Section 11

Tucker
KBF
10/15/87

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
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MMS CORRESPONDENCE CONTROL

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ACTION OFFICE:	[ROY]	DATE RECEIVED IN MMS:	[09-30-87]
CC:	[ ]	DATE DUE TO REQUESTOR:	[10-15-87]
	[ ]	>>>>>>DATE DUE TO MMS:	>[10-14-87]
		DATE COMPLETED:	[ ]

TO: [BETTENBERG, WILLIAM]

SURNAMES REQUIRED: [ ]
[ ]

FROM: [TUCKER, JAMES CONTROLLER]

FOR SIGNATURE OF: [DIRECTOR]

SUBJECT: [COMMENTS ON REFINED PRODUCT VALUE ANALYSIS]
[ ]

COMMENTS: [ ]

STATUS: [ ]
[ ]
[ ]

"Dead Issue"
Sant will personally respond.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
WASHINGTON, DC 20240

Mr. James Tucker
Chief Deputy Controller
State of California
P.O. Box 942850
Sacramento, California 94250-0001

Dear Mr. Tucker:

Thank you for your letter of September 25, 1987, which conveys your views regarding the Refined Product Value (RPV) method of analyzing oil prices. Your letter also included responses by the California State Controller's Office (SCO) to comments of our staff regarding RPV analysis. I will first respond to some of the points made in your letter and then summarize our views on application of RPV methods in relation to our current and future requirements for assuring receipt of fair royalty value. Comments on the SCO responses, as well as other related points, are provided in the enclosure prepared by the Minerals Management Service (MMS) staff.

Various points in your letter of September 25, 1987, together with our responses, are as follows:

- You felt that our analysis of the RPV method relied on some fundamental misconceptions concerning the RPV program and some misinformation about California crude oil markets. You pointed out that the principal intended usage of RPV was to provide an independent cross-check of the "bona fides" of prices reported for royalty purposes.

<u>Response</u>

Even as a cross-check of field posted prices, we do not intend to rely on net-back analyses of any type except as a method of last resort. The new oil valuation regulations as presently proposed continue and amplify this position. More detail on this point is provided in the enclosure.

- You go on further to say that once an RPV cross-check establishes a posted price as invalid, RPV could also be useful in establishing royalty value.

<u>Response</u>

We do not agree that the RPV cross-check as proposed can, in and of itself, establish that a given posted price is either valid or invalid. Neither do we agree that RPV should be used in establishing royalty value. The real issue here in determining whether postings represent market value is whether a competitive and open market exists. An RPV analysis cannot provide an answer to this question. The volume of litigation resulting from even limited application of RPV for such purposes in California would likely be staggering.

- You quote Assistant Secretary Griles as having acknowledged differences between west coast crude oil markets and crude oil field pricing elsewhere in the country. You also say that his statement has been ". . . fully corroborated by studies made by the Department of Energy."

Response

Few would disagree that there are differences between crude oil markets on the west coast and elsewhere, but this alone does not demonstrate underpricing of west coast crude oil. We presume your reference to Department of Energy studies applies to the article, "California Crude Oil Price Levels," in Energy Information Administration's July 1987 edition of Petroleum Marketing Monthly. That study identified several possible factors that could explain the difference in west coast oil pricing and oil pricing elsewhere in the United States. None of these factors individually were found to explain the entire pricing difference, but neither was any conclusion drawn that west coast crude oils are underpriced. Given these facts, and the lack of proof of underpricing, MMS will generally continue to rely on crude oil posted prices in California as an acceptable value basis.

Conclusions

The issue here is whether the royalty value paid for California oil production is market value. You maintain that RPV results can establish the validity of posted prices. You further maintain, however, that RPV is a valid method for actually valuing products for royalty purposes.

We continue to believe that the best available indicators of market value are the oil contract and posted prices actually paid for the first product, crude oil. Our proposed regulations reflect this fact. We have no reason to believe that the results of an RPV analysis would be more valid. Most importantly, we have no evidence of undervaluation of California crude oil that would render contract and posted prices invalid.

We cannot agree that where the results of an RPV analysis are inconsistent with a posted price, the posted price must be deemed invalid as a market value indicator or must necessarily be the subject of further investigation. Until or unless specific instances of undervaluation are proven, we cannot agree that an RPV analysis has any utility as either a cross-check of posted prices or as a method of final royalty value determination. To apply RPV analysis in lieu of market prices would imply acknowledgment that it is a fairer method for establishing royalty value than the market itself.

Even though MMS does not intend to require the usage of RPV or any similar net-back procedure as an audit tool or cross-check of the validity of posted prices by its auditors, all royalty payments are subject to audit. If normal audit procedures or other evidence demonstrate that undervaluation has taken place, MMS will take all reasonable steps to assure that proper royalty values are assessed retroactively and prospectively.

I understand your concerns related to the proper valuation of California crude oil. Likewise, I trust that you understand our position. I appreciate your interest in the issues involved and hope we have continued, constructive dialogue in the future.

Sincerely,

Director

Enclosure

ROYALTY MANAGEMENT PROGRAM
Minerals Management Service

California State Controller's Office Comments on Use of the Refined Product Value in California

General Background

- By letter of September 25, 1987, the Chief Deputy Controller (CDC) of the State of California wrote the Director, Minerals Management Service (MMS), concerning application of the Refined Product Value (RPV) method of valuing crude oil for royalty purposes. Enclosed with that letter were responses by the California State Controller's Office (SCO) to comments made by MMS staff regarding RPV analysis and transmitted by letter of December 9, 1986.

Findings and Conclusions

SCO Responses

(1) State Sell-offs

- If the MMS staff was wrong in its statements regarding "sell-off" crude oil, it was only to the extent that it received inaccurate information from the City of Long Beach. That information showed at least two negative bonus amounts, for 1-year contracts beginning October 1, 1985, and June 1, 1986, respectively. Further, no representation was made by the MMS staff that the information presented related to the period 1981 through 1983. In fact, a clear reference was made to sales conditions existing at the time of MMS's visit to California on July 10 and 11, 1986.

(2) The Pending Antitrust Case

- The MMS staff stated only that the Federal District Court ruled there was no conspiracy to artificially constrain prices and that this decision was being appealed. We agree with the SCO statement that the issue of undervaluation does not depend on a finding of conspiracy. However, MMS has seen no proof of underpricing and has no basis to assume that it has taken place. (This is not to say, of course, that MMS auditors will not diligently pursue valuation questions in California--it simply means that MMS cannot accept RPV price comparisons as proof of undervaluation per se.)

(3) Administrative Costs

- As a practical matter, it would be difficult for MMS to institute RPV analysis <u>just</u> for California or for specific time periods. If applied in California, these same methods should be applied to all Federal and Indian leases.

- The SCO also comments that ". . . regular use of an RPV program would significantly reduce the difficulty and cost of determining value for audit purposes." A significant reduction in difficulty and cost of actually determining value is difficult to imagine, given that SCO proposes RPV to be principally an audit tool to identify potential problems. The only way RPV could significantly reduce the difficulty and cost of value determinations would be if it were applied extensively as a royalty value <u>determinant</u>. This MMS cannot do under its existing or proposed regulations.

- Mr. Bettenberg's remarks of April 2, 1987, at the MMS/State/Tribal meeting were apparently misunderstood. The Product Value Exception Routines he referred to are meant to check lessee-reported prices against a reference data base to assure proper value reporting. In the case of oil, the reference data would likely consist of field posted prices, perhaps as acquired from various independent services. Significant differences in reported versus expected prices could result in additional royalty billings.

  This is quite different from applying a net-back procedure such as RPV, which as SCO has noted would be used primarily as an audit tool. No direct billings could be made as a result of RPV application in a given case. The administrative problems with RPV application are not limited to cost considerations.

(4) <u>Posted Prices as "Market-determined" Prices</u>

- As will be discussed separately below, the new proposed (and soon-to-be-final) oil product value regulations rely primarily on arm's-length contracts or, in the case of non-arm's-length transactions, a prioritized benchmark system. In the benchmark system, net-back analysis is the procedure of last resort. Of course, where gross proceeds to the lessee can be shown to be higher than would result from application of value determined by the arm's-length contract price or the benchmark system, then such higher value would apply as the royalty basis. The benchmark system relies heavily on field posted prices, as do current MMS royalty valuation procedures.

- The SCO's dominant theme here is that RPV analysis can identify those instances where California postings are suspect. However, once these "suspect" prices are identified, the next step is obviously to determine the proper royalty value. In his letter of September 25, 1987, the CDC suggested that RPV or some similar net-back method is the only means of accounting for the full value of California crude oil. We cannot agree with this stance and feel that net-back procedures should only be used on a limited basis; e.g., where the form of the original lease product has changed subsequent to production in order to derive a marketable product and no clear value attaches to the original product (as with geothermal resources). The RPV or other net-back procedures do not directly measure the value of the produced commodity (oil) itself, as do methods relying on arm's-length contracts and posted prices.

- Application of RPV or any other net-back procedure as an up-front price check does not and cannot, per se, prove undervaluation. Likewise, we could not agree that, because we cannot fully explain the differences in gulf coast and California crude oil price postings, there is a prima facie showing of undervaluation in California. (The Energy Information

Administration, in its July 1987 edition of Petroleum Marketing Monthly, published an article titled, "California Crude Oil Price Levels." This article attempted to explain the reasons for different crude oil price levels in the gulf coast and California markets. No conclusions were drawn, and the differing prices went unexplained.)

(5) Assumptions as to Transportation and Refining Costs

- The SCO discusses the fact that transportation and refining costs can be estimated for RPV purposes. We, of course, acknowledge this fact but point out at the same time that no such assumptions are needed where value is tied to arm's-length contracts or posted prices.

(6) RPV Lag

- The SCO states here that if the cross-check mechanism (RPV) discloses a significant variance from the asserted price, even though the RPV does not provide an absolute "price" on a given day for a particular transaction, an appraisal may be used to set fair market value. Obviously this is true, but the appraisal method of first choice traditionally is that of "comparability." Establishment of "comparability" is the aim of both the current and proposed MMS product value regulations, which rely heavily on posted prices. We can agree that, if the RPV method is used only as a cross-check mechanism, the lag problem would probably not be severe.

Current and Proposed Oil Product Value Regulations

- The current oil product value regulations at 30 CFR § 206.103 (1986) (onshore) and § 206.150 (1986) (offshore) require consideration of several factors, including the highest price paid for a part or majority of like-quality products in the field or area, prices received by the lessee, posted prices, regulated prices, and other relevant matters. The royalty value is not to be less than the gross proceeds accruing to the lessee. Historically, net-back valuations of any form have been used sparingly. Recently they have been applied only where (1) there was no direct market for the initial product (geothermal) and it was converted to another form to make it marketable (electricity), (2) electricity was generated from leasehold oil production and then sold (gross proceeds), and (3) where the product was temporarily converted to another form, transported over a long distance by the lessee, reconverted, and sold at the distant point (liquefied natural gas).

- The second "draft final" version of the revised oil product value regulations is due to be published in the Federal Register of October 23, 1987. This second further notice of proposed rulemaking is being issued to obtain additional public review and comment. The preamble to these proposed regulations discusses comments received from various sources (up to the time the new draft was written) and provides MMS responses. Net-back procedures were addressed by commenters several times, and some of the MMS responses in the preamble are as follows:

- The performance of labor intensive net-back calculations on a routine basis is impractical.

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- MMS's intent is that a net-back method be used for valuation primarily where the form of the lease product has changed, and it is necessary to start with the sales prices of the changed product and deduct transportation and processing costs. An example would be where oil production from a Federal lease is used on lease to generate electricity which is then sold. If the value of the oil cannot be determined through application of the first four benchmarks in the regulations (see § 206.102(c)), then a net-back method would involve beginning with the sale price of the electricity and then deducting the costs of generation and transportation, thus working back to a value at the lease.

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- The MMS believes that a prioritized benchmark system is workable and fair.

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- The MMS believes that the use of a net-back analysis on a routine basis to verify oil value is impractical and unnecessary.

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- The MMS believes that the proposed benchmark system is a valid and realistic system for determining the value of oil not sold pursuant to an arm's-length contract.

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- The MMS agrees that there will be infrequent use of the net-back method. It is believed, however, that the other benchmarks which have higher priority will result in a reasonable value for royalty purposes and obviate the need to undertake a labor-intensive net-back method. The MMS routinely will verify lessee-generated information used in applying the benchmarks during its monitoring process and through audit.

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- The MMS believes that gross proceeds received under arm's-length contracts and posted prices used to purchase significant quantities of oil in arm's-length transactions generally represent the market value of oil and does not agree that it is necessary to perform a refined product net-back analysis to verify them.

- As can be seen from the quotes above, it is not MMS's intent to adopt a policy which would, in effect, "follow" products to the tailgate of the refinery in order to determine oil royalty value at the lease.

- Valuation standards are provided at § 206.102 of the proposed regulations. For oil sold arm's-length, the royalty value shall generally be the gross proceeds accruing to the lessee. For non-arm's-length transactions, royalty value is to be determined according to the first-applicable of the following (in abbreviated form):

  1) The lessee's posted prices or other field or area contract prices used in arm's-length transactions for purchases or sales of significant quantities of like-quality oil, provided comparability exists between these prices and other contemporaneous prices at arm's-length in the field or area;

  2) The arithmetic average of contemporaneous posted prices used in others' arm's-length transactions;

  3) The arithmetic average of other contemporaneous arm's-length contract prices;

  4) Prices received in arm's-length spot sales and other relevant matters; or

  5) A net-back method or other reasonable method.

- The proposed regulations also provide that under no circumstances is the royalty value to be less than the gross proceeds accruing to the lessee, less applicable allowances.

- Important to the SCO concerns is proposed § 206.102(k), which states:

  > Notwithstanding any provision in these regulations to the contrary, no review, reconciliation, monitoring, or other like process that results in a redetermination by the MMS of value under this section shall be considered final or binding as against the Federal Government, its beneficiaries, the Indian Tribes, or allottees until the audit period is formally closed.

Section 12

Market Valuation of Domestic Crude Oil for Royalty Purposes

Presented to the
Minerals Management Service

by

Mike Harris

Reed Consulting Group

August 22, 1996

Presentation Outline

- Introduction
- Distinctions and Definitions
- A General Approach to Valuation Analysis
- MMS Questions About Valuation
- Issues to Consider/Recommendation

Introduction

- Presenter's Background
  - Educational: Dissertation research (California)
  - Professional: Focus of consulting assignments and associated research
  - Technical Skills: Mathematical modeling and empirical methods
  - Qualifications as related to this assignment
    - Understanding of the dynamics of pricing domestic crude
    - Expertise in the fundamental of transportation in the US. oil market
    - Understanding of effects of sulfur, API gravity, etc.
- Perspective for Today's Presentation
  - Valuation frameworks
  - Definition and identification of appropriate benchmarks and indices
  - Underlying determinants of crude oil value
  - Empirical methods

Distinctions and Definitions

- Auditing vs. Valuation
- Competitive Market Value vs. Market Value
- Terms:
  - Market Value
  - Fair Market Value
  - Open Market Value
  - Reasonable Market Value
  - Comparable Market Value
  - Arms Length Transaction

General Issues to Consider in a Valuation Analysis

Valuation Objective:
Competitive Market Valuation or Comparable Market Valuation

Motives of Producers/Sellers

- Competitive Market Valuation
  - Is market competitive or likely to be competitive?
    - Structural and empirical evidence
    - Degree of integration with other markets
  - If not competitive, what is market structure?
    - Quasi-monopoly
    - Oligopoly
    - Price Leaders
  - Focus of analysis
    - Price evidence internal to market
      - Netback models
      - Statistical models
    - Price evidence external to market
      - Price of foreign imports
      - Spot and futures market prices
      - Other regional markets
      - Other commodity markets

General Issues to Consider in a Valuation Analysis (cont.)

- Comparable Market Valuation
  - Market Concentration
    - If high market concentration ⇒ Price evidence external to market is required or netback model
    - If low to moderate concentration ⇒ Price evidence internal to market is acceptable
  - Homogeneity of products
    - Quality
    - Location
    - Other Attributes
    - If homogeneous products ⇒ Market value = average price of comparables
    - If heterogeneous and sufficient variability ⇒ Market value = average price of comparables derived directly or via statistical techniques (e.g. hedonic models)
    - If heterogeneous and sufficient variability does not exist ⇒ Price evidence external to market required or netback
- Motives of Producers/Sellers

MMS Questions

- What does posted price actually mean? -- Is it an offer to buy? Is it different today vs. in the past?
  - Traditionally an offer to buy -- a firm offer?

- What percentages of purchases or sales are made at posted prices?
  - Traditionally a large portion of sales are made at posted prices

- Can you explain why competing companies' posted prices have historically moved in tandem?
  - California: Market imperfections
  - East of California: "Rules of Thumb" and price leaders

MMS Questions (cont.)

- What happened to posted prices in 1992 when they appeared to have diverged? What changed in the market?
  - Posted prices tend to diverge with market shocks.
- Briefly outline how most crude oil is marketed and sold today.
  - California: Exchanges, swaps, intra-company transfers
  - East of California:
- What relative percent of crude oil production is disposed of by each of the following cases?
  - Sold to third party at the lease
  - Sold to third party after it is transported to a refining center
  - Transferred to producer's refinery or an affilitated refinery
  - Sold after it is transported by another party
  - Exchanged under a buy-sell agreement
  - Transferred under an exchange agreement where no price is referenced

MMS Questions (cont.)

- What part of value is determined by location vs. its intrinsic value (*i.e.*, is the effect of location simply the cost of transportation or is value added to the oil by moving it to refining centers)?
  - Statistical models indicate that premium/discount for location is secondary to quality attributes.
  - Implicit transportation cost of a barrel of oil generally not equivalent to tariff rates.
- If location differentials amount to more than the cost of transporting oil, how can we segregate value added to oil which may not be royalty bearing?
  - Posted prices in many cases reflect the wellhead not delivered value
  - Statistical methods can be used to estimate implied location differential.
- Do you consider buy-sell agreements (where a price is referenced) to be actual arm's length sales? What is the mechanism to establish a fair price in such agreements: aren't they really simply mechanisms to provide transportation or location advantages?
  - Such arrangements are arm's length to the extent that the behavior of the market participants is non-collusive. If the market is characterized by collusive behavior, all transactions (e.g., straight purchases) are suspect.
  - Price determined by relative qualities
  - Unless all purchases are made through exchanges, it is difficult not to reference broader market.
  - Location advantage is motivation (parallels to gas markets).

MMS Questions (cont.)

- Is NYMEX a better proxy for market value than postings?
  - NYMEX reflects transactions of many buyers, sellers and speculators thus serves as a good proxy for competitive market value.

- How can you value oil in Wyoming, New Mexico, and California based on NYMEX prices for oil deliverable in Cushing, OK? Wouldn't any transportation differential be arbitrary?
  - Geographical basis differentials are problematic for all crude transactions. However, transportation differential for Wyoming, New Mexico, and California would be highly arbitrary and speculative.

- Since NYMEX prices are forward contracts, will basing current production valuation on these prices be problematic procedurally or administratively?
  - On a forward-looking basis, the inter-temporal basis differential should not be a problem. Those months when the cash price exceeds the price in the forward contract will be offset by those months when the cash price falls short of the contract price. Availability of supplier basis bids would allow contemporaneous comparisons.

MMS Questions (cont.)

- How does the Posting Plus market relate to market value? Would it be useful for our purposes?
  - To the extent price postings do not reflect competitive market value neither will premium or discount to posting.

- Are spot prices accurate and useful? What are their limitations?
  - Yes. As was the case with the NYMEX market, the prices in spot markets reflect the transactions of buyers, sellers, and speculators and thus reflect competitive market value.
  - Spot markets can be tested for integration and thus degree of competition.
  - Spot markets are integrated with the futures market.

- Explain quality considerations of crude oil and their effect on price (gravity, pitch, sulfur, metals content, other)?
  - The vast majority of the variance in crude oil prices is accounted for by gravity
  - Results of statistical valuation models reveal little explanatory power can be attributed to other considerations. (exception: sulfur in California crude oil)

MMS Questions (cont.)

- What valuation method do you think will best ensure that royalties are based on market value without being too burdensome or administratively costly, and at the same time provide flexibility under changing market conditions?

  - If royalties are based on prevailing competitive market price:
    - East of California: Use of spot market, NYMEX, and price of imported stocks.
    - California: Tied to ANS, imported prices, and/or refined product prices.

  - If royalties are based on prevailing comparable market price:
    - East of California: Sufficient homogeneity to adjust for quality and location. Consider taking royalty in-kind and sell directly or via broker.
    - California: Validate quality/location differentials using statistical means. Consider taking royalty in-kind.

Other Issues

Section 13

NOT TO BE PUBLISHED

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION ONE

THE PEOPLE OF THE STATE OF CALIFORNIA et al., Plaintiffs, Appellants, and Respondents, v. CHEVRON CORPORATION et al., Defendants and Appellants, MOBIL OIL CORPORATION, Defendant and Respondent.	No. B078250 (Super. Ct. No. C 587912 c/w No. C 561310) COURT OF APPEAL - SECOND DIST. FILED AUG 3 1994 JOSEPH A. LANE Clerk VICTOR L SALAS Deputy Clerk

APPEAL from judgments of the Superior Court of Los Angeles County. Jack Tenner, Judge. (Retired judge of the superior court sitting under assignment by the Chairperson of the Judicial Council.) Affirmed in part and reversed in part with directions.

Kaye, Scholer, Fierman, Hays & Handler, Barry Willner, Anton Arbisser, Robert W. Wilson, W. Casey Walls and Robert D. Wilson; Pillsbury, Madison & Sutro, Philip L. Judson, C. Douglas Floyd and Michael J. Higgins for Defendants and Appellants.

Hoecker, McMahon & Buck, Gary W. Hoecker and M. Brian McMahon; John R. Calhoun, City Attorney, James N. McCabe, Deputy City Attorney; Daniel E. Lungren, Attorney General, Richard N. Light, Deputy Attorney General, for Plaintiffs, Appellants and Respondents.

Girardi & Keese and Thomas V. Girardi; Hogan & Hartson L.L.P., Maureen O'Bryon and William L. Monts III; Peter M. Howard for Defendant and Respondent.

Plaintiffs State of California and City of Long Beach sought declaratory and injunctive relief finding defendants' Mobil Oil Corporation, Chevron Corporation, and Texaco Inc. pipelines common carriers subject to state regulation. The trial court entered judgment for Mobil but against Chevron and Texaco. Chevron and Texaco appeal. Plaintiffs appeal from the judgment for Mobil. We affirm the judgment for Mobil and reverse those against Chevron and Texaco.

BACKGROUND

In 1986 plaintiffs sued defendants and three other major oil companies, alleging unfair competition, fraud, antitrust violations, and breaches of contract and good faith. In addition, the complaint sought declaratory and injunctive relief (Code Civ. Proc., § 1060; Bus. & Prof. Code, § 17203) that three heated crude oil pipelines owned respectively by Mobil, Chevron, and Texaco were dedicated to public use and should be declared public utilities and common carriers subject to Public Utilities Commission (PUC) regulation.

In 1991, all parties except Exxon Corp. settled,[1] the other five defendants agreeing to dedicate their crude oil pipelines in California as common carriers subject to PUC regulation. However, the settlement did not include these three heated crude oil pipelines. The parties disputed whether the three pipelines were private property exempt from PUC regulation, or common carriers and public utilities dedicated to public use and subject to such regulation. The parties agreed to litigate the status of the three pipelines in this court trial.

FACTS

The three disputed pipelines run from heavy crude oil fields in the San Joaquin Valley to coastal refineries or ports. The Mobil pipeline consists of three segments. The M-55 segment begins north of Belridge and runs south to Mobil's Midway station, where it connects to the M-1 segment. M-1 runs south to Lebec Station, where it connects to the M-70 segment. M-70 runs south and ends at Mobil's Torrance refinery. The Chevron pipeline runs west from fields near Bakersfield to a

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1. The case against Exxon is still pending in the trial court and is not before us.

terminal on Estero Bay on the California coast. The Texaco pipeline runs from the southern San Joaquin Valley to a terminal on San Francisco Bay. The three pipelines are heated to assist the flow of the generally heavy, viscous crude oil generally produced in the San Joaquin Valley.

The defendants operated the three disputed pipelines as private carriers, and shipped oil from their fields through their pipelines. However, the defendants also bought oil from other companies and transported it in these pipelines. Plaintiffs claim these latter transactions made the three pipelines common carriers and public utilities subject to PUC regulation.

The relevant transactions were primarily of two types. In the first, called in/out exchanges, one party delivers oil to the pipeline owner, who takes title to it, pumps it through the pipeline, and then delivers an equivalent amount of oil to the first party or its designee at the other end of the pipeline. In the second, called reciprocal exchanges, one party exchanges its oil located near a second company's pipeline for an equal amount of oil located near the first company's pipeline. Each company takes title to its newly acquired oil and ships it through its pipeline for refining or resale. In all the relevant transactions, the pipeline company takes title to the oil before or as it enters the company's pipeline, and bears the risk of loss or damage during transit.

These exchanges were legitimate, arms-length transactions supported by consideration and memorialized by separate written contracts.

In addition, in some but not all of the transactions, the pipeline owner obtaining title to oil it later shipped down its pipeline also received a fee per barrel of oil shipped, variously called consideration, differentials, or location differentials. The oil companies contend these fees reflected the different values oil had in different locations, i.e., oil in a field in the San Joaquin Valley is worth less than oil at a refinery or terminal where it can be more profitably resold, or oil far away from a pipeline is worth less than oil much nearer a pipeline which can be more easily and cheaply shipped.

Moreover, each oil company's profitability was maximized when its pipeline carried the maximum amount of oil up to the pipeline's capacity that could be immediately refined or resold. For example, nearly all of the oil Mobil shipped through its pipeline was refined in its Torrance refinery, specifically modified at great expense over several decades to specialize in refining the heavy, viscous San Joaquin Valley crude oil. If the Torrance refinery experienced an equipment breakdown, its refining capacity would temporarily drop. To avoid the expense of storing some of the pipeline oil into tanks, or if it had no available storage capacity at that moment, Mobil would exchange the oil, which would be transferred to the buyer and shipped elsewhere, for an equal amount of similar crude oil to be delivered to the pipeline later, when refinery repairs were complete. Conversely, if field production dropped for technical or market reasons, and Mobil could not fill the pipeline, it would buy additional oil and pipe it to Torrance. Rather than paying cash, Mobil would exchange a similar amount of oil in the future. Plaintiffs on the other hand contend these fees demonstrate the pipeline owners essentially shipped oil for others for fees.

Only Mobil's pipeline ended at a refinery. Chevron's pipeline ended at the Estero Bay terminal, while Texaco's ended at the San Francisco terminal. Over 98 percent of the oil shipped over Chevron's Estero Bay pipeline was shipped by tanker to its El Segundo refinery. Texaco either shipped the oil piped to San Francisco to refineries or resold it to others. Like Mobil, both companies spent large sums modernizing and expanding their pipelines. Because heavy crude approaches a solid state at room temperature and at rest, the companies heated their pipelines and required a steady minimum volume of crude oil to avoid plugging the lines.

By contrast, PUC regulated pipelines must offer to ship oil for all wanting to do so, and if capacity is inadequate to meet all the demand, must offer all a proportionate share of available pipeline space.

Chevron and Texaco engaged in the same type of transactions as Mobil. The three companies did not offer to transport oil for anyone wanting to ship oil. In addition, portions of Mobil's pipeline run over federal land for which Mobil secured federal mineral act rights of way.

The trial court found that Mobil's pipeline was not, but Chevron's and Texaco's pipelines were, common carriers and public utilities, dedicated to public use, and subject to PUC regulation.

ISSUE

The state contends, and the oil companies deny, that the oil companies transported oil for others for compensation in the disputed pipelines, which were dedicated to public use.

DISCUSSION

"'Pipeline corporation' includes every corporation . . . owning, controlling, operating, or managing any pipeline <u>for compensation</u> within this state." (Pub. Util. Code, § 228, emphasis added.)2/

"'Pipe line' includes all real estate, fixtures, and personal property, owned, controlled, operated, or managed in connection with or to facilitate the transmission, storage,

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2. Unless otherwise indicated, all further statutory references are to the Public Utilities Code.

distribution, or delivery of crude oil . . . through pipe lines." (§ 227.)

"'Common carrier' means every . . . corporation providing transportation for compensation to or for the public or any portion thereof . . . . [¶] 'Common carrier' includes: [¶] (a) Every . . . oil . . . corporation . . . operating for compensation within this state." (§ 211, subd. (a), emphasis added.)

Section 216 provides: "(a) 'Public utility' includes every common carrier [or] pipeline corporation . . . where the service is performed for, or the commodity is delivered to, the public or any portion thereof. [¶] (b) Whenever any common carrier [or] pipeline corporation . . . performs a service for, or delivers a commodity to, the public or any portion thereof for which any compensation or payment whatsoever is received, that common carrier [or] pipeline corporation . . . is a public utility subject to the jurisdiction, control, and regulation of the [PUC] . . . . [¶] (c) When any . . . corporation performs any service for, or delivers any commodity to, any . . . private corporation . . . , which in turn either directly or indirectly, mediately or immediately, performs that service for, or delivers that commodity to, the public or any portion thereof, that . . . corporation is a public utility subject to the jurisdiction, control, and regulation of the [PUC] . . . ." (Emphasis added.)

"'Public or any portion thereof' means the public generally, or any limited portion of the public, including a . . . private corporation, . . . for which the service is performed or to which the commodity is delivered." (§ 207.)

For an oil company to be a public utility and common carrier subject to PUC regulation, in addition to the statutory requirements that it transport oil for others for compensation, the company must have dedicated its property to public use. Dedication means "'whether or not those offering the service have expressly or impliedly held themselves out as engaging in the business of supplying . . . the public as a class, "not necessarily to all of the public, but to any limited portion of it, such portion, for example, as could be served from his system, as contradistinguished from holding himself out as serving or ready to serve only particular individuals, either as a matter of accommodation or for other reasons peculiar and particular to them. . . . " [Citation.]' [Citations.]" (Yucaipa Water Co. No. 1 v. Public Utilities Com. (1960) 54 Cal.2d 823, 827-828; Richfield Oil Corp. v. Public Util. Com. (1960) 54 Cal.2d 419, 426-432.)

Dedication requires that the pipeline owner unequivocally offer transportation service on equal terms to all members of the public who might be able to use it. (Richfield Oil Corp. v. Public Util. Com., supra, 54 Cal.2d at pp. 426-433, 435-441; Associated etc. Co. v. Railroad Commissio[n] (1917) 176 Cal. 518, 520-530.)

Generally, whether private property is subject to state regulation is a question of fact, which we review under the substantial evidence test. (Campbell v. Southern Pacific Co. (1978) 22 Cal.3d 51, 60; see Yucaipa Water Co. No. 1 v. Public Utilities Com., supra, 54 Cal.2d at pp. 827-828; Richfield Oil Corp. v. Public Util. Com., supra, 54 Cal.2d at pp. 435-436, 439.)

"Questions of fact concern the establishment of historical or physical facts; their resolution is reviewed under the substantial-evidence test. Questions of law relate to the selection of a rule; their resolution is reviewed independently. Mixed questions of law and fact concern the application of the rule to the facts and the consequent determination whether the rule is satisfied. If the pertinent inquiry requires application of experience with human affairs, the question is predominantly factual and its determination is reviewed under the substantial-evidence test. If, by contrast, the inquiry requires a critical consideration, in a factual context, of legal principles and their underlying values, the question is predominantly legal and its determination is reviewed independently. [Citation.]" (Crocker National Bank v. City and County of San Francisco (1989) 49 Cal.3d 881, 888.)

The parties correctly agree on the above legal principles, but hotly dispute their applicability to this record. Respondents argue the disputed issues are primarily factual and our review is governed by the substantial evidence test, while appellants argue the disputed issues are primarily legal and subject to our independent review. Given the trial court's judgment, the state argues both positions based on its dual status as appellant and respondent, and respondent Mobil argues the opposite position from appellants Chevron and Texaco. The fundamental dispute between the parties is whether the oil companies transported oil for others for compensation through pipelines dedicated to public use.

We need not decide whether the issue is primarily legal or a mixed legal and factual one. Under either standard, we conclude the oil companies' conduct here establishes these pipelines were private, not common carriers subject to PUC regulation as public utilities. First, the pipeline company always owned the oil being piped and suffered any risk of loss. Second, to the extent the piped oil was bought from other producers rather than coming from fields owned by the company piping it, the purchases were always legitimate, arms-length transactions supported by consideration and memorialized in separate written contracts. Third, the companies never offered to transport oil produced by others on demand, but always bought or sold oil depending on their pipeline capacity and refining needs, as well as on market conditions. Fourth, the percentage of piped oil acquired from other producers always was very low.

Moreover, we see no difference between Mobil's pipeline, which piped essentially all the oil to its Torrance refinery, and those of Chevron and Texaco. The factors discussed above apply equally whether the oil left the pipeline into the pipeline owner's refinery, or was resold to another company, or was loaded into tankers for shipment to the pipeline owner's refinery. In all of these cases, the pipeline owner is using its pipeline to transport its products to market, whether or not the product first goes to a refinery before being sold.

In an analogous situation, if a large supermarket company produced some agricultural products on its own farms, and shipped them to market in its private trucks, but occasionally bought other produce from independent producers to fill its trucks when its own harvest could not, whether bought with cash or a promise to give produce to the other company at a later time, the supermarket's trucks would not thereby become common carriers, whether the trucks delivered the produce only to the supermarket's stores, or delivered it to others for resale.

We fail to see how defendants' transactions constitute transporting oil for others for compensation, in pipelines whose owners offer to ship oil for any producer desiring to do so. The state has failed to satisfy any of the three elements which must be proven to render the pipelines common carriers subject to PUC regulation as public utilities.

The cases cited above all support our analysis of these transactions. In both Richfield Oil Corp. v. Public Util. Com., supra, 54 Cal.2d 419, and Associated etc. Co. v. Railroad Commission, supra, 176 Cal. 518, the Supreme Court held that similar transactions did not render the pipelines common carriers. In Associated etc. Co., the transactions were essentially the same, except the additional piped oil bought from other producers was purchased with cash rather than with other exchanged oil. We agree with the oil companies that the State's claim that that distinction is significant lacks merit. In Richfield, the fact that some pipeline capacity was resold to others rather than retained by the pipeline company ~~did not~~ render the private pipeline a common carrier.

Moreover, while we agree that because portions of Mobil's pipeline cross federal land, and thus require federal mineral leasing rights-of-way, is some evidence of dedication to public use, it is not conclusive, nor do any of the cases relied on by the state so hold. Even if such evidence was conclusive on the issue of dedication to public use, it would not change the fact that the other elements of transportation for others for compensation are not present. Because of this conclusion, any error by the trial court in not admitting the federal audit report regarding Mobil's pipeline was harmless.

Thus, we conclude the trial court correctly concluded that Mobil's pipeline was not a common carrier subject to PUC regulation as a public utility, but erred in reaching the opposite conclusion regarding Chevron's and Texaco's pipelines.3/

DISPOSITION

We affirm the judgment in favor of Mobil, and reverse the judgments against Chevron and Texaco. We remand the matter to the trial court with instructions that it vacate the judgments against Chevron and Texaco and enter judgments in their favor.

Mobil, Chevron, and Texaco are awarded their costs on appeal.

NOT TO BE PUBLISHED.

We concur:

ORTEGA, J.

SPENCER, P.J.

VOGEL (Miriam A.), J.

3. The parties have been notified that Justice Vogel owns a community property interest in shares of Texaco and Chevron Stock. The People's request that individual or all members of the panel be disqualified or recuse themselves is denied. (See Kaufman v. Court of Appeal (1982) 31 Cal.3d 933, 940; People v. Castellano (1978) 79 Cal.App.3d 844, 862.)