases has entered into individual lease and unit gas sales agreements over the years with Pacific Gas and Electric (PG&E), the only buyer of gas production in the area. Leases PRC 3743 and PRC 3896 are jointly held by Chevron and Shell. Shell's 50 percent share of the gas is transported to their Bay Area refinery for use as fuel and payment for State royalty gas is based on the price Chevron receives under its gas sales agreement with PG&E.

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These gas sales contracts state the price the "Buyer" (PG&E) is willing to pay the "Seller" (Chevron) for a minimum required purchase quantity of gas. This quantity is a percentage of the mutually agreed-to lease producibility. The percentage is called the "load factor". The load factor concept provides a means for the purchaser to meet its peak winter demands and adds value to the gas, although currently the price does not include any consideration for this flexibility.

The gas sales agreements are amended to reflect changes in price or load factor resulting from economic conditions or regulatory agency requirements.

PG&E has requested Chevron to agree to reductions in price paid it under the several gas sales agreements from $3 per MMBTU effective January 1, 1985 to $2.92 per MMBTU effective October 1, 1985, to $2.66 per MMBTU effective November 1, 1985, to $2.50 per MMBTU effective January 1, 1986, and finally to $2.23/MMBTU effective April 1, 1986.

In addition, PG&E has requested Chevron to agree to reduction of the load factor for the Rio Vista Deep Zone (LSE 415) to 33 1/3 percent from the present 50 percent. (All of the other sales agreements between Chevron and PG&E relative to State leases have a 33 1/3 percent load factor).

PG&E advised that the amendments are required to permit PG&E to comply with the California Public Utilities Commission (CPUC) approved average cost sequencing guidelines, and will preserve Chevron's present sales sequencing position (i.e., for discretary purchases Chevron's gas will have priority over interstate gas). PG&E further advised that under the CPUC mandate, PG&E will honor the minimum purchase requirements of all agreements and will make discretionary purchases only from those sellers who have agreed to the load factor of 33 1/3 percent and the proposed sales price. In addition to the above amendments, Chevron and PG&E have:

1. Entered into two new gas sales contracts for the River Island and Isleton Fields, PRC 714 and PRC 729.

2. Entered into a new gas sales agreement for a newly-issued State Oil and Gas Lease, PRC 6498, for State owned lands of the Stockton State Hospital.

3. Included newly completed Well, State 20, in the gas sales agreement dated September 22, 1967 for Lease E-415.

Pursuant to terms of the various leases, the Lessee must obtain prior state approval before entering into any sales contracts for the disposition of production from the leased lands.

A summary of the requested approvals is attached as Exhibit "A".

OTHER PERTINENT INFORMATION:

1. On October 24, 1985 the Commission deferred action on this item pending clarification of Chevron's and PG&E's stated policy during certain public hearings held by the Commission in 1977 and 1978 regarding the use of California produced gas and its impact on consumer prices. Attached as Exhibit "C" is a staff report addressing this matter.

2. Pursuant to the Commission's delegation of authority and the State CEQA Guidelines (14 Cal. Adm. Code 15061), the staff has determined that this activity is exempt from the requirements of the CEQA because the activity is not a "project" as defined by CEQA and the State CEQA Guidelines.

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

CALENDAR ITEM NO. 23 (CONT'D)

AB 884: N/A.

EXHIBITS:
A. Gas Sales Agreement.
B. State Lease Information.
C. Staff Report.

IT IS RECOMMENDED THAT THE COMMISSION:

1. FIND THAT THE ACTIVITY IS EXEMPT FROM THE REQUIREMENTS OF THE CEQA PURSUANT TO 14 CAL. ADM. CODE 15061 BECAUSE IT IS NOT A PROJECT AS DEFINED BY P.R.C. 21065 AND 14 CAL. ADM. CODE 15378.

2. APPROVE THE GAS SALES AGREEMENTS AND AMENDMENTS TO GAS SALES AGREEMENTS COVERING GAS PRODUCED UNDER STATE LEASES LISTED IN EXHIBITS "A" AND "B" AND BY REFERENCE MADE A PART HEREOF.

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EXHIBIT "A"
CHEVRON U.S.A., INC.
GAS SALES AGREEMENTS

Gas Sales Contract Date	Field	State Lease(s)	Document Submitted	Price Provision
6/30/67	Sherman Island	LSE E-415.1	Amendment 10/8/85	Modify price to $2.66/MMBTU eff. 11/1/85
8/19/85	Stockton	PRC 6498.1	Amendment 10/8/85	Modify price to $2.66/MMBTU eff. 11/1/85
7/18/57	West Thornton	PRC 2966.1	Amendment 10/8/85	Modify price to $2.66/MMBTU eff. 11/1/85
9/22/67	Rio Vista Deep (State)	PRC 415.1	Amendment 2/21/86	Modify price to $2.50/MMBTU eff. 1/1/86
5/16/40	Rio Vista (State)	PRC 415.1	Amendment 2/21/86	Modify price to $2.50/MMBTU eff. 1/1/86
1/1/56	Rio Vista Gas Unit	PRC 415.1	Amendment 2/21/86	Modify price to $2.50/MMBTU eff. 1/1/86
1/20/85	River Island & Isleton	PRC 714.1 & 729.1	Amendment 2/21/86	Modify price to $2.50/MMBTU eff. 1/1/86
11/26/68	Ryer Island	PRC 3743.1 & 3896.1	Amendment 2/21/86	Modify price to $2.50/MMBTU eff. 1/1/85
6/30/67	Sherman Island	PRC 415.1	Amendment [illegible]	Modify price to $2.50/MMBTU eff. 1/1/86
8/19/85	Stockton	PRC 6498.1	Amendment [illegible]	Modify price to $2.50/MMBTU eff. 1/1/86
7/18/57	West Thornton	PRC 2966.1	Amendment 2/21/86	Modify price to $2.50/MMBTU eff. 1/1/86
9/22/67	Rio Vista Deep (State)	PRC 415.1	Amendment 4/1/86	Modify price to $2.23/MMBTU eff. 4/1/86
5/16/40	Rio Vista (State)	PRC 415.1	Amendment 4/1/85	Modify price to $2.23/MMBTU eff. 4/1/86
1/01/56	Rio Vista Gas Unit	PRC 415.1	Amendment 4/1/86	Modify price to $2.23/MMBTU eff. 4/1/86
1/20/85	River Island & Isleton	PRC 714.1 & 729.1	Amendment 4/1/86	Modify price to $2.23/MMBTU eff. 4/1/86
11/26/68	Ryer Island	PRC 3743.1 & 3896.1	Amendment 4/1/86	Modify price to $2.23/MMBTU eff. 4/1/86
6/30/67	Sherman Island	PRC 415.1	Amendment 4/1/86	Modify price to $2.23/MMBTU eff. 4/1/86
8/19/85	Stockton	PRC 6498.1	Amendment 4/1/86	Modify price to $2.23/MMBTU eff. 4/1/86
7/18/57	West Thornton	PRC 2966.1	Amendment 4/1/86	Modify price to $2.23/MMBTU eff. 4/1/86

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EXHIBIT "A"
CHEVRON U.S.A., INC.
GAS SALES AGREEMENTS

Gas Sales Contract Date	Field	State Lease(s)	Document Submitted	Price Provision
9/22/67	Rio Vista Deep	LSE E-415.1	Amendment-12/17/84	Modify price to $3.00/MMBTU eff. 1/1/85
9/22/67	Rio Vista Deep	LSE E-415.1	Amendment-7/17/85	Reduce load factor to 33 1/3% eff. 3/1/85
6/30/67	Sherman Island	LSE E-415.1	Amendment-12/17/84	Modify price to $3.00/MMBTU eff. 1/1/85
7/18/57	West Thornton	PRC 2996.1	Amendment-9/11/85	Modify price to $2.92/MMBTU eff. 10/1/85
11/26/68	Ryer Island	PRC 3743.1 & 3896.1	Amendment	Modify price to $3.00/MMBTU eff. 1/1/85
11/26/68	Ryer Island	PRC 3743.1 & 3896.1	Amendment-9/11/85	Modify price to $2.92/MMBTU eff. 10/1/85
8/19/85	Stockton	PRC 6498.1	Amendment-9/11/85	Modify price to $2.92/MMBTU eff. 10/1/85
1/20/85	River Island & Isleton	PRC 714.1 & 729.1	Amendment-9/11/85	Modify price to $2.92/MMBTU eff. 10/1/85
1/1/56	Rio Vista Gas Unit	LSE E-415.1	Amendment-3/12/84	Modify price to $3.00/MMBTU eff. 1/1/85
1/1/56	Rio Vista Gas Unit	LSE E-415.1	Amendment-3/11/85	Modify price to $2.92/MMBTU eff. 10/1/85
5/16/40	Rio Vista (State)	LSE E-415.1	Amendment 9/11/85	Modify price to $2.92/MMBTU eff. 10/1/85
1/20/85	River Island & Isleton	PRC 714.1 & 729.1	New Contract-1/20/85	Price $3.00/MMBTU
9/22/67	Rio Vista Deep	LSE E-415.1	Amend Contract 9/6/85	Include new well, State 20, eff. 3/26/85
8/19/85	Stockton	PRC 6498.1	New Contract-8/19/85	Price $3.00/MMBTU
9/22/67	Rio Vista Deep (State)	LSE E-415.1	Amendment 10/8/85	Modify price to $2.66/MMBTU eff. 11/1/85
5/16/40	Rio Vista (State)	LSE E-415.1	Amendment 10/8/85	Modify price to $2.66/MMBTU eff. 11/1/85
1/1/56	Rio Vista Unit	LSE E-415.1	Amendment 10/8/85	Modify price to $2.66/MMBTU eff. 11/1/85
1/20/85	River Island & Isleton	PRC 714.1 & 729.1	Amendment 10/8/85	Modify price to $2.66/MMBTU eff. 11/1/85
11/26/68	Ryer Island	PRC 3743.1 & 3896.1	Amendment 10/8/85	Modify price to $2.66/MMBTU eff. 11/1/85

EXHIBIT "B"

LSE E-415.1

Chevron U.S.A., Inc.
State Lease Information

LSE E-415.1 - Lease issued on June 1940. The Rio Vista Field includes State-owned and submerged lands within an 8000 acre block of private and federal land in Solano, Contra Costa, San Joaquin and Sacramento Counties. State submerged lands are in the beds of the Sacramento, San Joaquin and Mokelumne Rivers and Threemile and Sevenmile Sloughs.

PRC 714.1 - Lease issued in April 1952. Held by Chevron and Union Oil Company. In the River Island Field, contains 377 acres of State submerged lands in the beds of the North Fork of the Mokelumne River and Georgiana Slough.

PRC 729.1 - Lease issued in June 1952. Held by Chevron and Union. In the Isleton Gas Field and contains 357 acres of State submerged lands in the bed of the Sacramento River, north of Isleton.

PRC 2966.1 - Compensatory Agreement issued in June 1962. Held by Chevron, Texaco and Union. Part of the West Thornton Field and contains approximately 294 acres of submerged lands in the Sacramento and Mokelumne Rivers and Snodgrass and Georgiana Sloughs.

PRC 3743.1 - Lease issued in April 1967. Held by Chevron and Shell. Contains approximately 2200 acres of tide and submerged lands around Ryer Island, Suisun Bay. Ryer Island Gas Field.

PRC 3896.1 - Lease issued in January 1968. Held by Chevron and Shell Oil. Approximately 1400 acres of tide and submerged lands in Suisun Bay around Middle Ground and Snag Islands, in the Ryer Island Gas Field.

PRC 6498.1 - Lease issued in September 1983 to Chevron. Contains 112 acres of State-owned lands of the Stockton State Hospital, Stockton, San Joaquin County.

State of California | EXHIBIT "C" | State Lands Commission

Memorandum

To : D. J. Everitts

Date : June 5, 1986

File No.: W 9738

From : A. D. Willard
STATE LANDS COMMISSION
245 West Broadway, Suite 425 — Long Beach, CA 90802

Telephone: ATSS
( )-

Subject : Northern California Gas Purchasing Policies

1. Review of Public Record (1977/78 Transcripts on Determination of Reasonable Market Value of Natural Gas) Regarding the Use of California Produced Gas.

On October 24, 1985, the Chairman of the State Lands Commission requested staff to review and report on P.G. & E.'s and Chevron's previous testimony on how California gas was being used for the benefit of the consumer. Did PG&E and Chevron testify that they would produce and use California gas to the maximum extent possible?

We have reviewed all records of testimony presented to the Commission (see Exhibit "1" Listing of Public Hearings) regarding the determination of reasonable market value of natural gas in Northern California in 1977 and 1978. We have also had discussions with PG&E on its present practices. The review and discussions show that there has been a shift in PG&E's practices and that this shift has occurred because of statutory and regulatory changes.

The testimony provides that it is PG&E's policy to produce California gas to the maximum extent possible given its responsibility to husband such gas for use during periods of peak demand. Mr. Jack F. Fallin, Jr. an attorney representing PG&E testified that the California Public Utilities Commission (CPUC) requires PG&E to husband California produced gas for use in meeting winter peak demands of the consumer. He further stated that although most California gas is used for peaking purposes, it is not exclusively used in that manner. A portion of California gas as required under the various sales agreements (load factors, wet well minimums and exchanges) is produced and delivered on a steady basis. Attached as Exhibit "2" are excerpts of testimony by Mr. Fallin on this matter.

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Additional testimony by Mr. Greville Way of the CPUC confirms the PUC's position on conserving California gas for use of residential customers. Although he did not specifically testify that PG&E was ordered to husband California gas for peaking use, its purchasing practice sanctioned by the PUC is evidence of its policy (Exhibit "3").

Chevron did not testify on the specific issue of its position on the production of California gas. Perhaps they felt this was a given, on the theory that producing such gas to the maximum extent possible is obviously in Chevron's best interest.

Based on preliminary results of a current audit of Gas Lease Agreement E 415, it appears that Chevron may not have enforced the minimum purchase obligations (take or pay) under certain sales contracts with PG&E. This practice may have resulted in less California gas being produced. However, such action could be consistent with PG&E's directive to husband California gas for the residential customer. Chevron's position in this matter is not yet clear as more information is being sought under the audit.

2. Reasonable Market Value

Following the lengthy investigation by the Commission for determination of the reasonable market value of natural gas in Northern California the Commission in August 1978 established such prices for the period January 1977 through June 1978. These prices were based on the evidentiary record including the results of recently completed arbitration proceedings between P.G. &E. and Texaco-Aminoil-Superior.

3. Statutory and Regulatory Changes

In November 1978 the Natural Gas Policy Act (NGPA) was enacted which continued controls over interstate supplies and extended the price controls to intrastate supplies. The regulatory framework of the NGPA provided ceiling prices with procedures for ultimate price deregulation by January 1, 1985. During the period of price controls California produced gas was initially sold below the ceiling price, but was gradually negotiated upward to the ceiling price in January 1982. PG&E's purchasing policy of

California gas was evolving during this period because of the rapidly increasing price of Canadian gas. California produced gas became an economically attractive source of supply, not only for peak winter demands but for base supplies. Thus during the early 1980's PG&E was progressively purchasing larger quantities of California gas.

In 1983 California gas purchasing policy was officially changed with enactment of the California Gas Policy Act (Section 785 of the Public Utilities Code). As amended in 1985 the act provides in part that "To the extent consistent with Federal law and regulations and contractual obligations regarding other available gas, the Commission shall ... encourage on a first priority, the increased production of gas in this state ... and shall require ... every gas corporation to purchase that gas ... which is produced in this State having an actual delivered cost, measured in equivalent heat units, equal to or less than other available gas ...".

PG&E's gas purchasing practices are established in its rate proceedings before the CPUC. When gas supply exceeds existing demand, the CPUC hearings include determination of "sequencing" guidelines for purchases of gas by PG&E. The current approved practice requires purchases of contractual and operational minimums first, then discretionary purchases are to be made sequentially, on a least cost basis. It is in PG&E's determination of "least cost" that disagreement occurs. PG&E, with confirmation by the CPUC, has determined the sequencing price for California produced gas as the average of the delivered (border) price of El Paso out-of-state and PGT - Canadian gas less $0.44/MMBTU ($0.34/MMBTU, PG&E's gathering cost of California gas, and $0.10/MMBTU, a "window" to prevent large swings in sales volumes with small changes in prices). PG&E has recently submitted to the CPUC a study of its Northern California gathering costs. The study concluded that the gathering costs applicable to its purchases from California producers should be increased from $0.34 MMBTU to $0.40 MMBTU. California producers have challenged the gathering cost and window deductions before the CPUC and the matter is under investigation with resolution expected later this year.

Therefore, presently, in order for California produced discretionary gas (above contract minimums) to be sequenced ahead of out-of-state and Canadian discretionary gas purchases it must be equal to or less than the border prices minus $0.44/MMBTU.

The key elements to assurance that California gas will be produced and purchased at maximum deliverabilities are:

1. That discretionary gas purchases are greater than the available California discretionary gas; and

2. That California gas is price competitive with El Paso and Canadian gas (after deduction of the gathering and window costs).

The discretionary gas purchases by PG&E have far exceeded the volumes of available California gas. As long as PG&E continues this practice in its negotiations of minimum take provisions, California gas can be produced and sold at maximum deliverabilities under the sequencing policy established by the legislature for the benefit of the consumer and the California producers.

Essentially all California gas purchased by PG&E is pursuant to 33% load factor (minimum purchase obligation) contracts (see attached Exhibit "4"). Sales prices for California gas have been "negotiated" (fiat by the monopoly purchaser) by insisting that producers accept the formula price or be subject to minimum contract purchases. The sequencing price effective November 1, 1985, for California produced gas was $2.66/MMBTU. This is based on the delivered cost of PG&E's El Paso out-of-state purchases of $3.11/MMBTU (the lower of PG&E's El Paso and PGT Canadian gas purchases) less $0.44/MMBTU, or $2.67/MMBTU. Therefore, pursuant to the sequencing formula approved by the CPUC, all California discretionary gas available to PG&E at $2.66/MMBTU must be purchased before any out-of-state discretionary gas purchases in order to achieve a "lease cost gas mix". Although objections have been filed with the CPUC regarding the deductions used in arriving at the sequencing price, California producers have conditionally agreed to the formula price.

Under most California gas purchase contracts prices are established on January 1 of each year (this is in addition to price changes brought about by the sequencing purchases). The annual price "negotiations" are to be based on the "fair market value". Therefore effective January 1, 1986 PG&E established the "fair market value" at $2.50/MMBTU. This price being significantly lower (0.16/MMBTU) than the sequencing price in effect under the CPUC approved sequencing guidelines. The recourse to accepting a non-negotiable price is to request arbitration under the contract, at a very lengthy and costly process. During arbitration, PG&E could and probably would discontinue taking gas under the contract, resulting in a significant economic impact, as well as a potential for reservoir damage. Such action certainly appears contrary to legislative policy and the CPUC's implementing orders.

Effective April 1 the price of gas purchased by PG&E from El Paso and Canada was $2.74/MMBTU and $2.6769/MMBTU respectively. This translates into a sequencing price for California gas of $2.23/MMBTU ($2.6769 - $0.44).

A. D. WILLARD
Supervising Mineral
Resources Engineer

ADW:vn

attachment: Exhibits 1 - 4

Exhibit "1"

Public Hearings

August 11, 1977	Public Hearing on Natural Gas Pricing conducted by staff.
September 29, 1977	State Lands Commission regular meeting - Minute Item No. 19.
January 12, 1978	Public Hearing - Reasonable Market Value of Natural Gas in Northern Califonria conducted by staff.
January 26, 1978	State Lands Commission regular meeting - Minute Item No. 55.
February 23, 1978	State Lands Commission regular meeting.
March 30, 1978	State Lands Commission regular meeting - Minute Item No. 10.
August 31, 1978	State Lands Commission regular meeting - Minute Item No. 25.

Exhibit "2"
September 29, 1977 - Meeting of the
State Lands Commission

mix of gas -- your client does. Your client chooses to use California gas for peak load only, and chooses not to use it for full utilization.

MR. FALLIN: Two things --

CHAIRMAN CORY: And you're in essence using your cheaper supply of gas -- your domestic California gas: Ryer Island, Rio Vista gas -- for peak load, not for full utilization; and you're taking Canadian gas constantly.

MR. FALLIN: First comment: PG&E doesn't get Ryer Island gas. That's an exchange arrangement. That's Standard Oil's gas.

CHAIRMAN CORY: River Island. Pardon me.

MR. FALLIN: Second, we do not use California gas only on peak. That's wrong. We do use it for a lot of peaking purposes --

CHAIRMAN CORY: These particular contracts --

MR. FALLIN: -- are not used only on peaking at all. They are used more heavily on peaking, but it's not at all accurate to say they're used only for peaking. I think the staff will agree with that statement. To carry it still further --

CHAIRMAN CORY: Let's go to your alternate fuel sources.

MR. FALLIN: I would like to finish answering your first question. We have been directed by the California

Exhibit "2" continued

very real sense this gas, the state's gas from Rio Vista, has been dedicated to those residential customers at those rates which currently recover us an absolute loss. If you want to use that system to price this Rio Vista gas, you're going to end up coming out below $1.20, because if you want to provide the cost of taking it to those residential customers and provide a rate of return on the facilities involved and back it up to a price, it's going to come out below $1.20.

That's a little bit of a long run. I think it's followable, however.

MS. SMITH: On what basis or how did you determine that the staff's method of calculating the reasonable market value is against public policy?

MR. FALLIN: Okay. Essentially that is, I guess, what you would call a matter of law as opposed to strictly a matter of fact. We know the method used. The method used was testified to by Mr. Lippitt before the staff, and Mr. Cory has confirmed the method used. It is to include those Canadian prices which have no relationship to the standard you're using, which says "market value". They're not set in any market. That's a contractual question, or a question that we all can deal with.

The second question is: how are those prices determined? It's our contention that those prices are

Exhibit "2" continued

Public Utilities Commission to husband supplies of California gas for the very reason you're talking about, for the same reason the government talks about husbanding supplies of domestic crude oil: in an attempt to defend those supplies against the fact that they're controlled from without. It's just simply that true. The Commission has told us to husband California gas.

Now that brings up a very interesting point. The staff throws up another high number in our faces, and says, "Well, gee, industrial customers pay $2.29 for gas from PG&E." The staff well knows -- Mr. Lippitt knows it perhaps better than the rest of them do -- that PG&E's rates have been skewed for policy reasons. We now have a lifeline arrangement, which means that for the lowest levels of residential gas customers, we're serving gas at essentially no return at all -- in fact, at a return which is close to if not below our average cost of purchased gas: in other words, an absolute loss.

In turn industrial customers are paying a much higher level. That's true. Putting that number in front of you and in front of the public can't be described in any other way but as deceptive.

But to carry the point a little further, the fact that PG&E has been directed to husband this gas for the California residential customer raises the point that in a

Exhibit "3"
September 29, 1977 - Meeting of the
State Lands Commission

because certainly the gas consumer has a right under contracts that the utilities or pipelines may have to the gas. The only real benefit the consumer can get is by higher price for new gas yet to be discovered. It does seem to me that that does have some benefit to the consumer. But to just continually price up gas that's not entitled to higher prices doesn't really do the consumer much benefit.

CHAIRMAN CORY: The question of gas he's entitled to: there was previous testimony that there is a public policy posture of the PUC that we should minimize our consumption of California gas. Can you explain that policy and that concept? You just stated that the consumer is entitled to that older gas. They seem to be in conflict. Is that the public policy?

MR. WAY: I think at one of the hearings two years ago a question was raised -- I think it was raised by Henry Lippitt -- as to whether or not California gas should be produced at a higher rate than it was. PG&E historically has used California gas as a peaking gas. You must appreciate that compared to the gas that is now received from Canada, and the quantity of gas that's now received from El Paso, California gas is not a major item.

Of course I guess the other thing is -- at least looking at it in a more close-to-home framework -- the

Exhibit "3" continued

Canadians about two years ago raised the issue of curtailing gas out of Canada. Certainly that's always in the wings. Therefore it doesn't seem to me that to some extent conserving the production of California gas is an advantage to the state.

But as I say, I think PG&E has contract commitments to produce a level of gas. They do produce it. They do use the gas primarily for peaking purposes.

CHAIRMAN CORY: I guess I don't like the dilemma I'm in with conflicting instructions in terms of how to look at this problem, and I presume you find yourself at the Public Utilities Commission in similar binds from time to time. But how can they use our gas for peaking rather than constant load if it's less expensive? I would feel far more compelled to seek $1.20 or even 90 cents if they were showing evidence of good faith in using that first and foremost, rather than using it for peaking and using the higher priced gas.

Am I missing something? That's where I'm really having trouble deciding who's wearing the white hat in this whole mess. I'm not sure that anybody is.

MR. WAY: If you cut back on your Canadian takes, which I certainly wouldn't advise doing, and if you cut back on your takes from El Paso, which is one way of doing it, and produce California gas at a maximum, I think you

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Exhibit "3" continued

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would exhaust California gas rather quickly, because there really is not a --

CHAIRMAN CORY: But you've got to play that hand out. If you take that statement which you just said, maybe our best public policy is to jointly go to the Legislature and say, "Hey, our public policy should be to not allow these things to be produced at all. Let's save them." I don't know. Maybe that's what we should do.

But again if we look at costs, it seems to me we should arbitrarily set all state-owned gas at 90 cents and run it out as fast as we can. I don't know the answer to that.

MR. WAY: Well, I don't either. It's certainly very complicated. But as I say, there is an advantage, I think, to also being sure that you're not totally cut off from your gas supplies if Canada or somebody else curtails.

Certainly the United States government at the present time is storing sizable blocks of oil just in assurance that the Arabs won't cut --

CHAIRMAN CORY: That is just as bizarre. We're pulling out of Elk Hills, so we have oil to keep the price down, and then taking other oil and putting it in a hole in the ground. I sort of feel like no matter what I do, it's got to be wrong.

Exhibit "3" continued

MR. WAY: Could well be.

(Laughter.)

MR. WAY: I don't think there are easy answers to any of these questions or that there is one definitive answer.

MR. McCAUSLAND: I move we go to the Legislature and cap all the wells.

CHAIRMAN CORY: I'm prepared to go to the Legislature if I could figure out what the hell to ask them for. I really can't identify what the best position for the public is. I really honestly can't.

I see some inconsistencies. Your statement is very simple and very brief and sounds very nice, but the reasons you buttress it with seem to be at loggerheads with one another, and I can't figure out what the hell to do.

MR. WAY: Well, perhaps not, but the other thing you must appreciate is that gas in the ground is like money in the bank. If it's not produced, it's there. But you also must appreciate that the producers have expended a considerable amount of money to explore and develop gas that is now being produced. Certainly I think there's an entitlement on their part to recover these investments, so I think --

CHAIRMAN CORY: I'm just wondering, though: maybe we should jointly go and condemn it back. Pay them what

Exhibit "3" continued

they've got in it, and get out of these inane contracts we have with two middlemen. We take the people's gas, sell it to two middlemen, who make a profit on it, to sell it back to the people. Harry Truman had a word for that.

MR. WAY: I think the only one who is making a profit on it is the producers, because PG&E does not make a profit on the product they sell as a cost of gas. What they're making a profit on is their investment in the facilities to deliver the gas.

CHAIRMAN CORY: What would be the effect of that last statement, so I understand it. If we decided not to produce the gas, would their capitalized cost of that gathering system still be in their rate base or not?

MR. WAY: Yes, it would, but you must appreciate it would have an impact on the consumers in that PG&E would want to recover the cost of its facilities, which are not being used to the extent that they had previously been used. So if you did cut off the production of California gas, you would have, to some extent, a rate increase out of that.

CHAIRMAN CORY: So they've got the system rigged so that no matter what, they get the rate increase.

MR. WAY: I'm not sure it's rigged. I think it's all by law or statute as to what they're entitled to recover.

Exhibit "3" continued

If you want to do what you want to do, it would be to pass something in the Legislature forbidding any more exploration activities beyond developmental drilling within reserves that are now known.

CHAIRMAN CORY: I don't know if that's what I want to do. I'm trying to ask you if you have any --

MR. WAY: I think that would be one way of approaching what you want to do. That would then maintain the production from the present reserves. But it could of course have an impact on --

CHAIRMAN CORY: -- long-term gas supplies.

MR. WAY: Yes, you could have an impact on the availability of gas into the future.

CHAIRMAN CORY: Staff, why don't you bring us easy problems?

MR. McCAUSLAND: Let me ask a question.

CHAIRMAN CORY: Go ahead.

MR. McCAUSLAND: Along that line of thinking, if we stayed at $1.20, there's relatively little incentive to upgrade the production capability of the existing fields. Is there any thought in your mind that there might be adequate supplies under the ground -- that if the price were raised those fields would be producing at a higher level and consequently exhaust it sooner?

MR. WAY: Well, of course, that could well come to

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EXHIBIT 4

PG&E NATURAL GAS SUPPLY

1985/86 Sources	Supply BTU x 10^9	Percentage of Total	Price $/MMBTU
El Paso	317.377	40.5	3.11
Canada	302.365	38.5	3.14
California	147.434	18.8	2.66
Rocky Mountain	17.519	2.2	3.46

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