Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Joint Application of Lodi Gas Storage, L.L.C., Western Hub Properties L.L.C., and WHP Acquisition Company, LLC, to Transfer Control of Lodi Gas Storage, L.L.C., to WHP Acquisition Company, LLC, Which Will Occur Indirectly as a Result of the Purchase of Western Hub Properties L.L.C. by WHP Acquisition Company, LLC, Pursuant to Public Utilities Code Section 854(a) and of Lodi Gas Storage, L.L.C. for Approval of a Secured Long-Term Financing Pursuant to Public Utilities Code Sections 816, 817, 818, 823 and 851.	Application 01-09-045 (Filed September 28, 2001)

O P I N I O N

I. Summary

We approve, subject to conditions, the unopposed request of Joint Applicants, Lodi Gas Storage, L.L.C. (LGS), Western Hub Properties, L.L.C. (Western Hub) and WHP Acquisition Company, LLC (WHP), for a change in the ultimate ownership of LGS and its Lodi gas storage facility and for authority to enter into a secured, long-term bank financing agreement. The change in ownership, by which WHP will acquire Western Hub and indirectly, LGS and the Lodi Facility, will not affect the rates, terms or conditions under which LGS is to operate pursuant to previous Commission decisions.[1] As certificated, LGS will

[1] See Decision (D.) 00-05-048 and subsequent decisions.

continue to offer market-based rates to noncore natural gas storage customers in accordance with the requirements of those decisions and its tariff. In addition, we authorize Joint Applicants to negotiate contracts on behalf of LGS, on a provisional basis, for the management of continuing construction at the Lodi Facility and for management of the day-to-day operations of LGS. We decline to authorize contracts with any LGS affiliate for the marketing of unsubscribed firm and interruptible storage capacity at the Lodi Facility and moreover, prohibit LGS from engaging in any storage or hub services transactions with its ultimate corporate parents or their affiliates.

The change of control will not affect our prior determination that LGS is exempt from our 1997 Affiliate Transaction Rules, pending conclusion of a reexamination of this issue in Rulemaking (R.) 01-01-001. Until further order, LGS must continue to comply with the same reporting requirements as the other, similarly-situated, independent natural gas storage utility certificated to operate in California. The transfer of control qualifies for an exemption from the California Environmental Act (CEQA) and therefore, additional environmental review is not required. However, we will continue the restrictions that prevent persons and entities with a beneficial interest in LGS or its present owners from monitoring the implementation of the environmental mitigation measures and we will extend these restrictions to persons and entities with a beneficial interest in the new owners.

As discussed in the body of this decision, we condition our approval upon disclosure to the Director of the Commission's Energy Division of the following information, including contracts and other documents, so that we may monitor LGS' position under its new ownership:

- Clear representation in writing, prior to the change of control, that the bonding entities will continue to bond LGS and the Lodi Facility under the $20 million performance bond we ordered in D.00-05-048;

- Copies of the contracts, and any amendments to those contracts, for the management of continuing construction and day-to-day operations at LGS and the Lodi Facility;

- A copy of the final, debt financing arrangement from the proposed and / or any alternative lenders, once that arrangement is finalized in accordance with the terms we approve today.

- Information regarding ownership by LGS, its parents or affiliates of its parents of natural gas facilities or other entities specified herein as well as copies of service agreements for short-term and long-term gas transactions.

II. Background

In D.00-05-048, the Commission granted LGS a certificate of public convenience and necessity (CPCN) for the development, construction, and operation of an underground natural gas storage facility and ancillary pipeline, known as the Lodi Facility, located in San Joaquin County approximately 5.4 miles northeast of Lodi.[2] The Commission authorized LGS, a new public utility under Pub. Util. Code § 216 and § 222, to provide firm and interruptible

[2] The LGS project is expected to add 12 billion cubic feet (Bcf) of working gas to California's natural gas storage supplies, with a maximum firm deliverability of 500 million cubic feet per day (MMcf / d) and a maximum firm injection capacity of 400 MMcf / d. D.00-05-048 clarifies that "…this is LGS' project description, and does not refer to PG&E's ability to transport gas to and from LGS." (D.00-05-048 at footnote 4.)

gas storage services at market-based rates. D.00-05-048 also certifies the Environmental Impact Report for the LGS project, conditioning the Commission's authority on compliance with mitigation measures set forth in the report. (See generally, D.00-05-048, 2000 Cal. PUC LEXIS 394; D.00-08-024, 2000 Cal. PUC LEXIS 546.)

Two subsequent decisions address additional matters. In D.00-12-026, among other things, the Commission granted LGS limited waivers and exemptions from certain project financing requirements with respect to the project financing then in place. (D.00-12-026, 2000 Cal. PUC. LEXIS 978.) More recently, in D.01-08-023, the Commission authorized LGS to proceed with a replacement debt financing arrangement for the project. (D.01-08-023, 2001 Cal. PUC. LEXIS 652.)

D.01-08-023 notes LGS' representation that in the near future it would be filing a joint application with a prospective purchaser (now publicly disclosed as WHP) to request Commission approval of a change of control of LGS. This proceeding concerns that Application, filed on September 28, 2001, and an Amendment, filed on November 20, 2001. The same day they filed the Amendment, Joint Applicants filed a motion requesting an order shortening time for protests and / or responses and limiting the scope of response. The assigned administrative law judge (ALJ) took no action and the matter is now moot. No protests or responses were filed to either the Application or the Amendment.

An Assigned Commissioner's Ruling (ACR) on May 17, 2002 directed Joint Applicants to supplement the record on market power by responding to questions in the ACR. Joint Applicants filed their response on May 22.

III. The Proposed Change of Control

A. Overview--Parties to the Transaction

LGS, Western Hub and WHP, the Joint Applicants in this proceeding, seek Commission authorization for the transfer of control of Western Hub to WHP, and thereby, the indirect change of control of LGS, Western Hub's wholly owned subsidiary, as well as the Lodi Facility. On August 22, 2001, Western Hub, its owners, and WHP executed a Unit Purchase Agreement for the sale of Western Hub to WHP, subject to this Commission's approval. The transaction provides for cash consideration of $105 million plus up to $3 million in expenses.[3] Joint Applicants assert that "the change in ownership at the holding company level will not result in the transfer of any certificates, assets, or customers of LGS, which will continue to be bound by the terms and conditions prescribed by the Commission in D.00-05-048." (Application at 2.)

At present, three limited partnerships (Haddington / Chase Energy Partners LP, Haddington Energy Partners LP and Haddington Energy Partners II LP) own all but approximately 1% of Western Hub; ten individuals own the remainder.[4]

WHP, a Delaware limited liability company with its principal place of business in Kansas City, Missouri, was formed expressly to acquire and own

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[3] By ruling on January 4, 2002, the ALJ granted Joint Applicants' motion for leave to file under seal certain terms and conditions in the Unit Purchase Agreement, as well as certain other commercially sensitive, confidential information.

[4] Footnote 3 to the Application states that Western Hub also owns, indirectly (1) an 18.5% interest in CenTex Market Center, L.P. and (2) a 25% interest in undeveloped gas storage sites in Texas and in California. None of these holdings is the subject of the authority sought in this proceeding.

Western Hub. The Application identifies two, 50%-50% owners of WHP--Aquila WHP Storage, L.P. and ArcLight WHP, L.L.C., the former wholly owned by Aquila, Inc. and the latter, by ArcLight Energy Partners Fund I, L.P. (ArcLight). The Application proposes that WHP's two owners, through their respective subsidiaries, own and manage WHP on a 50-50 basis. Each will contribute up to $25 million in equity capital in return for common or preferred stock and each has designated two individuals to serve on WHP's four-member Management Committee.

The Application identifies Aquila, Inc., a Delaware corporation with principal offices in Kansas City, Missouri, as a major wholesale energy merchant in the United States and abroad and a subsidiary of UtiliCorp United Inc. (UtiliCorp), which owns various utility and other, unregulated businesses in the United States, Canada, Australia and New Zealand.[5]

Subsequently, Joint Applicants filed a March 4, 2002 declaration of Jeffrey D. Ayers, General Counsel and Corporate Secretary of Aquila Merchant Services (AMS). Ayers' declaration states that UtiliCorp has successfully

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[5] At the time the Application was filed, UtiliCorp owned 80% of Aquila Inc., having successfully placed the other 20% in public hands through an initial public offering in April 2001. According to the Application, UtiliCorp intended to spin off its 80% interest in Aquila Inc. to its shareholders by April 2002. However, those plans changed. The November 2002 Amendment to the Application states that UtiliCorp's board of directors determined to acquire all outstanding public shares of Aquila Inc. via a tax-free exchange of 0.6896 shares of UtiliCorp common stock for each share of the Class A common stock of Aquila Inc. and then to merge Aquila Inc. with an UtiliCorp subsidiary in a stock for stock transaction.

The Amendment to the Application recognizes that this change of plan renders moot Joint Applicants' request, in the Application, that the Commission authorize the "spin-off" of the remainder of Aquila Inc. in its decision on the Application.

acquired all outstanding public shares of Aquila, Inc., has taken the name "Aquila, Inc." for itself, and that the former "Aquila, Inc." has been renamed AMS. The declaration states that the name change "did not result in any change in the business or operations or corporate structure of [AMS]".

To avoid confusion, hereafter we use the name "Aquila" to refer to the holding company formally known as UtiliCorp and we use the name "AMS" to refer to that holding company's subsidiary, formerly known as Aquila, Inc.

ArcLight, the other 50% equity investor in WHP, is a Delaware limited partnership with its principal place of business in Boston, Massachusetts. It is managed by ArcLight Capital Holdings, L.L.C., a Delaware limited liability company founded by former executives of John Hancock Life Insurance Company and the investment banking community. The company was formed to make private equity, equity-like and debt investments in regulated and unregulated public utilities and in other energy and telecommunications enterprises. According to the Application, John Hancock Life Insurance Company has committed to invest up to $500 million in ArcLight.

B. Discussion: Ramifications of the Change of Control

Pub. Util. Code § 854 requires Commission authorization before a company may "merge, acquire, or control…any public utility organized and doing business in this state…." The purpose of this and related sections is to enable the Commission, before any transfer of public utility authority is consummated, to review the situation and to take such action, as a condition of the transfer, as the public interest may require. (*San Jose Water Corp./Company*. (1916) 10 CRC 56.)

As outlined above, the instant Application presents a proposed, indirect change of control of LGS (the entity this Commission regulates) via the sale of its corporate parent, Western Hub, to WHP and through WHP, to AMS and ArcLight. Both Western Hub and LGS will continue as separate legal entities. Joint Applicants do not seek the transfer of LGS' CPCN; rather, LGS will continue to hold it and will continue to operate under the terms and conditions it imposes, pursuant to D.00-05-048, as modified by subsequent Commission decisions, including today's decision. We stress that unless and until modified, all terms and conditions D.00-05-048 mandates (e.g., a general liability policy of $1 million and umbrella policy in the amount of $50 million per occurrence) will continue to apply. Likewise, LGS will continue to operate in conformance with its tariff, filed with the Commission on July 13, 2001, and with any subsequent amendments of that tariff.

Thus, our primary concern in this proceeding is how the indirect change of control will affect LGS, its customers and the market place. Joint Applicants concede that AMS' holdings and business interests are significant in the aggregate. AMS owns or controls a geographically diverse portfolio of energy assets, trades commodities which include, among other things, electricity and natural gas, coal, weather derivatives, emission allowances and bandwidth capacity, and offers products and services which allow its clients, including regulated and unregulated public utilities, industrial companies and other wholesale energy merchants, to manage risks such as price volatility and supply availability. AMS has a client base in North America, the United Kingdom and Europe.

However, Joint Applicants state that at present AMS' activities do not constitute market power in California. They state that while AMS owns, controls

or has under development some 4,100 megawatts (MW) of electric power generation capacity, the portion in California is limited to a minority, non-operating interest in four co-generation facilities and that this interest, in the aggregate, totals approximately 88 MW. AMS also owns the 21 Bcf Katy Storage Facility and Market Hub outside of Houston, Texas,[6] in addition to 13 natural gas gathering systems, 1.6 Bcf / d of natural gas transportation capacity, approximately 30,000 barrels per day (Bbls / d) of natural gas processing capacity and a coal terminal capable of moving five million tons of coal annually. AMS also has a small amount of gas capacity into California under contract but it has no intrastate pipeline capacity or other natural gas facilities.

In their Response to the Assigned Commissioner's Ruling on Market Power, Joint Applicants submitted various analyses in support of their position, including a market assessment, but no market power study. Recently, in our review of the application of Wild Goose Storage, Inc. (Wild Goose), for approval of its proposed expansion project, we examined market power in the gas storage market in California and the western United States.[7] The Commission found evidence of a highly concentrated market for storage injection and withdrawal in both the northern California and statewide California markets and a significant market share for Wild Goose. Though the Commission was unable to conclude definitively, on the record of that proceeding, "whether Wild Goose possesses and can exercise market power", the Commission imposed a number of

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[6] Once its expansion project is finished, the Katy Facility will have the capacity to cycle working gas 5+ times (or "turns") per year.

[7] Wild Goose was the first competitive, natural gas storage utility to receive a CPCN from the Commission. LGS was a party to the recent expansion proceeding.

reporting requirements and rescinded certain, other reporting relaxations, "to monitor the situation more fully in the future." (See *Wild Goose Expansion*, D.02-07-036, mimeo. at pp. 16-17 and Finding of Fact 12.) The Commission also prohibited Wild Goose from engaging in any storage or hub services transactions with its parent company or any affiliate owned or controlled by its parent.

The Lodi Facility has a smaller inventory capacity than Wild Goose (12 Bcf of working gas compared to 29 Bcf for the expanded Wild Goose facility) but the physical attributes of its storage reservoir permit highly flexible storage operations. The peak injection capacity at the Lodi Facility (400 MMcf/d) nearly matches Wild Goose (450 MMcf/d) and its peak withdrawal capacity is substantial (500 MMcf/d, compared to Wild Goose's 700 MMcf/d). Moreover, part of Wild Goose's peak withdrawal capacity (200 MMcf/d) moves through Line 167, the major transmission line into Sacramento; the remaining volumes (500 MMcf/d), associated with Wild Goose's expansion project, will compete directly with the Lodi Facility for transmission access to the Bay Area load center.

Considering these realities, we must question assertions that LGS does not have and cannot exercise market power in the gas storage market. The evidence Joint Applicants have presented is at best inconclusive; certainly, it does not permit us to find for LGS on this issue. Therefore, as a condition of the authorization of transfer of control (and continued market-based rate authority), we will impose the same reporting requirements we have imposed on Wild Goose. Specifically, we will prohibit LGS from engaging in any storage or hub services transactions with its ultimate parents, Aquila and ArcLight (or their successors) or any other affiliate owned or controlled by either of those entities. In addition, we will direct LGS to promptly inform the Commission of the

following changes in status that would reflect a departure from the characteristics the Commission has relied upon in approving market-based pricing: LGS' own purchase of other natural gas facilities, transmission facilities, or substitutes for natural gas, like liquefied natural gas facilities; an increase in the storage capacity or in the interstate or intrastate transmission capacity held by affiliates of its parents or their successors; or merger or other acquisition involving affiliates of its parents, or their successors, and another entity that owns gas storage or transmission facilities or facilities that use natural gas as an input, such as electric generation.

We will also require LGS to provide the Commission with service agreements for short-term transactions (one year or less) within 30 days of the date of commencement of short-term service, to be followed by quarterly transaction summaries of specific sales. If LGS enters into multiple service agreements within a 30-day period, LGS may file these service agreements together so as to conserve the resources both of LGS and the Commission. The quarterly transactions summaries should list, for all tariffed services, the purchaser, the transaction period, the type of service (e.g., firm, interruptible, balancing, etc.), the rate, the applicable volume, whether there is an affiliate relationship between LGS and the customer, and the total charge to the customer. For long-term transactions (longer than one year), LGS should submit the actual, individual service agreement for each transaction within 30 days of the date of commencement of service. To ensure the clear identification of filings, and in order to facilitate the orderly maintenance of the Commission's records, long-term transaction service agreements should not be filed together with short-term transaction summaries.

All reports required by the preceding paragraphs should be provided to the Director of the Commission's Energy Division within 60 days of the effective date of this decision on an initial basis and thereafter, as specified above or by the applicable rule, General Order, or statute.

We turn next to other aspects of the proposed transfer of control, which we also must review against Joint Applicants' uncertain market power showing. Joint Applicants propose that AMS provide construction management services during the remainder of the construction project at the Lodi Facility, including a "turnkey wrap" of all construction arrangements.[8] They also propose that AMS manage the ongoing, day-to-day operations of LGS and the Lodi Facility. Both management agreements are to be market-based and negotiated with ArcLight on behalf of LGS.

According to Joint Applicants, the banks involved in the debt financing transaction require that AMS assumes the turnkey wrap function, a typical requirement in project finance lending transactions. With respect to the proposal that AMS assume, under contract, the day-to-day management of ongoing operations for LGS and the Lodi Facility, Joint Applicants point out that AMS has expertise in the management and operation of an active gas storage facility (e.g., Katy Hub). They contend that this expertise, together with AMS' broad experience in other, related aspects of the natural gas industry should benefit LGS and its customers.

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[8] AMS would assume contractual responsibility for all contractors to complete the Lodi Facility on time, within budget and in compliance with specifications. Thus AMS, as the turnkey contractor, would "wrap" the obligations of all of the subcontractors – if a problem were to occur, the project owner could claim against the turnkey contractor who in turn could claim against responsible subcontractors.

We do not question AMS' managerial expertise and ability to fulfill the obligations under these proposed contracts, including, most importantly, to ensure completion of unfinished construction at the Lodi Facility. From a practical standpoint, it appears highly desirable to have a single entity assume the turnkey wrap function, since none of the three main contractors involved in the project at present has that construction obligation. However, because the contracts would create an affiliate role in the management of LGS, we need to examine the proposal closely.

As noted above, *Wild Goose Expansion* imposes a ban on affiliate transactions with respect to any storage or hub services.[9] Such services typically concern the movement and storage of natural gas for the owner of the gas, unlike the management contracts Joint Applicants propose for construction and day-to-day operations. Furthermore, the terms of these management contracts would be negotiated between the two equity owners, AMS and ArcLight, on behalf of LGS—a factor which should militate to curb the exercise of affiliate self-interest at the expense of LGS or its customers.

Wild Goose Expansion also lifts the stay on the Commission's review of whether the 1997 Affiliate Transaction Rules should apply to independent storage—and LGS, as well as Wild Goose, is a respondent to that proceeding, R.01-01-001.[10] The regulatory propriety of such contracts necessarily will be at

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[9] The ban is specific to Wild Goose; dicta in *Wild Goose Expansion* state "this prohibition … is not intended as precedential toward any other independent storage operations." (*Id.* at footnote 1.)

[10] The Affiliate Transaction Rules, adopted by D.97-12-088 as subsequently modified by D.99-09-002, govern relationships between energy utilities and their affiliates and resulted from proceedings the Commission initiated in 1997 in light of fundamental

Footnote continued on next page

issue in the rulemaking. We will not prejudge the outcome of R.01-01-001 by exempting these contracts, or similar contracts, from consideration in that proceeding. Thus, because we believe it desirable to take steps to ensure that the change of control leaves LGS with able management over the remaining construction as well as day-to-day affairs, we will authorize the management contracts, on a provisional basis. We recognize that provisional approval may create more business risk than Joint Applicants are willing to assume, but that is a matter that they, alone, can decide.

A final, critical aspect of our consideration of whether to authorize the change of control is the financial standing of AMS and ArcLight. Both AMS (which Standard & Poor's and Moody's rate as investment grade[11]) and ArcLight bring substantial financial resources to the proposed transaction. As Joint Applicants explain in the Application, following issuance of D.00-12-026, LGS began the search that has lead to the proposal before us today:

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changes in the California electric and gas markets stemming from electric restructuring and the consequent potential for utility / affiliate self-dealing and cross-subsidization. D.00-05-048 granted LGS an exemption from the Affiliate Transaction Rules because like Wild Goose, LGS had not been made a respondent to the rulemaking that promulgated those rules and because the Commission had determined that, at that time, like Wild Goose:

> … it [LGS] does not possess market power in the California gas storage market or the ability to cross-subsidize LGS' affiliates with ratepayer assets at this time… (D.00-05-048, 2000 Cal. PUC LEXIS at *99.)

[11] In the period since the Application was filed, AMS' credit rating has fallen (to BBB) but it is still considered investment grade. AMS' lower credit-worthiness is not unique; most energy utilities, their publicly rated affiliates and other, rated, unregulated energy companies have lost value during this period.

> … LGS' existing investors began exploring alternative sources of additional equity capital in order to complete construction of the Lodi Facility, as was clearly contemplated in D.00-12-006 (citation omitted). These efforts identified two potential sources of funding: financial investors who would find it attractive to purchase a passive minority interest in the Lodi Facility; and industry investors who are active in the energy business and would be interested only in acquiring a controlling interest in the Lodi Facility. Based on the financing term offered by various potential investors, Western Hub elected to enter into an interim financing transaction [authorized in D.01-08-023] and this transaction with WHP Acquisition. (Application at 12.)

Between them, AMS and ArcLight appear to bring sufficient managerial and financial expertise, as well as adequate financial resources, to oversee the successful operation of LGS and the Lodi Facility and to bring the remaining portions of the construction project to fruition. Their 50% - 50% ownership position suggests appropriate checks and balances will be in play to govern their negotiation of the contracts for management of construction and day-to-day operations at LGS. Disclosure of those contracts, and any amendments, to the Commission will provide another check. We will require such disclosure to the Director of the Commission's Energy Division as a condition of our approval of the transfer of control.

IV. Other Issues

In addition to approval of the change of control, Joint Applicants seek authority regarding three other matters, which we review below.

A. The Proposed Debt Financing

Pursuant to Pub. Util. Code §§ 816, 817, 818, 823, and 851, which require such approval, Joint Applicants request Commission authority to enter into a

secured, long-term bank financing, the proceeds to be used to acquire Western Hub and to refinance interim construction financing provided LGS by WHP. Negotiations are underway with two banks (SB Bank Deutsche Genossenschaftsbank AG and Union Bank of California, N.A. [the Banks]) to arrange a debt financing for LGS of up to $175 million to supplement the equity capital from AMS and ArcLight (i.e., $25 million each, $50 million total). Joint Applicants have supplied the Indicative Terms and Conditions (Exhibit 11 to the Application) and request authority to enter into a debt financing arrangement on these terms with the Banks, once the Banks have finished their due diligence and upon execution of definitive documents. Should the current negotiations fail for reasons now unknown, Joint Applicants seek authority to enter into a debt financing arrangement with other lenders on substantially similar terms as those stated in the Indicative Terms and Conditions.

The Application describes the debt financing arrangement sought as a medium-term loan (a "construction mini-perm project finance facility"). This means that the loan initially may be extended to finance construction and after completion of construction, the term loan then becomes a "miniature permanent" loan, which in the instant case would be repayable in five years. However, if construction of the Lodi Facility has been completed prior to our decision on the Application, then the construction portion of the loan would never be drawn.[12]

Interest rates and other charges in connection with the debt financing proposal appear to require market rates and arm's-length negotiation between

[12] The Commission's Energy Division has been advised that LGS commenced commercial operations at the Lodi Facility in December 2001. Phase II construction is underway.

the parties, as Joint Applicants contend. While the substantial debt acquisition will increase the debt in LGS' capital structure, Joint Applicants argue that higher debt levels are not unreasonable for an independent gas storage utility. They also point out that the financing terms are similar to those the Commission approved in 1997 in another proceeding, which unlike this one, concerned captive ratepayers; it also concerned substantial unregulated operations. (*In re: Application of Red and White Fleet to Transfer to Blue & Gold Fleet*, D.97-06-066, (1997) 72 CPUC2d 851; 1997 Cal. PUC LEXIS 229, *43-51.)

We agree that the Commission need be less concerned about the capital structure of an independent gas storage utility like LGS, where the owners bear the risk for the Lodi Facility's success, and where customers are not captive but have other market choices – but we stress that this is not to say we have no interest in reviewing capitalization issues (and other indicia of financial viability) as we consider a proposed transfer of control.

Two additional factors favorably influence our consideration of this proposal. First, Joint Applicants represent that the $20 million performance bond we ordered in D.00-05-048 will remain in place to assure appropriate decommissioning should that prove necessary, however unlikely it now appears. To ensure this security continues, we will require Joint Applicants to provide the Director of the Commission's Energy Division clear representation that the bonding entities will bond LGS and the Lodi Facility under its new ownership. This representation must be in writing, must be verified, and must be submitted prior to any change of control.

Second, the Banks' financial analysis regarding the sizing of the debt financing is based on a conservative assessment of LGS' cash flow (i.e., cash to operate the Lodi Facility and to make payments to the Banks under the debt

financing arrangement), since it relies only on the aggregate demand charges which LGS' customers must pay for storage contracts for firm service. These contracts include demand charges payable whether or not a customer uses the storage, as well as volumetric usage charges payable when a customer injects or withdraws gas from the Lodi Facility.

Considering the LGS' position as an independent gas storage utility, we conclude that these aspects of the proposed debt financing are reasonable, and we will not impose a debt / equity ratio more typical of a monopoly public utility on LGS' capital structure. We will require that LGS provide a copy of the final debt financing arrangement to the Director of the Commission's Energy Division, whether LGS and the other parties to the transaction obtain debt financing on these terms from the Banks or from alternative lenders. Our authority today applies to the financing terms disclosed in the Application and attached Exhibits. LGS shall secure our approval, pursuant to Pub. Util. Code § 851 and other relevant statutes, before executing a financing agreement that contains substantially different terms and / or conditions.

B. Proposed Affiliate Transactions

Joint Applicants propose two additional contractual arrangements, both of which would involve transactions between LGS and marketing affiliates they propose to form. Joint Applicants represent that the Banks that are extending the debt financing require these contractual arrangements as further security.

The first proposal concerns the Lodi Gas Marketing (LGM) Storage Agreement. According to the Application, at the time the debt financing arrangement closes, LGS does not expect the storage available at the Lodi Facility to be fully subscribed. Thus, upon such closing, Joint Applicants propose that AMS and ArcLight contract for any firm storage that remains uncommitted to

third parties via LGM, a separate limited liability company which AMS and ArcLight would form and which WHP would own. LGM would enter into a firm service storage contract with LGS for any unsubscribed firm storage, which would be subject to release for subscription by third parties in periodic open seasons.[13] The LGS/LGM contract rate would be a market-based rate, no less than the rates charged to existing third-party customers or those future customers who subscribe in the periodic open seasons that LGS will offer.

Under the second proposal, referred to as the LGM Marketing Contract, LGS would post daily all available interruptible capacity and make this subscribed but unused capacity available to other customers who agree to pay appropriate usage charges. Joint Applicants state that maximization of storage capacity in this way is critical to support the equity investment by AMS and ArcLight. They propose that LGS contract with LGM to provide such marketing services because, they state, the Banks will not permit LGS to market this interruptible capacity in order to avoid the risk of any liability not specifically identified and quantified in the connection with the debt financing arrangement. Joint Applicants propose that LGM bear 100% of any liability associated with the marketing of the interruptible capacity and in return, be entitled to 95% of all profit, with LGS taking the remaining 5%.

Both arrangements trouble us because they require contracts between LGS and an affiliate regarding the marketing of LGS' core utility business, the provision of gas storage services. Therefore, these proposals raise larger

[13] An "open season" is a specific period during which prospective customers may elect service, in this case, firm storage.

concerns about the potential for affiliate abuse than do the agreements for construction oversight and management of day-to-day operations. While it is true that our 1997 Affiliate Transaction Rules do not apply to LGS at present, at the time we granted that exemption we put LGS (as well as Wild Goose) on notice that we intended to examine application of those Rules to independent gas storage. As noted above, we do not want to prejudge R.01-01-001. Without a fuller record, we conclude we should not approve, even provisionally, a regulatory regime that could provide LGS with economic and competitive opportunities that we have barred Wild Goose from exploring. We decline to approve the LGM Gas Storage Agreement and the LGM Marketing Agreement. If AMS, ArcLight and the Banks conclude that investment in LGS, as otherwise proposed, lacks sufficient security or could fail to produce the economic returns sought, LGS should seek a different merger partner.

C. Exemption from Affiliate Transaction Rules & Other Reporting Requirements

Joint Applicants ask for confirmation that LGS' exemption from the Affiliate Transaction Rules will continue if we approve the change of control and also request exemption from or the relaxation of other reporting requirements.

In addition to a review of the Affiliate Transaction Rules, R.01-01-001 also is examining the general reporting requirements for utility-affiliate transactions adopted in 1993 by D.93-02-019. These requirements, known as the Interim Affiliate Reporting Requirements, remain in effect today. As modified or interpreted by decisions issued after D.93-02-019, the requirements apply variously to all electric, gas, and telecommunications utilities regulated by the Commission. Thus, while LGS has a current exemption from the Affiliate Transaction Rules, it remains subject to the Interim Affiliate Reporting

Requirements, as well as to other disclosure and filing requirements contained in the Commission's General Orders (GOs) and under Pub. Util. Code § 587. LGS seeks relief from the following:

- GO 65-A: This general order requires submission of "each financial statement prepared in the normal course of business" by a utility with annual operating revenues of at least $200,000 and the "annual report and other financial statements issued to its stockholders".

- GO 77-K: This general order requires submission of data on the compensation of officers and employees, dues and donations, and legal fees.

- GO 104-A: This general order requires the filing of what is usually meant as an "annual report."

- Pub. Util. Code § 587, which concerns reports on transactions with affiliates as implemented by D.93-02-019 (adopting the Interim Affiliate Reporting Requirements), and most recently, D.99-05-011 (confirming the continued application of the 1993 rules).

At the time Joint Applicants filed their Application, Wild Goose enjoyed an exemption from the requirements of GO 65-A and GO 77-K, pursuant to D.00-12-030, and was authorized to comply with GO 104-A by filing a simplified annual report containing the information listed in Exhibit A of that decision (i.e., the type of information the Commission currently requires from competitive local telecommunications carriers and interexchange telephone utilities). D.00-12-030 also narrowed the reporting requirement on Wild Goose under Pub. Util. Code § 587 by limiting reports on affiliate transactions to those in the direct chain between itself and its parent. However, as a condition of amendment of Wild Goose's CPCN, *Wild Goose Expansion* rescinds the exemption

from GO 65-A and GO 77-K and requires more rigorous compliance with GO 104-A and Pub. Util. Code § 587.

As we consider this proceeding, we are mindful that one of our regulatory goals is to treat similarly situated utilities in a similar way and thus avoid creating a competitive advantage for one over another merely by applying different regulatory policies. LGS competes for some of the same noncore customers as Wild Goose does. LGS is subject to the same market-based ratemaking regime. Thus, pending our reexamination in R.01-01-001, we will continue to exempt LGS, like Wild Goose, from the Affiliate Transaction Rules. We see no reason, at this time, to grant LGS authority to comply with GO 65-A, GO 77-K, or GO 104-A in a different fashion than Wild Goose. Accordingly, we decline to exempt LGS from GO 65-A and GO 77-K and will require continued, full compliance with GO 104-A and Pub. Util. Code § 587, rather than the simplified compliance sought.

D. CEQA

Under the California Environmental Quality Act (CEQA) and Rule 17.1 of the Commission's Rules of Practice and Procedure, we must consider the environmental consequences of projects that are subject to our discretionary approval. (Pub. Resources Code § 21080.) It is possible that a change of ownership and / or control may alter an approved project, result in new projects, or change facility operations, etc. in ways that have an environmental impact. Based upon the record, the transfer of control at issue in this proceeding will have no significant effect on the environment for a number of reasons. The Lodi Facility will continue to be developed and operated as previously authorized by this Commission, all environmental mitigation measures contained in the certified EIR will continue to apply, and all monitoring requirements and

restrictions imposed in D.00-05-048, which certified the EIR, will continue. Therefore, the proposed project qualifies for an exemption from CEQA pursuant to § 15061(b)(3)(1) of the CEQA guidelines and the Commission need perform no further environmental review. (See CEQA Guidelines § 1506(b)(3)(1).)

D.00-05-048 restricts persons and entities with a beneficial interest in LGS or its present owners from monitoring the implementation of the environmental mitigation measures. The restriction applies to such persons and entities, defined as anyone

> … who beneficially owns any security of, or has received during the past five years or is presently entitled to received at any time in the future more than a de minimus amount of compensation for consulting services [from LGS or its owners]. (D.00-05-048, Ordering Paragraph 16.)

We will continue to apply this restriction to such persons and entities following the transfer of control and we will extend the same restriction to LGS' new owners and their consultants.

V. Conclusion; Protection of Competitively Sensitive Information

For the multiple operational and financial reasons articulated in Parts III and IV above, we find it is in the public interest to approve the Application and we do so, subject to each of the conditions and limitations also discussed in those Parts. Thus, as conditioned we authorize the transfer of control of LGS and the Lodi Facility via the sale of Western Hub to WHP, and thereby, jointly to AMS and ArcLight. We also authorize the debt financing proposal, as specifically conditioned herein.

To the extent compliance with our conditions of approval requires the disclosure of competitively sensitive, confidential information, LGS may submit

the information under seal, in accordance with the Commission's GO 66-C and Pub. Util. Code § 583.

VI. Miscellaneous Procedural Matters

Notice of this Application appeared in the Commission's Daily Calendar on October 15, 2001 and notice of the Amendment, on November 29, 2001. The Commission has received no protests of either filing.

In Resolution ALJ 176-3074, the Commission preliminarily categorized this proceeding as ratesetting, and preliminarily determined that hearings were not necessary. We confirm those determinations. As no hearing is required, and pursuant to Rule 6.6 of the Commission's Rules of Practice and Procedure, Article 2.5 of the Rules ceases to apply to this proceeding.

This is an uncontested matter in which we grant, in part, and deny, in part, the ultimate relief requested. In such situations, the public review and comment provisions of Pub. Util. Code § 311(g)(1) apply, absent a waiver by stipulation of all parties to the proceeding in accordance with Pub. Util. Code § 311(g)(2). On July 11, 2002, Joint Applicants filed a request to shorten the comment period on the draft decision to 15 days. We grant Joint Applicants' unopposed request.

VII. Comments on Draft Decision

The draft decision in this matter was mailed to the parties in accordance with Rule 77.7 of the Commission's Rules of Practice and Procedure.

Findings of Fact

1. This Application is the joint application with a prospective purchaser for a change of control pursuant to Pub. Util. Code § 854 that is referred to in D.01-08-023. This Application and Amendment are unopposed.

2. On August 22, 2001 Western Hub, its owners and WHP executed a Unit Purchase Agreement for the sale of Western Hub to WHP, subject to this

Commission's approval. The transaction provides for cash consideration to Western Hub's current owners of $105 million plus up to $3 million in expenses.

3. Western Hub will continue to exist after the change of control. Consequently, this transfer will result in the indirect change of control of LGS and the Lodi Facility but will not result in the transfer of any certificates, assets, or customers of LGS. LGS will continue to be bound by the terms and conditions prescribed by the Commission in D.00-05-048, as modified, which granted LGS a CPCN and certified the EIR for its project, and by the terms and conditions of LGS' filed tariff.

4. The direct owners of WHP are ArcLight and AMS, which will each invest $25 million in the acquisition. Aquila now owns 100% of AMS.

5. The evidence Joint Applicants have presented on market power is at best inconclusive; it does not permit us to find that LGS cannot exercise market power.

6. To ensure LGS does not exercise market power in the storage market, the change of control should be authorized only if LGS complies with the prohibition on affiliate transactions for storage or hub services and with the reporting requirements described in this decision.

7. WHP has a four-member Management Committee, with two individuals designated to serve by AMS and two by ArcLight. AMS will provide construction management at the Lodi Facility, including the "turnkey wrap" function that the banks require, and management of the day-to-day operations of LGS. AMS' managerial fees will be market-based and negotiated with ArcLight on behalf of LGS.

8. Both AMS and ArcLight bring substantial financial resources to the proposed transaction, and between them, sufficient managerial and financial

expertise to oversee the successful operation of LGS and the Lodi Facility and to bring the remaining portions of the construction project to fruition.

9. The 50% - 50% ownership position suggests appropriate checks and balances will govern negotiations between AMS and ArcLight for management contracts. Disclosure of those contracts, and any amendments, to the Commission will provide another check.

10. Approval of the management contracts should be provisional and subject to reexamination in R.01-01-001.

11. The Indicative Terms and Conditions for the debt financing under negotiation provide for a market-rate loan to LGS of up to $175 million, repayable within five years, to supplement the equity capital from AMS and ArcLight. The proceeds are to be used to acquire Western Hub and to refinance interim construction financing provided LGS by WHP.

12. Considering the status of LGS as an independent gas storage utility, the Commission need not impose a debt/equity ratio more typical of a monopoly public utility on LGS' capital structure. Concern about the impact of the proposed debt financing on LGS capital structure is mitigated further by several factors: the $20 million performance bond ordered in D.00-05-048 will remain in place and the Banks' financial analysis regarding the sizing of the debt financing is based on a conservative assessment of LGS' cash flow.

13. LGS should provide a copy of the final debt financing arrangement to the Director of the Commission's Energy Division.

14. To ensure that the performance bond will continue without interruption, Joint Applicants should provide the Director of the Commission's Energy Division clear representation that the bonding entities will bond LGS and the

Lodi Facility under its new ownership. This representation must be verified, must be in writing, and must be submitted prior to any change of control.

15. The proposed LGM Storage Agreement and LGM Marketing Contract would require contracts between LGS and an affiliate regarding the marketing of LGS' core utility business, the provision of gas storage services.

16. Pending reexamination of application of affiliates reporting requirements to independent gas storage in R.01-01-001, we should treat LGS like Wild Goose in order to avoid, through regulatory policy, creating a competitive advantage for one over another. Therefore, we should continue to: (a) exempt LGS from the Affiliate Transaction Rules; (b) require full compliance with GO 65-A, GO 77-K, and GO 104-A; and (c) decline to authorize a simplified annual report as compliance with Pub. Util. Code § 587.

17. This transfer of control will have no significant effect on the environment since the Lodi Facility will continue to be operated as previously authorized by this Commission, all environmental mitigation measures contained in the certified EIR will continue to apply, and all monitoring requirements and restrictions imposed in D.00-05-048, which certified the EIR, will continue.

18. The Commission should extend the environmental mitigation monitoring restrictions imposed by D.00-05-048, Ordering Paragraph 16, to persons and entities with a beneficial interest in any of LGS' new owners.

19. No hearing is necessary.

20. Joint Applicants' July 11, 2002 request to shorten the comment period on the draft decision to 15 days is unopposed and should be granted.

Conclusions of Law

1. The application should be granted in part and denied in part.

2. As conditioned herein, the portions of the application granted are in the public interest.

3. Following the change of control, LGS will continue to be bound by the terms of its CPCN, by all the requirements and conditions mandated in D.00-05-048 as modified by subsequent Commission decisions, and by the tariff filed with the Commission, as approved and subsequently modified by any approved amendments.

4. The preliminary determinations in Resolution ALJ 176-3074 should be confirmed.

5. Article 2.5 of the Commission's Rules of Practice and Procedure ceases to apply to this proceeding.

6. This transfer of control qualifies for an exemption from the California Environmental Act (CEQA) under CEQA Guidelines § 1506(b)(3)(1) and therefore, additional environmental review is not required.

7. The restriction preventing persons and entities with a beneficial interest in LGS or its present owners from monitoring the implementation of the environmental mitigation measures should be extended to persons and entities with a beneficial interest in any of LGS' new owners.

8. The change of control should not occur until Joint Applicants provide the Director of the Commission' Energy Division with verified representation, in writing, that the bonding entities will continue to bond LGS and the Lodi Facility under the $20 million performance bond ordered by D.00-05-048.

9. Because no action has been taken on Joint Applicants' November 20, 2001 motion for an order shortening time for protests and / or responses to the Amendment to the Application and limiting the scope of response, the motion is now moot.

10. Joint Applicants' July 11, 2002 request to shorten the comment period on the draft decision to 15 days complies with Pub. Util. Code § 311(g)(2).

11. This order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The Application of Lodi Gas Storage, L.L.C. (LGS), Western Hub Properties, L.L.C. (Western Hub) and WHP Acquisition Company, LLC (WHP), collectively Joint Applicants, is granted in part, as provided in these Ordering Paragraphs, and in all other respects is denied.

2. The transfer of ownership of Western Hub, and indirectly LGS and the Lodi gas storage facility, to WHP and its owners, pursuant to Pub. Util. Code § 854, is approved subject to the conditions listed in Ordering Paragraph 6 and shall not occur until Joint Applicants have complied with Ordering Paragraph 6(a). LGS and its new owners shall continue to be bound by all terms and conditions of LGS' certificate of public convenience and necessity, as granted by Decision (D.) 00-05-048 and modified by subsequent decisions of the Commission.

3. Joint Applicants' request, pursuant to Pub. Util. Code §§ 816, 817, 818, 823 and 851, for authority to enter into a secured, long-term bank financing agreement is approved, subject to the conditions listed in Ordering Paragraph 6.

4. Joint Applicants' requests for authorization to negotiate contracts, on behalf of LGS, for the management of continuing construction at the Lodi Facility and for management of the day-to-day operations of LGS are approved, on a provisional basis, subject to the conditions listed in Ordering Paragraph 6, but shall be reexamined in Rulemaking (R.) 01-01-001.

5. Pending further order of the Commission, LGS shall continue to be exempt from the Affiliate Transaction Rules.

6. The authority granted in Ordering Paragraphs 1 through 5, above, is conditioned upon compliance with the following subparagraphs. Disclosure of the required information, including contracts and other documents, shall be made to the Director of the Commission's Energy Division by LGS and its owners. Competitively sensitive, confidential information may be submitted under seal in accordance with General Order 66-C and Pub. Util. Code § 583. LGS shall:

a. Provide clear representation in writing, prior to the change of control, that the bonding entities will continue to bond LGS and the Lodi Facility under the $20 million performance bond ordered by D.00-05-048;

b. Provide true copies of the contracts with AMS, and any amendments to those contracts, for the management of continuing construction and day-to-day operations at LGS and the Lodi Facility;

c. Provide a true copy of the final, debt financing arrangement from the proposed and / or any alternative lenders, once that arrangement is finalized in accordance with the terms approved herein.

d. Provide prompt disclosure of the following changes in status that reflect a departure from the characteristics the California Public Utilities Commission has relied upon in approving market-based pricing: (i) LGS' own purchase of natural gas facilities, transmission facilities, or substitutes for natural gas, like liquefied natural gas facilities; (ii) an increase in the storage capacity or in the interstate or intrastate transmission capacity held by affiliates of its ultimate parents (Aquila, Inc. (Aquila) and ArcLight Energy

Partners Fund I, L.P. (ArcLight))or their successors; or (iii) merger or other acquisition involving affiliates of its ultimate parents (Aquila and ArcLight) or their successors and another entity that owns gas storage or transmission facilities or facilities that use natural gas as an input, such as electric generation.

e. Provide true copies of all service agreements for short-term transactions (one year or less) within 30 days of the date of commencement of short-term service, to be followed by quarterly transaction summaries of specific sales. If LGS enters into multiple service agreements within a 30-day period, LGS may file these service agreements together so as to conserve the resources both of LGS and the Commission. The quarterly transactions summaries shall list, for all tariffed services, the purchaser, the transaction period, the type of service (e.g., firm, interruptible, balancing, etc.), the rate, the applicable volume, whether there is an affiliate relationship between LGS and the customer, and the total charge to the customer.

f. Provide true copies of all service agreements for long-term transactions (longer than one year), within 30 days of the date of commencement of service. To ensure the clear identification of filings, and in order to facilitate the orderly maintenance of the Commission's records, long-term transaction service agreements shall not be filed together with short-term transaction summaries.

g. Not engage in any storage or hub services transactions with it its ultimate parents (Aquila and ArcLight), or their successors, or any affiliated entity owned or controlled by its ultimate parents or their successors.

7. The transfer of control qualifies for an exemption from the California Environmental Act (CEQA) under CEQA Guidelines § 1506(b)(3)(1) and therefore, additional environmental review is not required.

8. D.00-05-048, Ordering Paragraph 16, which prohibits persons and entities with a beneficial interest in LGS or its present owners from monitoring the implementation of the environmental mitigation measures, shall continue and shall extend, following the transfer of control, to persons and entities with a beneficial interest in any of LGS' new owners.

9. Joint Applicants shall notify the Director of the Commission's Energy Division in writing of the transfer of authority, as authorized herein, within 30 days of the date of the transfer. A true copy of the instruments of transfer shall be attached to the notification**.**

10. The authority granted herein shall expire if not exercised within one year of the date of this order.

11. Joint Applicants' November 20, 2001 motion for an order shortening time for protests and / or responses to the Amendment to the Application, and limiting the scope of response, is moot.

12. Joint Applicants July 11, 2002, request to shorten the comment period on the draft decision to 15 days is granted.

13. Application 01-09-045 is closed.

This order is effective today.

Dated _____, at San Francisco, California.