

**STAFF REPORT**

**57**

A 70  
S 33, 34

06/23/20  
503.2118  
J. Fabel  
M. Wiemer

**CONSIDER APPROVAL OF THE PROPOSED 2020 LONG BEACH  
TIDELANDS DRY GAS PRICE AGREEMENT, WILMINGTON OIL FIELD,  
LOS ANGELES COUNTY**

**PARTIES:**

California State Lands Commission

City of Long Beach

**BACKGROUND:**

In 2010, the Commission and the City of Long Beach (City) entered into the 2010 Long Beach Tidelands Dry Gas Price Agreement (2010 Agreement), which sets the reasonable wholesale market value that the City pays to the State for a majority of the Long Beach Tidelands (Tidelands) dry gas produced during Tidelands oil production operations. The price applies to the dry gas the City receives into its municipal gas system or that it is able to sell under short-term contracts to third parties ([Item C48, April 6, 2010](#)). Section 6 of Chapter 29 of the Statutes of 1956, First Extraordinary Session (Chapter 29) requires the Commission and the City to determine jointly, from time to time, the reasonable wholesale market value of such dry gas received by the City. The first dry gas agreement was entered into in 1967 with revisions in 1981, 1988, 1992, 2001, 2003, and most recently 2010.<sup>1</sup>

By statute, the State receives 100 percent of the value of dry gas produced in the Tidelands. (Chapter 29, Statutes of 1956, § 5, subd. (a)(3).) The Tidelands were granted in trust by the Legislature to the City. Chapter 29 was enacted to resolve a dispute that arose after such grant between the City and the Commission regarding the City's obligation to account for or pay oil and dry gas revenue to or for the benefit of the State. (Chapter 29, Statutes of 1956, § 3.)

Dry gas that is not used in the field to fuel repressuring operations is treated. The treated dry gas is then either used to run the gas-fired power plant owned by the City to power oil operations or sold to the City for use in its municipal system or for sale to third parties, or if those options are not available, the gas is flared.

---

<sup>1</sup> Revisions were generally negotiated in response to regulatory changes to the state and federal gas market that eliminated or altered indices used to value the State's dry gas.

STAFF REPORT NO. 57 (CONT'D)

There are no pipelines capable of physically transporting the State's dry gas directly to a market for third-party sales. Due to infrastructure limitations, the only available purchasers are the City or the City's contractor, California Resources Corporation.

Under the 2010 Agreement, the State was paid for its share of dry gas at the same price the City was paid under a short-term sales contract to Merrill Lynch Commodities, Inc. (MLCI), set at the reported market index "Spot Gas Prices: California – Southern Cal. Border Average," (Border Price) minus \$0.05 per million British Thermal Units (MMBtu).<sup>2</sup> Upon the expiration of the MLCI contract in 2016, the value reverted to another index, "Spot Gas Prices: California – SoCal Gas Citygate," (Citygate Price) minus \$0.05.<sup>3</sup> Historically, Border Price and Citygate Price indices have been comparable with only minor price differences between them; however, Border Price has always been identified as a wholesale price index whereas Citygate is a retail index.

Since late 2015, several events affected the Southern California dry gas market causing significant volatility in the Citygate Price. In October 2015, the Aliso Canyon gas storage facility suffered an incident that took that facility offline for gas storage and, in 2017, several desert pipelines supplying gas to Southern California failed, restricting supply. As a result of the combined constraint on gas flows into the Los Angeles basin and limited storage at Aliso Canyon, the Citygate Price began to oscillate when demand rose to near total physical supply. Since October 2017, inclement weather events have caused gas demand to exceed supply causing the Citygate Price to spike up to \$8 per MMBtu higher than the Border Price.

Given the extraordinary volatility in the Citygate Price, relative to other available indices, and given that the volatility is due to regional supply constraints on the SoCalGas system, which Tidelands gas does not access, in January 2019, the City requested to renegotiate the reasonable wholesale market value of the State's dry gas. The result of the negotiations between City staff and Commission staff is the proposed 2020 Long Beach Tidelands Dry Gas Price Agreement. The Long Beach City Council approved the proposed 2020 Long Beach Tidelands Dry Gas Price Agreement pursuant to a minute order adopted at its meeting held on April 21, 2020. ([Agenda Item C-3, File 20-0325.](#))

---

<sup>2</sup> Border Price is the average price index tracking sales at the California/Arizona border for natural gas deliveries into the Southern California Gas system.

<sup>3</sup> Citygate Price is the average price index tracking natural gas sales at the trading hub for the Southern California Gas local distribution system in Southern California.

## STAFF REPORT NO. 57 (CONT'D)

### **STAFF ANALYSIS AND RECOMMENDATION:**

#### **Authority:**

Chapter 29, Statutes of 1956, First Extraordinary Session; Chapter 138, Statutes of 1964, First Extraordinary Session; Chapter 941, Statutes of 1991; Chapter 446, Statutes of 2008.

#### **State's Best Interests Analysis:**

The proposed 2020 Long Beach Tidelands Dry Gas Price Agreement (Agreement) will value the State's share of dry gas produced in the Tidelands at the Border Price (with no adjustment), retroactive to February 1, 2019.<sup>4</sup> The Agreement applies to the State's share of all dry gas produced (Tract 1 and 2 of the Long Beach Unit and all tracts within the Tidelands Units) regardless of whether it is used in the City's municipal system or power plant.

Staff researched the various indices in the Southern California gas market and found that the Border Price best reflects the wholesale value of Tidelands dry gas, making a new agreement appropriate. The Border Price better approximates an objective wholesale price than the Citygate Price, which is a retail index. Further, supply and transportation constraints create significant and ongoing volatility in the Citygate Price that do not reflect the wholesale market or the circumstances within the Tidelands.

Chapter 29 provides that the value of dry gas should be the reasonable *wholesale* market value of such gas. But, as noted above, "Citygate," which is a commonly used industry term, is not a wholesale gas index but a retail index for gas priced to account for the costs to deliver across an interstate pipeline into a local utility's system. It incorporates the cost of transportation from a wellhead to an end-user. "Wholesale price" is commonly defined as the price paid by a purchaser of gas at the wellhead. Wholesale prices are lower than retail prices because the transaction occurs before transportation over potentially long distances. The 2010 Agreement set the fallback dry gas value at the Citygate Price minus \$0.05 to deduct the transportation costs built into that index and reach a value equivalent to wholesale.

---

<sup>4</sup> The 2010 Dry Gas Agreement allowed prices to be retroactively set to 30 days after the City or State first request negotiation. The City had errantly been paying the Border Price since 2016. A Commission staff audit found that the City owes approximately \$242,000 for the difference between the Border Price and Citygate Price from 2016 through January 2019. The City accepted these findings and agreed to pay this amount.

## STAFF REPORT NO. 57 (CONT'D)

Now because of significant price volatility, the Citygate Price no longer correlates with wholesale market trends—even with the \$0.05 deduction—leaving the Border Price as a more appropriate wholesale market index. Between 2008 and 2016, the Border Price and Citygate Price tracked closely with only small price differentials ( $\pm$ \$0.20) to account for the added transportation costs within the Citygate system. But the October 2015 Aliso Canyon incident and subsequent desert and regional pipeline restrictions created supply constraints within the Citygate system. According to independent assessments, the Citygate Price oscillated when demand outpaced the supply within the affected system. In December 2018, the Citygate Price was \$8/MMBtu higher than the Border Price and varied significantly leading up to that period. From the reporting of NW Energy Coalition, a clean energy nonprofit organization, that variation was linked to supply and transportation constraints within the SoCalGas Citygate system. These price oscillations continue.<sup>5</sup>

Tidelands dry gas does not enter the SoCalGas Citygate system. Dry gas is produced offshore, transported by Tidelands Unit-owned pipelines into the Tidelands gas treatment plant, then either used to operate the Tidelands power plant or sold to the City for use in its municipal system. Valuing Tidelands dry gas at the Citygate Price rather than the Border Price artificially inflates the value of the dry gas based on transportation constraints that do not exist within the Tidelands gas system.

Staff believes that execution of the Agreement is in the State's best interests because it ensures that the State is receiving the reasonable wholesale market value for its Tidelands dry gas, as contemplated by Chapter 29. The Border Price approximates a wholesale value and lacks the significant price volatility of the Citygate Price, which is caused by supply constraints within the region unrelated to the production, transportation, and use of Tidelands dry gas.

### **OTHER PERTINENT INFORMATION:**

1. Most dry gas produced from the Tidelands is used to power the City's power plant. The proposed Agreement clarifies that the value of the State's share of dry gas used in the power plant will be valued at the Border Price. This language will replace the valuation mechanism for power plant gas developed in the 2004 Interim Agreement for Sale of Tidelands Dry Gas to the Long Beach Unit Power Plant ([Item C49, December 9, 2004](#)).

---

<sup>5</sup> See *Double Squeeze: How the Artic Express and natural gas constraints are turning the West Coast gas and power markets upside down*. <https://nwenergy.org/wp-content/uploads/2019/03/double-squeeze-final.pdf>.

STAFF REPORT NO. 57 (CONT'D)

2. Approval of the 2020 Long Beach Tidelands Dry Gas Price Agreement is not a project in accordance with the California Environmental Quality Act because it is an administrative action that will not result in direct or indirect physical changes in the environment.

Authority: Public Resources Code section 21065 and California Code of Regulations, title 14, sections 15378, subdivision (b)(5).

3. This action is consistent with Strategy 2.1 of the Commission's Strategic Plan to optimize returns for the responsible development and use of State lands and resources, both onshore and offshore.

**EXHIBIT:**

- A. 2020 Long Beach Tidelands Dry Gas Price Agreement

**RECOMMENDED ACTION:**

It is recommended that the Commission:

**AUTHORIZATION:**

1. Approve the 2020 Long Beach Tidelands Dry Gas Price Agreement substantially in the form of the agreement set forth in Exhibit A, attached hereto.
2. Authorize the Executive Officer or her designee to execute any documents necessary to implement the Commission's action.

## EXHIBIT A

### **2020 LONG BEACH TIDELANDS DRY GAS PRICE AGREEMENT**

This 2020 Long Beach Tidelands Dry Gas Price Agreement (Agreement) is dated as of June 23, 2020, for reference purposes only, and is executed by and between the City of Long Beach (City) and the California State Lands Commission (State). Pursuant to section 6 of Chapter 29 of the Statutes of 1956, First Extraordinary Session, the City shall receive into the system of its municipal gas department all Long Beach Tidelands (Tidelands) dry gas that it can economically utilize, and which is not required for oil field injection or repressuring operations in the Tidelands. The City shall pay to the State the reasonable wholesale market value as jointly determined by the City and the State for such gas. Dry gas revenue is defined in Chapter 29 to include the reasonable wholesale market value of both this gas received into the municipal system and the net receipts to the City from the sale of Tidelands dry gas not received into the system. The City and the State's most recent determination of the reasonable wholesale market value of Tidelands dry gas is reflected in the 2010 Long Beach Tidelands Dry Gas Price Agreement dated March 16, 2011 (2010 Agreement).

In 2007, the Long Beach Bond Finance Authority (LBBFA) entered into a long-term agreement with Merrill Lynch Commodities, Inc. (MLCI) pursuant to which LBBFA prepaid for a supply of natural gas. LBBFA receives the prepaid natural gas pursuant to the agreement with MLCI and delivers the gas to the City for use in its municipal system at a discounted price pursuant to a separate natural gas supply agreement (Pre-Pay Supply Agreement). The Pre-Pay Supply Agreement decreased the City's need for Tidelands dry gas in the City's municipal system, but a need arose for Tidelands dry gas at the Long Beach Unit Power Plant (Power Plant). The City sells the majority of Tidelands dry gas to

## EXHIBIT A

the Unit for use at the Power Plant, rather than taking the dry gas into the City's municipal system.

The City gave notice under the terms of the 2010 Agreement for a renegotiation of the reasonable wholesale market value of Tidelands dry gas, and the ensuing negotiations between the City and the State resulted in this Agreement. Therefore, the City and the State agree as follows:

1. The City shall accept Long Beach Tidelands dry gas into the City's municipal gas department system whenever it can be utilized economically.

2. Beginning retroactively on February 1, 2019 (Effective Date), and continuing thereafter, the reasonable wholesale market value of Long Beach Tidelands dry gas shall be First of the Month Price published by Natural Gas Intelligence under the heading "SoCal Border Average Bidweek" California natural gas prices.

3. The price of Tidelands dry gas that is the subject of this Agreement and that is agreed upon in Paragraph 2 shall be applicable to all Tidelands dry gas received into the City's municipal system and all Tidelands dry gas used at the Power Plant. Specifically, Tidelands dry gas includes all dry gas produced in the Long Beach Unit, Tract 1 and Tract 2, and in the Tidelands Unit/West Wilmington.

4. This Agreement supersedes the 2010 Agreement in its entirety, and after the effective date such 2010 Agreement shall have no further force or effect.

5. If either the City or the State believes that the price established by this Agreement no longer reflects the reasonable wholesale market value of Tidelands dry

EXHIBIT A

gas, either the City or the State may demand a renegotiation of this Agreement. The demand for renegotiation shall be made in writing and shall provide a factual basis for the belief on which the demand is based. Upon the making of a valid demand for renegotiation, the City and the State shall commence negotiations in good faith on a new pricing mechanism for Tidelands dry gas within 30 days of the notice. If a new price is agreed upon, the price shall be adjusted retroactively to reflect the newly established price from 30 days after the date of the notice demanding a price renegotiation.

6. This Agreement shall remain in effect until a new agreement takes its place or until the City and the State mutually determine that this Agreement no longer is needed for purposes of valuing Tidelands dry gas.

7. This Agreement has been approved on behalf of the City by the Long Beach City Council pursuant to a minute order adopted at its meeting held on April 21, 2020 and on behalf of the State by the California State Lands Commission, at its meeting held on June 23, 2020.

CALIFORNIA STATE LANDS  
COMMISSION

\_\_\_\_\_, 2020

\_\_\_\_\_  
Jennifer Lucchesi, Executive Officer

CITY OF LONG BEACH, a municipal  
corporation

\_\_\_\_\_, 2020

By \_\_\_\_\_  
Tom Modica, City Manager

This Agreement is approved as to form on \_\_\_\_\_, 2020.



EXHIBIT A

CHARLES PARKIN, City Attorney

By \_\_\_\_\_  
Richard Anthony, Deputy City Attorney