

Decision **PROPOSED DECISION OF ALJ VIETH** (Mailed 1/25/10)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**Application of Lodi Gas Storage, LLC to
Modify Decision 00-05-048 (U912G).Application 09-06-011
(Filed June 12, 2009)**DECISION DENYING APPLICATION OF LODI GAS STORAGE, LLC
TO MODIFY DECISION 00-05-048****1. Summary**

Today's decision denies this contested application, in which Lodi Gas Storage, LLC (Lodi) asks the Commission to authorize replacement of the currently required \$10 million surety bond with a parental guaranty in the same amount. The Commission required the bond as a condition of its grant of a certificate of public convenience and necessity to Lodi and subsequently reduced the original bonding requirement, \$20 million, to \$10 million. The public interest supports maintenance of the bond.

2. Background

The Commission currently requires Lodi Gas Storage, LLC (Lodi), an independent natural gas storage owner and operator, to retain a \$10 million surety or performance bond to ensure its ability to meet the costs of certain obligations under a certificate of public convenience and necessity (CPCN) granted in 2000. Decision (D.) 00-05-048, which granted the CPCN, states: "These costs include, but are not limited to, reburial of the pipeline in the event of subsidence of the soil covering the pipeline, costs of restoring the areas in the

event of abandonment or bankruptcy, etc.”¹ In 2000 (and until 2008), Lodi’s owner was Western Hub Properties, LLC (WHP), a development company with limited assets. D.00-05-048 fashioned the bond requirement to address concerns raised by individual landowners and the San Joaquin Farm Bureau Federation about the potential risks development and operation of a gas storage facility posed in the local areas. The bond was set at \$20 million.² In 2004, based on completion of the construction and a successful operating history, D.04-05-034 modified D.00-05-048, at Lodi’s request, to reduce the bond to \$10 million, adjusted annually for inflation from May 18, 2000 (the date of issuance of D.00-05-048). More recently, D.08-01-018 authorized the transfer of indirect control of Lodi from WHP to Buckeye Partners, L.P. (Buckeye Partners), which is publicly traded on the New York Stock Exchange. Buckeye Partners owns 100% of Buckeye Gas Storage, L.L.C. (Buckeye Gas Storage), which owns 100% of Lodi.

3. Procedural History

The San Joaquin Farm Bureau Federation and the California Farm Bureau Federation (referred to here, collectively, as Farm Bureau) jointly protested this application, as did the Commission’s Division of Ratepayer Advocates (DRA).³

¹ D.00-05-048 at 34. See also, D.04-05-034, Finding of Fact 3.

² The Proposed Decision had recommended that the Commission deny the CPCN, concluding that given the degree of opposition in the community, the project failed to comport with community values, one of the factors to be considered under Public Utilities Code Section 1002. (D.04-05-034 at 3-4.) An Alternate Decision sponsored by two Commissioners proposed a bond of \$30 million to mitigate community concerns about environmental degradation and other problems. (*Id.* at 4.) D.00-05-048 granted the CPCN, but conditioned it upon acquisition of a \$20 million bond.

³ A document titled *Reclamation District No. 563 Objection to Application of Lodi Gas Storage, LLC to modify Decision 00-05-048* was tendered for filing after expiration of the

Footnote continued on next page

With the permission of the Administrative Law Judge (ALJ), Lodi filed a reply to the protests, which included a request that the parties attempt to resolve their differences through the Commission's Alternative Dispute Resolution (ADR) program. At a prehearing conference (PHC) held on August 14, 2009, the parties discussed their views of the issues and the potential use of ADR. Counsel for DRA and Lodi also advised the ALJ of some preliminary discovery disputes between them, and after taking argument, the ALJ resolved them. Following the PHC, the assigned Commissioner filed a scoping memo, which memorialized the scope and schedule for this proceeding.⁴

The scoping memo authorized the parties, in their discretion, to file a stipulation of facts as well as motions requesting leave to file briefs. No party elected to make either filing. The parties agreed to mediate their dispute, but mediation did not result in settlement. In mid-December 2009, by email to the ALJ, the parties asked that this proceeding be submitted for decision on the pleadings filed as of that time.

4. Discussion

The ultimate issue for the Commission is whether changed circumstances exist which warrant substituting Lodi's current \$10 million bond obligation with a parental guarantee in the same amount. Lodi asks the Commission to order the substitution by modifying D.00-05-048 (as modified by D.04-05-034) to cancel the

protest period without a motion requesting leave to file late. The Commission's Docket Office notified counsel for the Reclamation District of the options available to cure this defect; however the Reclamation District determined not to seek party status but rather asked to have the document placed in the correspondence file for this proceeding.

⁴ *Scoping Memo and Ruling of Assigned Commissioner*, September 3, 2009.

bond requirement in return for a \$10 million guaranty from Buckeye Partners, Lodi's current, indirect owner. Buckeye Partners owns and controls Lodi through its ownership of 100% of Buckeye Gas Storage, which owns 100% of Lodi.

Lodi argues that the financial strength of Buckeye Partners, together with Lodi's strong operating record, should cause the Commission to reassess its requirement that Lodi continue to carry the bond. Lodi contends that a parental guaranty should suffice and would avoid the annual cost of the bond, which it considers to be an unnecessary financial burden. If the Commission were to grant this request, Lodi observes that the Commission would be free to re-impose a bond requirement upon a new owner, were an application for such a transfer to be filed in the future. (Lodi's present application states that no such transfer is being contemplated.)

Lodi's application suggests specific changes to the decision text, Conclusion of Law 7, and Ordering Paragraph 5 of D.00-05-048 (as modified by D.04-05-034). Attached to the application are excerpts from Buckeye Partners' 2008 SEC Form 10-K and 1st Quarter 2009 Form 10-Q (Attachment A), a draft of the proposed parental guaranty (Attachment B), and an affidavit from the Vice President, General Counsel and Secretary of Buckeye GP LLC (the General Partner of Buckeye Partners) attesting to, among other things, the investment grade rating of Buckeye Partners' long-term unsecured debt,⁵ and Buckeye Partners' commitment to issue the parental guarantee (Attachment C).

⁵ The undated affidavit, filed as part of the application on June 12, 2009, lists Standard & Poor's rating of Buckeye Partners as BBB and Moody's rating as Baa2.

The basic point that Farm Bureau and DRA make is that a parental guaranty offers less protection than a bond. They reiterate that the Commission imposed the bonding requirement to mitigate the concerns of the local, agricultural community by ensuring that sufficient funds would be available to remedy any environmental degradation attributable to construction and ongoing operation of the gas storage facility. They point to the recent collapse of very large, publicly traded companies – much larger than Buckeye Partners – and ask the Commission to keep the bonding requirement in place. Moreover, they argue that the cost of the bond premium cannot reasonably be characterized as burdensome. According to a data request response to DRA, in 2009 the premium cost \$122,000. DRA calculates that sum to be approximately four-tenths of one percent of Lodi's 2008 operating expenses. Using a slightly lower estimate of \$120,000, Farm Bureau characterizes the approximate cost of the premium was 0.00065 of Buckeye Partners' 2008 profits.

Neither DRA nor Farm Bureau dispute that publicly traded Buckeye Partners is financially more stable than Lodi's earlier owners. The question is whether that improved financial status, plus a safe operating record to date, mean that the Commission should authorize substitution of a \$10 million parental guarantee for the \$10 million bond.

When the Commission reduced the bond requirement from \$20 million to \$10 million (after construction of Lodi was complete and initial operation had commenced), the Commission stated: "The history of the surety bond condition demonstrates that acceptance of this condition was integral to LGS [Lodi]

receiving its CPCN.”⁶ The Commission also observed that “[s]oil subsidence can occur at any time, as can the cost of restoring the area in the event of abandonment or bankruptcy.”⁷ The Commission noted Lodi’s acknowledgement “that a surety bond of \$10 million, as adjusted for inflation, is a reasonable amount to cover [Lodi’s] costs in the event reburial of the pipeline becomes necessary and to restore the areas in the event of abandonment or bankruptcy.”⁸

Farm Bureau’s protest cites California case law describing a surety bond and the protection afforded a third party (such as the Lodi community) by the surety/principal relationship, based on the surety’s expert risk assessment and the principal’s payment of bond premiums. By comparison, a parental guaranty is a promise by a parent company to cover the debt of its subsidiary. As Farm Bureau correctly observes, a parental guaranty “is no more secure than the company providing the guarantee.”⁹ At the present time, Buckeye Partners’ offer of a parental guarantee appears to provide real value. However, the future is unknowable. We agree that the public interest does not support asking the local community to undertake that risk. Lodi’s application should be denied. Lodi should be required to retain the \$10 million surety bond as condition of its CPCN.

⁶ D.04-05-034, Finding of Fact 2.

⁷ D.04-05-034, Finding of Fact 2.

⁸ D.04-05-034, Finding of Fact 3.

⁹ Farm Bureau Protest at 10.

5. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Lodi, Farm Bureau, and DRA filed comments on February 16, 2010. Farm Bureau filed reply comments on February 19, 2010; Lodi and DRA filed reply comments on February 22, 2010.

The Farm Bureau and DRA comments support the proposed decision as written. Lodi's comments reiterate its view that the financial strength of Lodi's current owner, together with Lodi's successful operating record, constitute changed circumstances that weaken the rationale for a surety bond and that a parental guarantee (from Buckeye Partners) should suffice instead. In the alternative, Lodi's comments propose a revised plan by which the parental guarantee would apply only as long as Buckeye Partners retains an investment grade bond ratings (BBB- or higher from S&P and Baa3 or higher from Moody's); should the bond rating fall, a surety bond would be required again. Appendix A to Lodi's comments, entitled "Modifications to Original Proposal," sketches the plan in outline form. Both Farm Bureau and DRA oppose this new proposal. Farm Bureau's reply comments reiterate that the surety bond is integral to the protections promised the local community as a condition of Lodi's CPCN, that a parental guarantee lacks the security of bond, and that retention of the bond is not financially burdensome given Lodi's profitability. DRA's reply comments focus on the procedural irregularity of raising a new proposal in comments.

We decline to revise the proposed decision and need not reach the merits of the new proposal Lodi raises in its comments. Rule 14.3(c) of the Commissions' Rules of Practice and Procedure limits comments to "factual, legal,

or technical errors” in the proposed decision; comments that do not comply “will be given no weight.” Modifications to an original proposal may be raised by an amendment under Rule 1.12(a); in the case of an application, the amendment should be filed before the scoping memo issues. Otherwise, an amendment should be tendered for filing concurrently with a motion for leave to file that fully explains the reason a late amendment should be permitted (see generally, Rule 11.1 et seq.).

If Lodi wishes to pursue this idea in spite of the continued, strong opposition from other parties, Lodi may file a new application.

6. Assignment of Proceeding

John A. Bohn is the assigned Commissioner and Jean Vieth is the assigned ALJ in this proceeding.

Findings of Fact

1. Buckeye Partners, a publicly traded entity, appears to be financially more stable than Lodi’s earlier owners.
2. The cost of the bond premium to Buckeye Partners is small, whether measured as a percentage of Lodi’s recent, annual operating expenses or a percentage of Buckeye Partners’ recent, annual profits.
3. A surety bond generally provides more security to a third party than a guaranty from the principal’s parent company in instances where the parent company files for bankruptcy.
4. The public interest does not support asking the local community to undertake the risk that a \$10 million parental guaranty may become less valuable than a \$10 million surety bond.

Conclusions of Law

1. It is reasonable to retain the requirement that Lodi obtain a \$10 million surety bond, adjusted annually for inflation from May 18, 2000 (the date of issuance of D.00-15-048), as a condition of its CPCN.
2. The application should be denied.
3. This decision should be effective immediately to minimize business uncertainty for the parties.

O R D E R

IT IS ORDERED that:

1. Application 09-06-011 filed on June 12, 2009, by Lodi Gas Storage, LLC is denied.
2. Application 09-06-011 is closed.

This order is effective today.

Dated _____, at San Francisco, California.