

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



February 11, 2003

Agenda ID #1776

TO: PARTIES OF RECORD IN APPLICATION 01-09-045

This is the draft decision of Administrative Law Judge (ALJ) Vieth. It will not appear on the Commission's agenda for at least 10 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Pursuant to Rule 77.7(g), **comments on the draft decision must be filed within ten days of its mailing and no reply comments will be accepted.**

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at <http://www.cpuc.ca.gov>. In addition to service by mail, parties should send comments in electronic form to those appearances and the state service list that provided an electronic mail address to the Commission, including ALJ Vieth at xjv@cpuc.ca.gov. Finally, comments must be served separately on the Assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious methods of service.

/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:hkr

Attachment

Decision **DRAFT DECISION OF ALJ VIETH** (Mailed 2/11/2003)

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)

**OPINION APPROVING TRANSFER OF CONTROL
OF LODI GAS STORAGE, LLC**

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**OPINION APPROVING TRANSFER OF CONTROL
OF LODI GAS STORAGE, LLC**

I. Summary

We approve, subject to the conditions enumerated below, 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 Acquisition), for a change in the ultimate ownership and control of LGS and its Lodi gas storage. The change in ownership, by which WHP Acquisition will acquire an indirect 50% interest in LGS concurrent with the reduction of Western Hub's interest from 100% to 50%, will not affect the rates, terms, or conditions under which LGS is to operate pursuant to previous Commission decisions. LGS will continue to offer market-based rates to noncore natural gas storage customers in accordance with the requirements of its tariff and the orders of this Commission.

The transactions underlying the change in ownership qualify for an exemption from the California Environmental Quality 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 Decision (D.) 00-05-048;
- 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.

In addition, we prohibit LGS from engaging in any storage or hub services transactions with its ultimate corporate parents or with their affiliates. This ban, however, does not apply to the agreement by which Western Hub will continue to manage the day-to-day operations of LGS.

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.¹ The Commission authorized LGS, a new public utility under Pub. Util. Code § 216 and § 222, to provide firm and interruptible 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.

¹ 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.)

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. 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 notes LGS' representation that in the near future it would be filing a joint application with a prospective purchaser to request Commission approval of a change of control of LGS.

This proceeding concerns that application and several subsequent amendments to it. The parties' original proposal is the subject of the initial Application, filed on September 28, 2001, and an Amendment, filed on November 20, 2001 (2001 Amendment).² The original proposal has been revised and supplanted by an Amendment, filed on October 18, 2002 (2002 Amendment) and a Supplement, filed on November 4, 2002.

² 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. A draft decision and Assigned Commissioner's alternate draft decision mailed for public comment on August 7, 2002. That day and for several days thereafter (though the Commission had not acted on either draft decision), trade press articles reported that one of LGS' potential buyers was actively marketing, for resell, its interest in the Lodi Facility. On August 15, 2002 a second ACR issued to set aside submission and require additional information on these reports. Joint Applicants filed the required information on August 26 and this proceeding was resubmitted. Subsequently, the Commission received a letter dated September 13, 2002 from an officer of one of the investors in the proposed transaction, Aquila, Inc, which stated that circumstances underlying the parties' proposal and recounted in both draft decisions had changed with the passage of time. A third ACR issued on September 17, 2002 to set aside submission once more and to require further amendment of the Application or in the alternative, a motion for its withdrawal.

Concurrent with the filing of the 2001 Amendment and with the 2002 Amendment, Joint Applicants filed motions requesting orders shortening time for protests and/or responses and limiting the scope of response. The assigned administrative law judge (ALJ) took no action on either motion and these matters are now moot. No protests or responses were filed to the Application or to either Amendment. By rulings on January 4, 2002 and January 15, 2003, the ALJ addressed Joint Applicants' motions regarding for leave to file under seal commercially sensitive, confidential information filed, respectively, as part of the Application and the 2002 Amendment.

III. The Proposed Transaction

A. Overview

LGS, Western Hub, and WHP Acquisition, the Joint Applicants in this proceeding, seek Commission authorization for a change in the ownership and control of LGS and its Lodi Facility. From the time of certification, LGS has been the wholly owned subsidiary of Western Hub.

As initially proposed (in the Application and 2001 Amendment), Joint Applicants sought authority for two entities, Aquila, Inc. (the former UtiliCorp. United Inc.) and ArcLight Energy Partners Fund I, L.P. (ArcLight), to acquire equal shares in Western Hub through a chain of affiliated companies and thereby to acquire indirect control of LGS. Specifically, Joint Applicants proposed that WHP Acquisition (which was owned jointly by Aquila, Inc. and ArcLight), purchase Western Hub from its current owners. To this end, on August 22, 2001, Western Hub, its owners and WHP Acquisition executed a Unit Purchase Agreement for the sale of Western Hub to WHP Acquisition for cash consideration of \$105 million plus up to \$3 million in expenses.

The 2002 Amendment and Supplement propose a much simpler transfer in which Aquila, Inc. plays no role, as its interest in WHP Acquisition has been bought out by ArcLight. Under the terms of the revised transfer proposal, Western Hub and WHP Acquisition would become indirect co-owners of LGS and the Lodi Facility. Attachment A to today's order illustrates the organizational structure of the revised proposed transaction,³ which is memorialized in the Amended and Restated Unit Purchase Agreement, executed on October 30, 2002,⁴ and the attachments to it. The proposal requires that Western Hub spin off all of its equity interest in LGS (valued at approximately \$110 million) into a new subsidiary, Lodi Holdings, L.C.C. (Lodi Holdings), formed for the express purpose of owning, directly, 100% of LGS. WHP Acquisition would purchase a 50% share of Lodi Holdings by assigning to Lodi Holdings its interests (approximately \$110,000,000) in a note for the construction loan financing LGS obtained through the replacement debt financing arrangement approved by D.01-08-023. WHP Acquisition would also extend the maturity date of the note to June 30, 2003 (it was previously extended from August 22, 2001 to October 30, 2002 and then to December 31, 2002). Western Hub would serve as Company Manager under the parties' agreement and in that capacity would continue to provide the day-to-day management of LGS.

According to Joint Applicants, the purpose of Lodi Holdings is:

³ Attachment A is a copy of the diagram filed with the Supplement as Exhibit 6 to the 2002 Amendment. We have revised the diagram to include names, shown in parentheses, consistent with the nomenclature used in this order.

⁴ The Amended and Restated Unit Purchase Agreement, filed with the Supplement, is Exhibit 5 to the 2002 Amendment.

... to simplify WHP Acquisition's investment in LGS. Western Hub has separate employees and holds other assets and liabilities unrelated to LGS. If WHP Acquisition were to purchase 50% of Western Hub, the Joint Applicants would need to create a mechanism to separately account for those other employees, assets and liabilities. The Joint Applicants therefore decided to establish a standalone entity – Lodi Holdings – to serve as the vehicle for the joint ownership of LGS by Western Hub and WHP Acquisition. The creation of Lodi Holdings avoids the need to address a number of complex compensation, accounting and tax issues and keeps the non-LGS business interests of Western Hub separate from LGS. (Supplement at 2-3.)

In addition to Lodi Holdings, the proposed transaction would utilize a second new entity, Lodi Finance, L.L.C. (Lodi Finance), also represented in Attachment A. Lodi Holdings would transfer the \$110 million note from WHP Acquisition to Lodi Finance as a secured loan. Joint Applicants explain that the purpose of Lodi Finance is:

... to hold the construction Loan to be contributed by WHP Acquisition at the closing in exchange for its 50% interest in Lodi Holdings. This structure is intended to preserve LGS' potential tax benefits associated with the Construction Loan. It will also facilitate any future refinancing of the Construction Loan by enabling a prospective lender to purchase LGS Finance with the loan in place, thereby eliminating the necessity of re-filing mortgages and obtaining new title insurance policies. (Supplement at 3.)

The transaction Joint Applicants now propose differs from the prior one in the following, additional respects:

- Joint Applicants are no longer considering the debt-financing package (approximately \$175 million) submitted as part of the Application and 2001 Amendment. Joint Applicants state that in the near future LGS may seek additional debt

financing and at such time, will submit an application for Commission approval.

- Joint Applicants are no longer considering other contracts associated with the abandoned debt financing proposal and referred to in the Application and 2001 Amendment as the Turnkey Wrap of Construction Arrangements, the LGM Gas Storage Agreement, the LGM Marketing Contract or the Operations and Maintenance Contract.
- Joint Applicants recognize that the issue of whether LGS may retain its exemption from the 1997 Affiliate Transaction Rules will be considered in R.01-01-001 and they do not seek a determination in this proceeding.⁵
- Joint Applicants recognize that LGS is subject to the Interim Affiliate Reporting Requirements, the general reporting requirements for utility-affiliate transactions adopted in 1993 by D.93-02-019, as well as to other disclosure and filing requirements under Pub. Util. Code § 587 and Commission's General Orders (GOs), including GO 65-A, GO 77-K, and GO 104-A. Joint Applicants do not seek a relaxation of any of these requirements in this proceeding.

⁵ 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 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 LGS had not been made a respondent to the rulemaking that promulgated those rules and because the Commission had determined that, at that time:

. . . 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.)

B. Parties to the Proposed Transaction

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.⁶ Western Hub has owned LGS since its certification in 2000.

WHP Acquisition is a Delaware limited liability company with its principal place of business in Kansas City, Missouri. As related above, ArcLight now owns 100% of WHP Acquisition.

ArcLight, 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 passive private equity and equity-like investments, and certain debt investments in regulated and unregulated public utilities and in other energy and telecommunications enterprises. According to the Application, as of September 2001 John Hancock Life Insurance Company had committed to invest up to \$500 million in ArcLight. The 2002 Amendment states that subsequently ArcLight has received additional capital commitments from limited partners, resulting in total commitments of \$950 million as of September 27, 2002.

⁶ 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.

C. Legal Standards

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 Co. (1916)* 10 CRC 56.)

The 2002 Amendment queries whether the transaction, as now proposed, is a change of control under Pub. Util. Code § 854. Joint Applicants point out that, under the revised Unit Purchase Agreement, Western Hub will retain 50% ownership of Lodi Holdings as well as operational control of LGS’ day-to-day operations. Joint Applicants ask the Commission to approve the proposed transaction, or in the alternative, to state that such approval is not required.

Historically, the Commission has determined the applicability of § 854 on a case-by-case basis. Several previous Commission decisions explicitly recognize that Pub. Util. Code § 854 does not define “control” and refer to the California Corporations Code for guidance⁷; the Commission has not

⁷ Corp. Code § 160 defines “control” to mean, alternatively:

- a) Except as provided in subdivision (b), “control” means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a corporation.
- b) “Control” in Sections 181, 1001, and 1200 means the ownership directly or indirectly of shares or equity securities possessing more than 50 percent of the voting power of a domestic corporation, a foreign corporation, or an other business entity.

promulgated regulations to define “control” in terms of a percentage of stock ownership.

Under diverse fact situations where a public utility owner has either transferred or proposed to transfer a 50% interest in the utility, or has acquired a 50% interest in another utility, the Commission has asserted jurisdiction to review the transaction under § 854 and has approved or disapproved the transfer.⁸ Under facts involving a change in the form of ownership but no change in the actual control of the utility, several Commission decisions have held § 854 to be inapplicable and have dismissed the underlying application.⁹ But in an application under Pub. Util. Code § 852 (which requires any corporation holding a controlling interest in a California public utility to obtain prior Commission authorization before it acquires any part of the capital stock of another California public utility), the Commission expressed concern that

⁸ See *Application of PacTel Cellular for control of Bay Area Cellular Telephone through Bay Area Cellular Telephone Company*, D.87-09-028, 25 CPUC2d 350, 1987 Cal. PUC LEXIS 197 [definitions of term “control” in the Corporations Code are instructive for purposes of Pub. Util. Code § 854]; *Gale v. Teel*, D.87478, 81 CPUC 817, 1977 Cal. PUC LEXIS 152 [public policy implication of transfer warrants review of acquisition of 50% interest in public utility for purposes of Pub. Util. Code § 854]; *Dana Point Marin Telephone Co.*, D.83493, 77 CPUC 347, 1974 Cal. PUC LEXIS 829 [Pub. Util. Code § 854 requires Commission authorization of relinquishment of positive control (100% ownership) for negative control (50% ownership)].

⁹ See *Crico Communications*, D.92-05-006, 1992 Cal. PUC LEXIS 487 [dismissal appropriate because Pub. Util. Code § 854 inapplicable to public stock offering where original owners retain 20% of utility and no other person or entity acquires control]; *Paging Network of San Francisco*, D.93-11-063, 52 CPUC2d 127, 1993 Cal. PUC LEXIS 794 [dismissal appropriate because Pub. Util. Code § 854 inapplicable to distribution of shares of utility’s parent corporation from a limited partnership investment fund directly to its partners where no effect on actual or working control of utility’s service or operations].

blanket authorization for a utility to purchase additional shares in its holding company parent could affect control of the parent, and limited the authorization to five years to avoid conflict with § 854.¹⁰

Discussion

First we address the applicability of Pub. Util. Code § 854. We conclude that under the facts presented in this application, the Commission must approve the authority sought. Generally, we think it is prudent public policy to review and approve changes in the ownership and control of certificated natural gas storage utilities, whether those changes occur directly, or indirectly through corporate intermediaries. Such review should help to ensure the continued economic viability of such utilities and to prevent market manipulations that may affect not only their own customers but also larger ratepayer groups.

Moreover, as the instant transaction illustrates, indirect ownership may provide the potential for substantial influence and give rise to actual control, within the context of Corp. Code § 160(a). While the Lodi Holdings Agreement attached to the revised Unit Purchase Agreement states that Western Hub will provide day-to-day management of LGS' operations as Company Manager, Western Hub will no longer retain full discretion to set longer-term plans, including major fiscal policy. Instead, it will share that decision-making authority, equally, with WHP Acquisition. Further, since either equity owner has authority to remove the Company Manager, WHP Acquisition, acting alone, conceivably could remove Western Hub from that position, whereupon the

¹⁰ *San Jose Water Co.*, D.94-01-025, 53 CPUC2d 37, 1994 Cal. PUC LEXIS 43 [re: San Jose Water's request to invest in dividend reinvestment plan of its parent, California Water Service Co.].

two equity owners would then have to agree to appoint a replacement. We do not suggest that these aspects of the parties' agreement are problematic under the circumstances, but note that they describe a change in the structure of corporate control that affects various elements of actual control. So that we may continue to monitor LGS' operations in a meaningful way, we condition our approval by imposing the following reporting requirement. Should Western Hub cease to serve as Company Manager of Lodi Holdings for any reason, we direct LGS to promptly advise the Director of the Commission's Energy Division, in writing, of that fact and of the reasons for the change.

Next we consider how the indirect change of control will affect LGS, its customers and the market place. Joint Applicants assert: "the transaction effects no change in the LGS' name, rates, or conditions of service." (2002 Amendment at 10.) Joint Applicants do not seek the transfer of LGS' CPCN; rather, LGS will continue to hold it and will continue to offer natural gas storage at market-based rates, pursuant to D.00-05-048. 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 to LGS. Likewise, LGS must continue to operate in conformance with its tariff, filed with the Commission on July 13, 2001, and with any subsequent amendments of that tariff.

ArcLight brings substantial financial resources to the proposed transaction in return for its equity investment (the assignment of its rights under the construction loan to Lodi Holdings). We note, approvingly, that the proposed transaction avoids the likelihood of LGS' near-term default on the construction loan and probable bankruptcy. Thus, LGS will be able to continue to serve its customers, without interruption. The 2002 Amendment states that LGS has three customers with firm storage contracts with initial terms a year or longer (one of

these has less than a year remaining). LGS also provides short-term firm and interruptible service to several customers. With Western Hub serving as the Company Manager, day-to-day management and operations will continue under the same management that has been in place since certification.

The Application states that following issuance of D.00-12-026, LGS began the search that has led to the proposal before us today:

. . . 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). (Application at 12.)

Construction is now complete. The 2002 Amendment states that Phase I became operational on January 2, 2002, providing approximately 9 Bcf of storage with injection and withdrawal capacity of approximately 300 MMcf/d. Phase II was completed this past summer. As of August 30, 2002, the Lodi Facility has had storage capacity of 12 Bcf, with approximately 400 MMcf/d of injection capacity and 500 MMcf/d of withdrawal capacity.

We know that the natural gas storage market, while still relatively new, is not the same market that existed when we approved LGS' certificate. 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.¹¹ We 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 we were unable to conclude definitively,

¹¹ 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.

on the record of that proceeding, “whether Wild Goose possesses and can exercise market power,” we imposed a number of 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.) We 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, only 200 MMcf/d of Wild Goose’s peak withdrawal capacity moves through Line 167, the major transmission line into Sacramento. The Lodi Facility’s 500 MMcf/d of peak withdrawal capacity and Wild Goose’s remaining 500 MMcf/d, will compete directly for transmission access to the Bay Area load center. D.02-07-036 found that during peak periods for storage withdrawal, PG&E’s transmission system may have insufficient capacity to accommodate all demands for transportation of natural gas (i.e. whether from an in-state storage facility or from the California border) on an “as-available” basis.¹²

Considering these realities, the draft decisions that reviewed Joint Applicants’ initial proposal (which would have given Aquila, Inc. an indirect

¹² As-available (interruptible) transportation service is the lowest priority transportation service available to noncore customers on the PG&E system.

ownership interest in the Lodi Facility) questioned assertions that LGS would be unable to exercise market power in the gas storage market. The proposal before us today provides Western Hub with a financial partner that does not have an active energy market involvement at this time or the financial problems of Aquila, Inc. Our greatest concerns about the possible exercise of market power or possible abuse of affiliate relationships are allayed, but the fact remains that the natural gas storage market is a heavily concentrated one.

So that we may better monitor the evolving natural gas market, and as a condition of our approval of the change of ownership (with continued market-based rate authority), we will impose the same reporting requirements on LGS that we have imposed on Wild Goose. Specifically, with the exception of the agreement by which Western Hub will serve as Company Manager for Lodi Holdings, we will prohibit LGS from engaging in any storage or hub services transactions with its ultimate parents, Western Hub 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.

The storage contracts reports required by the preceding paragraphs should be provided to the Director of the Commission's Energy Division within 60 days of the date of issuance of this decision on an initial basis and thereafter, as specified.

V. CEQA

Under 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 change of ownership 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 change of ownership and control and we will extend the same restriction to LGS' new owners and their consultants.

VI. Conclusion; Protection of Competitively Sensitive Information

We find it is in the public interest to approve the Application and we do so, subject to each of the conditions discussed 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.

VII. Miscellaneous Procedural Matters

Notice of this Application appeared in the Commission's Daily Calendar on October 15, 2001, and notice of the 2001 Amendment on November 29, 2001, and notice of the 2002 Amendment on October 25, 2002. The Commission has received no protests.

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.

VIII. Comments on Draft Decision

This is an uncontested matter where, by stipulation submitted February 10, 2003, Joint Applicants have requested a reduced comment period. Accordingly, pursuant to Pub. Util. Code § 311(g)(2) and Rule 77.7(g) of the Commission's Rules of Practice and Procedure, the otherwise applicable 30-day period for public review and comment is being reduced. Comments are due ten days after the draft mails and there will be no reply comments.

IX. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Jean Vieth is the assigned ALJ in this proceeding.

Findings of Fact

1. The Application, 2001 Amendment, and 2002 Amendment are all unopposed.
2. On October 30, 2002 Western Hub, its owners and WHP Acquisition executed an Amended and Restated Unit Purchase Agreement, whereby Western

Hub and WHP Acquisition will become indirect, co-owners of a new entity, Lodi Holdings, created to own 100% of LGS.

3. The proposed equity interest of Western Hub in Lodi Holdings is valued at approximately \$110 million.

4. WHP Acquisition's proposed equity investment in Lodi Holdings consists of assignment of its interests (approximately \$110,000,000) in a note for the construction loan financing LGS obtained through the replacement debt financing arrangement approved by D.01-08-023, together with extension of the maturity date of the note to June 30, 2003.

5. The parties' agreement creates a second new entity, Lodi Finance, L.L.C. (Lodi Finance). Lodi Holdings will transfer the \$110 million note from WHP Acquisition to Lodi Finance as a secured loan, in order to preserve the tax benefits to LGS and simplify future refinancing.

6. The proposed transfer will result in the change of ownership and 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.

7. The direct owner of WHP Acquisition is ArcLight, which has no active involvement in energy markets. As of September 27, 2002, ArcLight had capital commitments of \$950 million from its limited partners.

8. The proposed transaction avoids the likelihood of LGS' near-term default on the construction loan and probable bankruptcy and ensures that LGS will be able to continue to serve its customers, without interruption

9. Under the Lodi Holdings Agreement attached to the Amended and Restated Unit Purchase Agreement, Western Hub will provide day-to-day management of LGS' operations as Company Manager.

10. With Western Hub serving as the Company Manager, day-to-day management and operations will continue under the same management that has been in place since certification.

11. Authorized construction of the Lodi Facility (Phases I and II) is complete.

12. The Lodi Facility has a smaller inventory capacity than Wild Goose but the physical attributes of its storage reservoir permit highly flexible storage operations. The Lodi Facility's 500 MMcf/d of peak withdrawal capacity and Wild Goose's remaining 500 MMcf/d, will compete directly for transmission access to the Bay Area load center, along with all other gas transportation volumes.

13. The 2002 Amendment and Supplement provide Western Hub with a financial partner that does not have an active energy market involvement or the financial problems of Aquila, Inc.

14. Though the 2002 Amendment and Supplement allay the Commission's greatest concerns about the possible exercise of market power or possible abuse of affiliate relationships, the fact remains that the natural gas storage market is a heavily concentrated one.

15. LGS participated actively in the proceeding that led to *Wild Goose Expansion*, D.02-07-036.

16. To better monitor the evolving natural gas market, and as a condition of our approval of the change of ownership and control (with continued market-based rate authority), the Commission should impose the same reporting requirements on LGS that it has imposed on Wild Goose.

17. The change of control should be authorized only if LGS complies with the prohibition on affiliate transactions for storage or hub services (with the exception of the agreement by which Western Hub will serve as Company Manager for Lodi Holdings) and with the reporting requirements described in this decision.

18. 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.

19. This change of ownership and 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.

20. 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.

21. No hearing is necessary.

Conclusions of Law

1. The transaction proposed constitutes a change of control, within the meaning of Pub. Util. Code § 854.

2. The Application, as amended on October 18, 2002, should be granted, as conditioned herein.

3. As conditioned herein, the Application, as amended on October 18, 2002, is in the public interest.

4. 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.

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

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

7. This change of control qualifies for an exemption from CEQA under CEQA Guidelines § 1506(b)(3)(1) and therefore, additional environmental review is not required.

8. 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.

9. The change of control should not occur until Joint Applicants provide the Director of the Commission's 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.

10. Because no action has been taken on Joint Applicants' November 20, 2001 and October 18, 2002 motions for orders shortening time for protests and/or responses and limiting the scope of response, the motions are now moot.

11. This order should be effective immediately.

O R D E R**IT IS ORDERED** that:

1. The Application, as amended on October 18, 2002, of Lodi Gas Storage, L.L.C. (LGS), Western Hub Properties, L.L.C. (Western Hub) and WHP Acquisition Company, LLC (WHP Acquisition), collectively Joint Applicants, is approved pursuant to Pub. Util. Code § 854, subject to the conditions set forth in the following Ordering Paragraphs.

2. LGS and its 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. The authority granted in Ordering Paragraph 1 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 prompt notice to the Director of the Commission's Energy Division, in writing, if Western Hub should cease to serve as Company Manager of Lodi Holdings for any reason, and explain the reasons for the change;
- c. 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 (Western Hub and ArcLight Energy Partners Fund I, L.P. (ArcLight)) or their successors; or (iii) merger or other acquisition involving affiliates of its ultimate parents (Western Hub 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.
- d. 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.
- e. 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.
- f. Not engage in any storage or hub services transactions with its ultimate parents (Western Hub and ArcLight), or their successors, or any affiliated entity owned or controlled by its ultimate parents or their successors. However, this ban does not apply to the agreement submitted a part of the Amended and Restated Unit Purchase Agreement, by which Western Hub will serve as Company Manager for Lodi Holdings.

4. The change in ownership qualifies for an exemption from the California Environmental Quality Act (CEQA) under CEQA Guidelines § 1506(b)(3)(1) and therefore, additional environmental review is not required.

5. 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 to persons and entities with a beneficial interest in any of LGS' new owners.

6. Joint Applicants shall notify the Director of the Commission's Energy Division, in writing, of the transfer of ownership, 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.

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

8. Joint Applicants' November 20, 2001 and October 18, 2002 motions for orders shortening time for protests and/or responses to the Amendment to the Application, and limiting the scope of response, are moot.

9. Application 01-09-045 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

ATTACHMENT A

(END OF ATTACHMENT A)