

Decision 84 06 132

JUN 20 1984

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Lighting Gas Supply Company and Pacific Gas and Electric Company for authorization to sell the Ten Section Underground Gas Storage Field.

Application 84-05-071
(Filed May 18, 1984)

O P I N I O N

Pacific Lighting Gas Supply Company (PLGS), a California corporation, and Pacific Gas and Electric Company (PG&E), a California corporation, seek authority to sell and convey to Century Production, Inc. (Century) the underground gas storage field located in the area known as Ten Section. PLGS is a gas corporation engaged in the business of transporting and selling natural gas in California. PG&E is a gas and electric corporation engaged principally in the business of furnishing gas and electric services in California. Century, a corporation located in Pasadena, owns and operates oil and gas producing properties. It is not now, and has never been, subject to the jurisdiction, regulation, supervision, or control of the Commission.

Background

PLGS and PG&E undertook the Ten Section project in the late 1970s. At that time, forecasts indicated that additional storage capacity would be necessary to avoid curtailment of high priority customers who have no alternative fuel capacity. In Decision (D.) 91856 issued on June 3, 1980, in Application (A.) 58905 the Commission issued a joint certificate of public convenience and necessity to PLGS and PG&E, finding that the development of Ten Section was necessary to protect against curtailment of high priority customers and was in the public interest. In July 1980, the utilities acquired the gas storage rights and appurtenant surface

facilities at Ten Section. Between July 1980 and January 1982, the utilities proceeded with development of Ten Section as an underground storage field, including ongoing injection of cushion gas.

During that period, the federal Natural Gas Policy Act of 1978 (NGPA) had a dramatic, unanticipated impact on natural gas markets throughout the United States. Because of higher prices permitted under the NGPA, the price of natural gas to the utilities increased significantly. This had a threefold effect upon the Ten Section project as follows:

1. Higher prices spurred gas producers to increase well drilling, which led to greater deliverability of gas supplies. This continues to be the case.
2. Higher prices, in conjunction with conservation programs, led to short-term decreases in customer demand and a long-term slowing in the anticipated growth of gas demand. This in turn reduces the near-term need for additional gas storage.
3. Higher gas prices and increased costs of capital, construction, and material substantially increased the capital cost of developing a new underground storage field.

As a result of these three factors the economics changed so that additional storage capacity could be obtained at a lower cost by expanding existing storage fields. By January 1982 PLGS and PG&E determined that it was not in the ratepayers' interest to continue development of the project, and all developmental activity ceased. During 1982 and early 1983 the gas supply outlook continued to improve, and customer demand for gas continued to decline. In the spring of 1983, the utilities decided to abandon the field as a gas storage project. From January 1982 through the present, the utilities have continued to withdraw gas and oil from the field for the benefit of the ratepayers.

In accordance with the contracts of sale between the original sellers of the field and the utilities, the utilities offered the field to Shell Oil Company and Tenneco West, Inc. for fair market value. Both companies declined to enter into negotiations to repurchase the field. In addition no other prospective purchasers could be found who were interested in owning and operating the gas storage project at Ten Section.

In early 1984 the utilities selected Evans, Carey, and Crozier (ECC), a Bakersfield firm specializing in petroleum engineering and oil property management, to act for them in locating prospective buyers of the field. In a report to the utilities dated May 2, 1984 ECC concluded that a fair market value of the Ten Section field was in the range of \$9-15 million.

ECC contacted a number of prospective buyers which it felt would have a desire and ability to purchase the field and explained the potential of the field to them. By April 30, 1984, ECC had received three offers. The highest offer was from Century. On May 4, 1984, the utilities accepted Century's offer subject to the approval of the Commission.

The Purchase Agreement

The letter agreement between the utilities and Century provides for the sale of all of the utilities' interests in the Ten Section field for a price of \$12,050,000. The effective date of the economic transfer of the field will be May 31, 1984, although the closing date of escrow may be extended until June 25, 1984.

The Public Interest

The utilities allege that their ability to produce gas from the field is nearing an end without a substantial investment in production enhancement facilities; and the utilities would soon be faced with substantial abandonment costs in order to comply with the requirements of the Department of Oil and Gas in an amount of about \$12 million.

The utilities also allege that the staff auditor's report in the current general rate case for test year 1985 of Southern

California Gas Company (SoCalGas) states that the staff expects the utility to make a reasonable effort to either sell or dispose of Ten Section in a financially prudent manner. The utilities state that the Century offer was the most favorable of the three bids received and that it is the opinion of the utilities and ECC that the offer represents the fair market value of the field at this time. They state that the offer price of \$12,050,000 is the highest that can reasonably be expected and that the utilities will also benefit by not having to incur abandonment costs of approximately \$12 million.

The approval by the Commission of this transaction will have no immediate rate impact upon the customers. The proceeds from the sale will be split equally between the utilities and will be used to offset remaining unrecovered costs of Ten Section. The disposition of those unrecovered costs will be considered in each utility's general rate case, pursuant to formal requests made in those proceedings.

Staff Analysis and Recommendation

In reviewing the proposed sale the staff of the Fuels and Operations Branch applied three standards:

1. Does the sale create a net benefit for the ratepayer?
2. Is the proposed price representative of the fair market value of the property?
3. Have PLGS and PG&E taken reasonable steps to obtain the highest offer within a reasonable time?

1. Net Benefit to Ratepayers

In its current general rate application SoCalGas seeks authority to abandon Ten Section and to amortize its investment plus accrued Allowance for Funds Used During Construction (AFUDC). To that investment and accrued AFUDC must be added estimated abandonment costs of about \$12,000,000, that the utilities expect to incur in complying with Department of Oil and Gas requirements. The

ratepayers of PLGS and PG&E could ultimately pay these costs if Ten Section were abandoned.

If Ten Section is sold, however, revenues from the sale would be split equally between PLGS and PG&E. These revenues would then offset some of the utilities' investments in Ten Section.¹ Moreover, PLGS and PG&E would incur no abandonment costs. The costs of sale would include a 2% fee to ECC (\$241,000) and other smaller costs.

From this analysis the staff concludes that the proposed sale would benefit the ratepayers because it would reduce the utilities' revenue requirements and thus the rates their customers would otherwise pay.

2. Fair Market Value

ECC estimated a range of fair market values of Ten Section in a study for PLGS and PG&E. ECC was able to estimate recoverable oil and gas within a fairly narrow range but estimating operating costs was more difficult because the wells and most surface facilities are over 50 years old. Therefore, the appraiser's assumptions regarding risk become a vital factor in the analysis. Examining various operating cost and discount rate scenarios, which take risk into account, ECC estimated the range of Ten Section's fair market value to be from \$9 million to \$15 million. ECC stated that a prudent buyer overly cautious because of reservoir and equipment risks as well as abandonment cost liabilities certainly could offer no more than \$9 million; and without risk an optimistic buyer might offer in the range of \$15 million and still hope to realize substantial ultimate profit.

¹ Ten Section costs will be reviewed in detail in SoCalGas' current general rate case, A.84-02-25, and in PG&E's next general rate case.

The staff concludes that since the price offered by Century (\$12,050,000) falls within the range established by ECC it is representative of the fair market value of Ten Section.

3. Reasonableness of Sales Efforts

The first step taken by PLGS and PG&E to sell Ten Section was to offer the property to Shell Oil Company and Tenneco West, Inc., former owners of the field. Neither company made an offer. When no other prospective buyers could be found, ECC was asked to locate potential buyers. ECC, through its knowledge of the industry, contacted several possible buyers and explained the potential of the field to them. A few other companies became aware of Ten Section through other industry contacts. ECC is a small company and did not feel it could adequately handle a large number of inquiries in the limited time available. Therefore, no advertisements were placed, for example, in trade journals. However, since ECC is paid a percentage of the sale price, it had an incentive to obtain the highest possible price for the properties.

The contacts made by the utilities and ECC and the three firm offers received for Ten Section show, the staff concludes, that PLGS and PG&E took reasonable steps to obtain the highest offer within a reasonable time.

The staff recommends that the Commission approve the proposed sale.

Findings of Fact

1. The sale of the property benefits the ratepayers.
2. The purchase price is within a range of fair market values estimated by expert appraisers.
3. The utilities took reasonable steps to obtain a reasonable offer within a reasonable time.

Conclusions of Law

1. The application should be granted.

2. Although this proposed decision did not appear on the agenda mailed to the public as required by the government code, it should be signed today because the upset date of the transaction is June 25, 1984. This matter constitutes an emergency condition under § 306(b) of the Public Utilities Code because the duty of the Commission to preserve the value of this transaction for the benefit of the ratepayers would not be fulfilled if further delay were allowed.

3. This order should be effective immediately since the agreed closing date of the transaction is June 25, 1984.

IT IS ORDERED that the application of PLGS and PG&E for authority to sell Ten Section is granted.

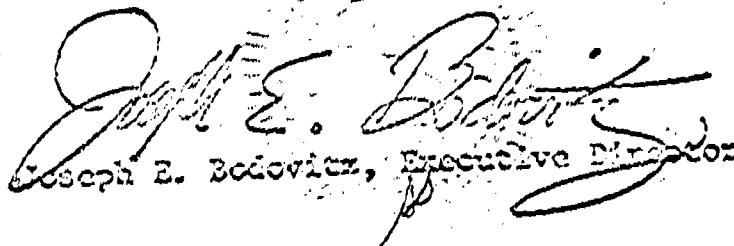
This order is effective today.

Dated JUN 20 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
FRISCILLA C. CREW
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

I dissent.
VICTOR CALVO, Commissioner

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY.


Joseph E. Bodovick, Executive Director

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