PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION & COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2726
May 29, 1987

R E S O L U T I O N

PACIFIC GAS AND ELECTRIC COMPANY (PG&E) ORDER AUTHORIZING DISPOSAL BY SALE OF ALL REMAINING GAS EXPLORATION AND DEVELOPMENT ADJUSTMENT (GEDA) ASSETS. (Advice Letter No. 1402-G, filed April 3, 1987 and Supplement filed April 7, 1987.)

SUMMARY

By Advice Letter No. 1402-G, Filed April 3, 1987 and Supplement filed April 7, 1987, PG&E submitted for filing a request for Commission authorization to dispose of all remaining GEDA assets of Natural Gas Corporation of California (NGC), PG&E's wholly-owned GEDA subsidiary.

BACKGROUND

1. GEDA is a ratemaking vehicle that was instituted in 1977, at a time of threatened natural gas shortages. Its purpose was to motivate gas utilities under this Commission's jurisdiction to seek and obtain independent gas supplies by exploration for new gas fields and development of proven reserves in existing fields. In the GEDA program the ratepayers, not the usual investors, assume the cost of exploration and development of gas reserves and reap the benefits of success if gas can be found at a price below market levels. Conversely, ratepayers bear the risk that the utilities could fail to outperform independent energy companies.

2. GEDA is essentially a procedure which provides the utilities full-cost recovery and a guaranteed after-tax return on their investment, with associated risks borne by ratepayers. The two gas utilities in California with GEDA programs are PG&E and SoCal. These two utilities were allowed to file project letters under Commission order, to obtain authorization for new GEDA projects.

3. All GEDA activity is carried out by gas exploration and development corporations which are wholly-owned subsidiaries of the utilities and which engage in no other activity. The wholly-owned GEDA subsidiary of PG&E is Natural Gas Corporation (NGC) and the wholly-owned GEDA affiliate of SoCal is Pacific Gas Lighting Development Corporation (PLGD). With the advent of the

West Coast LNG Project, NGC became a partner with PLGD in gas exploration and development in Alaska. The partnership is called Alaska Gas Exploration Associates (AGEA). SoCal Gas was authorized to dispose of the Alaska partnership GEDA properties By Resolution G-2715, dated February 11, 1987.

4. On December 20, 1983, the Commission issued an Order Instituting an Investigation (OII 83-12-02) on its own motion into the continuation of GEDA. It was found that since the passage of the Natural Gas Policy Act (1978) which resulted in deregulation of gas prices, natural gas producers have spurred exploration and development drilling, substantially increasing natural gas reserves. Also, the demand for gas and the world price of oil decreased early in 1986. As a result, the overall cost-effectiveness of the GEDA program was reversed. Additionally, it was found that the GEDA program would not be cost-effective in the future unless and until the supply price projections revert to those which existed when the GEDA program was implemented.

5. On November 13, 1985, Decision No. 85-11-062 was issued to OII-83-12-02 and became effective on December 13, 1985. This Decision was amended by Decision No. 86-02-032, dated February 9, 1986. These decisions provided for a separate analysis of each currently active California, Rocky Mountain Region, and Alaska GEDA project of PG&E to determine how each property should be treated to best serve the interests of gas ratepayers. The analysis was to be made to determine whether continued production and development, sale, or abandonment would be the most economic alternative for ratepayers. The evaluation was to also indicate whether or not further exploration and development is justifiable for any properties, that the Commission authorizes the companies to keep. In any case, no further exploration was to be permitted at ratepayer expense. Any development drilling must be justified on a case-by-case basis, and done at the least cost to the ratepayers.

6. NGC/PG&E filed its Plan of Disposal on June 5, 1986, subsequently revised by July 9, 1986 submittal. The study indicated that a sale was the preferred alternative for NGC's California properties, produce-out or delayed sale was the preferred alternative in the Rocky Mountains, and that the North Slope of Alaska be amortized as an abandoned GEDA project with any and all proceeds which may ultimately be received from future production flowed through to gas ratepayers. The study was based on oil and gas prices as of January 1, 1986, using estimates of remaining recoverable proved-reserves and fair market value of the properties as of January 1, 1986, and assumptions regarding pending changes to the federal tax code.

7. Upon review of the study, the Commission staff found that it would be in the best interest of the ratepayers to sell all GEDA properties based on a comparison between the Revenue Requirement to sell the properties vs. the Revenue Requirement to produce out. Therefore, the staff directed NGC to offer the GEDA properties for

sale by competitive bid. As directed by D. 85-11-062, an outside consultant, Pacific Resources Management Inc. (PRMI), was selected by the staff to direct the competitive bidding process and to receive and analyze the bids and identify the highest bidder.

8. After extensive public notification of the sale, bids were submitted for the California, Rocky Mountain, and River Bend (part of the Rocky Mountain properties) assets, to PRMI on February 12, 1987, and in early March 1987, PRMI advised PG&E Gas Supply Company (Supply Co.) that its bids for all three propertied were accepted. (The Supply Co. owns a 20 percent shareholder investment in GEDA properties as mandated in Decision No. 93368.)

9. Decision 85-11-062 found that the insignificant size of the Alaska GEDA properties compared with that level of reserves necessary for the Federal Energy Regulatory Commission (FERC) to approve the LNG project and the lack of cost-effectiveness suggested termination of this project, and therefore, the remaining Alaska GEDA properties were to be evaluated according to a previously mentioned mechanism and to be sold or abandoned.

PROTESTS

1. No protests have been received in this matter. However, Public Staff Division PSD has submitted comments stating among other things, that the appropriate ratemaking treatment regarding the recovery of the losses associated with the termination of the GEDA program be resolved in the upcoming gas implementation hearings. (I. 86-06-005)

2. In Decisions 86-12-009 and 86-12-010, the Commission identified certain costs as "transition costs". These were defined as costs resulting from the past structure and practices of the gas industry which were incurred to benefit all customer classes and which are today in excess of a reasonable level. D. 86-12-009, p. 25) The Commission stated that its objective was to get these costs behind us by first identifying them in the gas implementation proceeding and then spreading them to all customer classes on an equal cents per therm basis. (D. 86-12-010, p. 102)

3. The position of the PSD in the gas implementation proceeding is that all costs associated with termination of the GEDA program are transition costs which should be borne equally by all customer classes. (PSD Report on A. 87-01-032 and A. 87-01-033, p. 7-20) This means that each customer class should pay on an equal cents per therm basis until all losses associated with termination of the GEDA program are recovered. In effect this amounts to a continuation of past practices since historically the costs of the GEDA program have been paid by all customer classes on an equal cents per therm basis.

4. PSD further states that when all of PG&E's GEDA properties have been sold, all that will remain to be done is amortize the losses associated with the ratepayer participation in this

program. Since there is no longer any GEDA property that is used and useful in serving the ratepayer, PSD recommends that the entire unrecovered net cost be recovered as a transition cost over a one year period. The GEDA tariff should therefore be cancelled as of the effective date of the gas implementation decision and the remaining GEDA losses recovered as a transition cost.

5. Finally, PSD is concerned that it appears that ratepayers are required to make PG&E whole for the losses incurred by this program. However, they should not additionally be required to pay a return on those losses while they are being recovered. See D. 85-08-046, p.16 (no return allowed on abandoned nuclear power plant). It would simply be unconscionable for ratepayers to have to pay PG&E's shareholders a return at the same time that they are making them whole for the losses resulting from the program's failure. The PSD will be proposing the treatment outlined above in the upcoming gas implementation proceeding and recommends that the issues be resolved there.

6. In the interim, the PSD supports the sale of the PG&E GEDA properties as requested in the Advice Letter and recommends approval with the exceptions as noted above.

DISPOSAL PLAN AND DISCUSSION

1. The staff of the Evaluation & Compliance Division has reviewed this filing and determined that it is in compliance with D. 85-11-062 as amended by D. 86-02-032, dated February 5, 1986 in OII 83-12-02.

2. Decision 85-11-062 ordered PG&E to discontinue GEDA programs at ratepayers expense, effective August 4, 1985 and required NGC/PG&E to file a separate study for California, Rocky Mountain and Alaska properties for the Commission's consideration. The study should indicate whether continued production and development, sale, or abandonment of each property is the most economical alternative for gas ratepayers.

3. The utilities were authorized by D. 85-11-062 to retain the GEDA properties only if it is found, pursuant to the hurdle value method, that it is not in the best interest of the ratepayers to sell or abandon them. The "hurdle value" is defined as the market value associated with the after-tax flow through of a property sold at a gain or present value of the cost of service fo the scenario most beneficial to the ratepayer. The hurdle values for the properties were calculated to be $0.0, $11.1 million, and $32.4 million for the California, River Bend, and Rocky Mountain properties, respectively.

4. The Commission staff has reviewed this filing and determined that PG&E received a high bid of $4,800,000, $11,100,000, and $32,400,000 for California, River Bend, and Rocky Mountain properties, respectively, with 10% of the money accompanying the

bids. All of these bids were submitted by PG&E Supply Company, a subsidiary of PG&E.

5. Attachment A to Advice Letter No. 1402-G (also attached to this Resolution) indicates that a sale to PG&E Supply Company is more beneficial to the ratepayer than a produce-out. This analysis is based on estimates of future oil and gas prices specified by the staff, estimates of remaining proved-reserves as of January 1, 1987, and the amended federal tax code.

6. The sale of these GEDA properties to PG&E Supply Company will reduce the GEDA rate base attributable to NGC's GEDA program in California and the Rocky Mountains from $82,952,000 to $47,086,000. NGC requests authorization to project-finance 90 percent of such remaining rate base through a loan from an outside party at the prime interest rate plus one percent, secured by the GEDA tariff. In order to facilitate project financing, PG&E requests the Commission to re-affirm the provision of Decision 85-12-02 that expressly provides for NGC to recover the cost of funds obtained for project financing on a dollar-for-dollar basis.

7. The Public Staff Division (PSD) is currently engaged in the examination of PG&E's GEDA costs and when the audit is completed, its result will be introduced into the OII Gas implementation proceeding.

8. Timely authorization of this filing will preclude an extra cost to the ratepayers of approximately $250,000 per month because of higher financing costs. Thus, the staff recommends approval of the plan in part, to sell the properties as filed.

9. Public notification of this filing has been made by supplying copies of the filing to other utilities, governmental agencies, and to all interested parties who requested such notification.

10. This filing is in compliance with Decisions Nos. 85-11-062, 86-02-032, and 86-08-081, and approval of the sale is in the interest of the ratepayers of PG&E.

11. This filing should be authorized by the Commission in order to permit the sale agreement to go into effect as requested.

FINDINGS

1. The GEDA program was implemented during a time of threatened shortages of natural gas, for the purpose of motivating the California utilities to obtain new sources of natural gas.

2. Since the passage of the Natural Gas Policy Act (1978), gas utilities in California have not been able to seek and obtain independent gas supplies at a price below market levels.

3. Overall, the GEDA program has not been cost-effective in the past, nor will it be cost-effective in the future unless the supply-price scenario reverts to the projections which existed when the GEDA program was implemented.

4. Given the most reasonable assumptions to date, the present value of ratepayer's benefits under the GEDA program are all negative.

5. Decision No. 83-12-02 authorized PG&E to retain GEDA properties only if it is found, pursuant to the hurdle value methodology, that it is not in the best interest of the ratepayers to sell or abandon them.

6. A high bid in excess of the hurdle value was received for each of the California, River Bend, and Rocky Mountain properties.

7. Sale of the GEDA properties is in the best interests of the ratepayers based on the comparison of the Revenue Requirement if the properties are sold Vs. the Revenue Requirement if the properties are produced out.

8. NGC shall not be permitted to secure any loans, by the tariff, to the remaining rate base on the GEDA surcharge.

9 The recovery of any monetary losses to PG&E as a result of this sale is to be determined in OII 86-06-005, and not to be dependent upon or guaranteed by the GEDA rate surcharge.

10. The continuation of the present GEDA surcharge is to be further determined in OII 86-06-005.

11. We find that the sale of these GEDA properties with the exceptions as discussed in this Resolution are just and reasonable; therefore,

IT IS ORDERED that:

1. Pacific Gas and Electric Company is authorized to dispose of the Gas Exploration and Development Adjustment assets of the Natural Gas Corporation of California by sale to PG&E Supply Company according to the Letter of Notification of Acceptance of Bids submitted in Advice Letter No. 1402-G.

2. The method of recovery of any losses obtained by PG&E as a result of this sale shall be determined by the Commission in OII 86-06-005 and shall not be dependent upon or guaranteed by the GEDA surcharge.

3. Natural Gas Corporation shall not be permitted to secure any loans by filed tariffs pertaining to the remaining rate base on the GEDA surcharge.

4. The Commission shall be kept informed of any and all additional activity by Pacific Gas and Electric Company relating to these and other GEDA properties in which PG&E may have an interest. This information shall be sent to the Chief of the Fuels Branch of the Public Staff Division.

5. Within 10 days of the actual sale, PG&E shall record the gain/loss from the sale in an appropriate account and submit such accounting entries and supporting documentation to the Evaluation and Compliance Division of the Commission within 30 days there-after for review and approval.

6. This advice letter shall be marked to show that it was Approved accepted for filing with the exceptions noted above by Commission Resolution G-2726. This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular scheduled meeting on May 29, 1987. The following Commissioners approved it.

Victor Weisser

Executive Director

I abstain.

G. Mitchell Wilk, Commissioner

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
JOHN B. OHANIAN
Commissioners