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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation into the operations and practices of the Southern California Gas Company, concerning the accuracy of information supplied to the Commission in connection with its Montebello Gas Storage Facility.

FILED
PUBLIC UTILITIES COMMISSION
APRIL 22, 1999
SAN FRANCISCO OFFICE
I.99-04-022

ORIGINAL

ORDER INSTITUTING INVESTIGATION

I. SUMMARY

This investigatory proceeding is instituted to provide a forum for the Consumer Services Division (CSD) staff to adduce evidence on whether the Southern California Gas Company (SoCalGas) engaged in a pattern of providing inaccurate information in connection with giving requested information to the Commission about the utility's plans for the Montebello Gas Storage Facility. The CSD staff has conducted an investigation and advances an investigative report, based on an extensive collection of information and documents, much of which is from SoCalGas.

In 1997 the Commission's Energy Division staff investigated SoCalGas's plans for Montebello, preparing to respond to inquiries from then State Senator Calderon and some Commissioners about contested eminent domain or condemnation civil actions initiated in Superior Court by SoCalGas, to secure from landowners fee interests in order to operate Montebello to facilitate public utility service. Some landowners, defendants to the civil actions, had contested the eminent domain actions. Energy Division staff were told by SoCalGas in a meeting and in writings that the utility needed to continue operating the storage facility. SoCalGas also told the Los Angeles Superior Court that its eminent domain actions to acquire the outright

complete ownership or fee interest in a fee interest in underground mineral rights were necessary because the original leasehold interests were to expire and the utility needed to continue to operate the Montebello facility. However, according to the findings of staff's investigation, at those very times SoCalGas had initiated environmental reviews to be used in connection with disposing of the Montebello facility because the utility had decided it was not needed, and had not used the facility for over a year. Also, SoCalGas acquired by eminent domain mineral rights to a depth far deeper than needed were it to continue Montebello storage operations. (The leaseholds held by SoCalGas were only for storage operations in the Eighth Zone level, whereas SoCalGas used eminent domain to acquire total mineral rights to the Eighth zone and below.)

Based on this SoCalGas-supplied information advanced to agency staff and submitted in the civil actions, the Energy Division advised then Senator Calderon that the condemnation actions in courts did not appear out of line but would be referred to Legal Division for review. Further, Commissioners were ultimately advised of the questions about SoCalGas's condemnation actions presented by Senator Calderon and representatives of landowners, and that the utility appeared to need the Montebello facilities for future utility operations -- the utility's assertions in 1997 about its need for the storage facility are called into direct question in this case. Ultimately, SoCalGas in early January, 1998 filed an application for approval to sell the Montebello facility, with no restriction on use by a buyer, because the storage facility was no longer needed.

The questions raised in staff's report which require adjudication are whether SoCalGas provided inaccurate information, both by affirmative statements to the Commission or its staff made by employees or agents of the utility, or by material omissions in the course of the utility supplying information. If the Commission finds in the affirmative, the utility will be fined for violating Rule One of the Commission's Rules of Practice and Procedure. The Commission will also entertain

recommendations on any other orders which it may need to enter to mitigate against recurrence. The alleged misconduct is fundamentally troubling and undermining to this agency's regulatory role over a utility which is expected to serve the public trust.

II. BACKGROUND

Staff's report alleges the key facts as follows. The utility's Montebello Storage Facility, located in the City of Montebello, was placed into service in the mid 1950s, and deployed an underground formation conducive to holding natural gas injected under pressure. The formation, consists of the top two sands of the Eighth Zone, Puente Formation, of the West Montebello oil field. In 1955, by Decision (D.) 51554, the Commission approved SoCalGas's application to operate the Montebello storage facility, and for about 10 years Union Oil Company managed the facility for SoCalGas. But in 1966, because oil production had materially slowed and Union Oil Company apparently no longer wanted to maintain its role in oil production in the field, SoCalGas took over full operation of the storage facility. In 1996 the lease agreements with landowners for storage accessing in the Eighth Zone started to expire -- these leasehold interests were originally acquired by Union Oil Company before extensive drilling began in the early 1940s, and under contractual arrangements Eighth Zone storage access leases were assigned to SoCalGas. Under the lease terms, which clearly contemplated gas storage, SoCalGas had three years from lease termination to withdraw stored gas, which basically meant that SoCalGas had use of the underground Eighth Zone or facility into 1999.

When SoCalGas received approval from the Commission in 1955 for the facility, the utility made no mention of any need to acquire fee ownership of all the mineral rights from landowners. In 1993 the utility started contacting the almost 1,000 affected landowners about buying their interests. In late 1995 SoCalGas retained a law firm to initiate condemnation actions in superior court to secure in fee the mineral rights of landowners who had not accepted previous offers from SoCalGas to sell, and such landowners were contacted. In early 1996 lawsuits were filed to acquire the

landowners' interests in fee, citing to support the "necessity" for the eminent domain actions the Commission's 1955 decision, telling the court that the Montebello facility was necessary for the current and future provision of public utility service. The 1955 decision made no finding or mention of any eventual need for SoCalGas to ever acquire fee ownership.

Staff's investigation cites environmental clean-up or assessment reports prepared by firms for SoCalGas in 1996 which state that the purpose of the analysis is in preparation for sale of the property, and internal utility economic analyses which showed that Montebello was not essential. SoCalGas also apparently ceased injecting storage gas into the Montebello facility in 1996.

The Commission, during 1997, received inquiries from at least one defendant landowner's representative about the eminent domain process. The Energy Division undertook to get facts from SoCalGas to enable it to assess the complaints, and the CSD report lists meetings with the Energy Division Director and his staff wherein SoCalGas's representatives told them that the company needed and would use, the Montebello facility, and lists some collaborative documents sent by SoCalGas separately to one of the lead staff, Greg Wilson.

The communications to agency staff were used and relied on, culminating in a response to an inquiry to the Commission from then State Senator Calderon. The reply from Director Clanon said that the eminent domain actions seemed to be straightforward civil matters which the parties could resolve in court, and that the Energy Division had referred the matter to the Legal Division to assess some of the contentions. On October 20, 1997 advisory counsel for the Energy Division advised Commissioners and Director Clanon that there was no need for the Commission to intercede in the matter(s) because SoCalGas's "continued public service obligation to serve core needs and load balancing may justify SoCal's continued operation of Montebello." (He relied on the information which SoCalGas had supplied to Energy

Division and his review of SoCal's assertions in the civil court condemnation lawsuits.)

However, in January 1998, SoCalGas filed an application, which was in preparation for some period before its filing, to sell Montebello, citing no long-term need for the facility. Further, as late as June 1998, SoCalGas's attorneys answered interrogatories used in a civil court condemnation case saying that it needed to acquire fee ownership of the mineral rights in order to provide utility service, but also added that the facility could also be sold to another operator, regulated by the Commission, who would use it to benefit utility consumers (SoCalGas's application to sell had no condition for a buyer to use the facility to serve SoCalGas's retail consumers). The consultant assisting CSD with its investigation, a petroleum engineer, found that the scope of the mineral rights acquired by SoCalGas could provide a future owner with a great deal of oil which eventually could be produced from water-flooding, something apparently not conveyed to the landowners. It is also alleged that there are many environmental cleanup problems with the Montebello facility, and that for a number of years SoCalGas had problems with pressurized storage gas migrating upwards and in some cases out of old ill-capped oil wells.

III. DISCUSSION

The CSD staff has demonstrated cause to institute an investigation to hear evidence about the allegations that SoCalGas engaged in a pattern of misrepresentations and omissions in the course of proceeding with acquiring fee ownership interests in mineral rights connected with Montebello. If the allegations are proven, it means that reliance by the agency on incorrect information influenced a response to a State Senator who seems to have relied heavily on the Commission's regulatory expertise, and that key facts underlying an assessment prepared for Commissioners and Energy Division management were wrong. The allegations and the facts advanced by CSD staff require that we institute a formal investigation.

IT IS ORDERED that:

1. An investigation is opened into the operations and practices of the Southern California Gas Company respondent, surrounding the acquisition of fee ownership interests of mineral rights connection with the Montebello Gas Storage Facility, and respondent's representations or omissions in response to Commission staff requests for information and plans for the Montebello facility.

2. The respondent is placed on notice that providing the Commission inaccurate/misleading information or making material omissions in response to an agency request for information is a violation of Rule One of the Commission's Rules of Practice and Procedure, and that the penalty for violation of a Commission rule or order is $500 to $20,000 per violation, with each day of a continuing violation (i.e. failure to correct previously supplied erroneous information) constituting a separate count (Public Utilities Code sections 2107 and 2108).

3. The respondent is also placed on notice that if evidence presented in this proceeding shows that it was too reaching in its deployment of powers of eminent domain, or did not fully disclose to affected landowners material information, the Commission will, based on its broad regulatory oversight jurisdiction over SoCal's utility operations and practices, entertain recommendations on what orders to enter which could reasonably and fairly restore affected parties' interests.

4. The CSD staff's investigative report, which illustrates why this formal investigatory docket is required, refers to some specific materials supplied to staff by the respondent under PU Code section 583 and which are appended in full as supporting documents. Staff's report may be publicly released as it supports issuance of this order. However, the specific appendices which consist of the complete documents provided under §583 shall initially be redacted. The CSD staff shall advise the ALJ which appendices are redacted, and if there are any redacted appendices to staff's initial report/prepared testimony which SoCalGas thinks requires continued confidentiality, it may within 15 days from today file a motion which lists specific

information, details reasons and documents how the public interest of release in the course of a Commission adjudicatory proceeding is outweighed by the prospect of imminent and irreparable economic harm to the utility from disclosure.

5. A prehearing conference (PHC) shall be scheduled and held, where the schedule shall be set for staff to issue any supplemental reports beyond its initial report/prepared testimony, and for the respondent to advance any evidence which it may have to present. If CSD staff wishes to proceed with any additional discovery, such as depositions or other avenues, it shall do so expeditiously. It may issue additional prepared testimony within the timeframe established at the PHC.

6. Evidence which may be adduced in this proceeding may be germane to and have a direct bearing on the outcome of Application 98-01-015, SoCalGas's request to sell the Montebello Storage Field, and that proceeding shall be held in abeyance pending the outcome of this investigation, and it may, if the ALJ directs, be consolidated for hearing or further consideration with this new investigatory docket.

7. This ordering paragraph suffices for the "preliminary scoping memo" required by Rule 6 (c) of the Commission's Rules of Practice and Procedure. This proceeding is categorized as an adjudicatory proceeding and will be set for evidentiary hearing. The issues of this proceeding are framed in the above order. A prehearing conference shall be scheduled for the purpose of setting a schedule for this proceeding including dates for the exchange of additional written testimony, determining which of the Staff's percipient and collaborative witnesses will need to testify, and addressing discovery issues. We preliminarily propose that hearings be held in August and that any additional testimony of the Staff and testimony of the Respondents be issued three weeks prior to hearings. This order, as to categorization of this proceeding, is appealable under the procedures in Rule 6.4. Any person filing a response to this order instituting investigation shall state in the response any objections to the order regarding the need for hearings, issues to be considered, or proposed schedule. However, objections must be confined to jurisdictional issues which could nullify any

eventual Commission decision on the merits of the alleged violations, and not on factual assertions which are the subject of evidentiary hearings.

The Executive Director shall cause a copy of this order and the CSD report to be served by mail on SoCal Gas's designated regulatory affairs representative, and served by mail on all parties to A.98-01-015.

This order is effective today.

Dated April 22, 1999 at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

I.99-04-022 L/pds

INVESTIGATION OF SOUTHERN CALIFORNIA GAS (SCG) REGARDING RECENT EMINENT DOMAIN CASES, REPRESENTATIONS TO THE COMMISSION, AND PROPOSED SALE OF THE MONTEBELLO GAS STORAGE FACILITY

APRIL 6, 1999

OVERVIEW

SCG presently operates several underground natural gas storage facilities in California. In each facility, the storage area is nothing more than a layer of rock beneath the surface of the Earth, called a reservoir, which was at least partially depleted of oil in the past. SCG has installed equipment in each of these storage facilities which enables them to pump natural gas into these reservoirs and retrieve it later.

For the past forty years SCG has leased, from private property owners, all gas storage rights and mineral rights for a reservoir located in the West Montebello Gas Storage Field, which now lies beneath part of the City of Montebello, CA. SCG has been paying these property owners sums of money based on the amount of gas it withdraws from storage (storage rights) and, in some instances, based on the amount of oil incidentally produced with the withdrawal of stored gas (mineral rights).[1]

As the expiration of lease agreements loomed in the mid-1990's, instead of deciding to renew them or simply

[1] Contract between Pacific Lighting and Union Oil, February 28, 1955, appended to Application No. 36809 (Atch 1)

allow them to lapse, SCG aggressively began the acquisition of certain fee simple storage & mineral rights in the West Montebello Gas Storage Field by both voluntary sale and the process of eminent domain. This appropriation of private property, SCG claimed to the court in 1996, was ". . .necessary and strategic for present and future operation . . ." However, even as the eminent domain process was ongoing, SCG filed a petition with the Commission for approval to sell the gas storage facilities along with the storage and mineral rights.[2]

SCG's conduct raises pertinent questions about the propriety, if not the legality, of SCG's acquisition and proposed sale of the West Montebello Gas Storage Field:

1) In order to facilitate the purchase of storage and mineral rights from private owners at discount prices, did SCG manipulate its Montebello operations a) to deliberately deflate the apparent worth of the leaseholders' property, and b) to deceive property owners about its current and future need for acquisition of the storage and mineral rights?

2) Was SCG less than forthright with the court during eminent domain proceedings by a) seeking to acquire the storage and mineral rights through condemnation or the threat of condemnation by use of a 1955 Certificate of Public Convenience and Necessity (CPCN) from the Commission, and b) requesting permission at the same time for sale of the unneeded property from the Commission?

[2] SCG did not acquire ALL of the mineral rights, but is nevertheless proceeding with the sale. – SCG Ltr to B. Fong, Energy Division, CPUC, August 7, 1998. (Atch 2)

3) Was SCG less than forthcoming on facts about its ongoing need for the storage facility during a CPUC Energy Division investigation of complaints by Montebello property owners?

The affirmative answers to these questions will become apparent as this report reviews the history of SoCalGas's operations in the West Montebello Gas Storage Field from 1955 through present time. Table 1, at the end of this document, is a useful grid which illustrates SCG's representations contrasted to the facts.

DETAILS OF INVESTIGATION

Background

The West Montebello Gas Storage Field is located twelve miles east of Los Angeles within the northern city limit of the City of Montebello. The field consists of the top two sands of the 8th zone, Puente Formation, of the West Montebello oil field. (Figure 1- See page 5) It is situated on the southeast flank of the Repetto Hills. The old oil reservoir, which was converted to the gas storage area, extends approximately 1½ miles by ½ mile and borders on the Monterey Park Landfill, one of the California's worst toxic waste Superfund Sites.

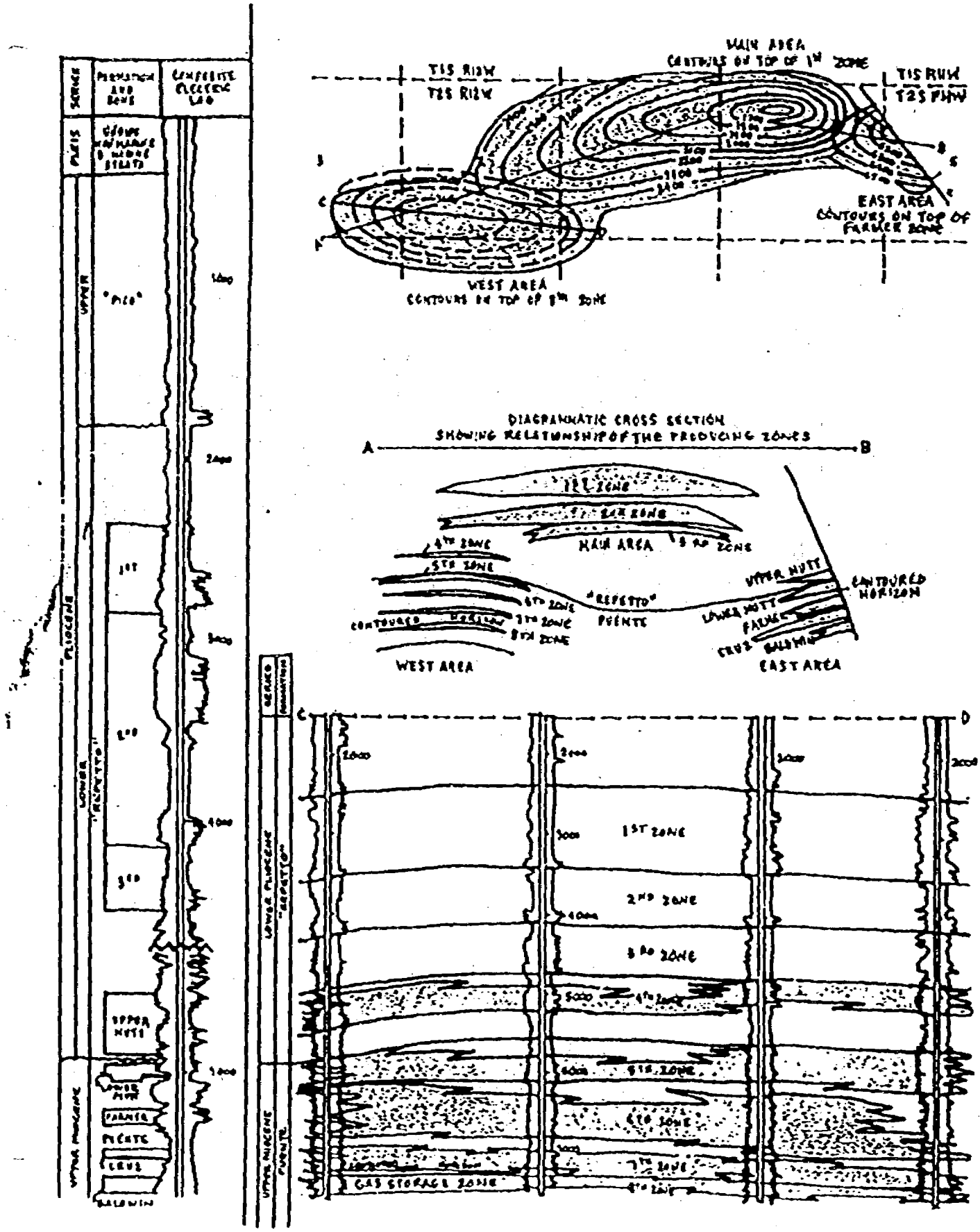
Oil was first discovered at Montebello in 1939 by Union Oil of California (UNOCAL). During the 1940's hundreds of holes were drilled in this field, but were never properly abandoned. Thus, there are many conduits linking the gas storage area to shallower zones above the storage area, creating pathways for gas to escape and eventually reach the surface beneath homes.

At the initiation of the gas storage project in 1956, the remaining oil reserves in the storage field were estimated at 52 million barrels, a significant potential resource.[3] This oil could not then be produced economically

[3] Division of Oil & Gas, Table 2 Reservoir Characteristics of the Montebello Storage Field, September 29, 1997. (Atch 3)

Figure 1

I.99-04-022 MONTEBELLO OIL FIELD L/pds



with available technology, so 40-year leases were contracted with private property owners by Unocal for the gas storage and ancillary mineral rights for oil recovered during the withdrawal of gas from the facility. The field was to be operated by Union Oil for SCG.

On July 7, 1955, in a City of Montebello Council Meeting, Oscar Sattinger, SCG Council, stated to property owners and the Council that:

> the particular agreement is to obtain permission of the property owner for rights in the 8th zone only. They have no interest in oil or gas in the 8th zone; they are only interested in bringing gas in from outside the field and injecting it into the field and are asking property owners for the right to store gas. There are several different contracts . . . some cases involve oil leases and some do not. . . .[4]

1955 Actions

Lease History

On February 28, 1955, SCG (Pacific Lighting Gas Supply Company at that time) and Union Oil Company of California (Unocal) agreed that Unocal would convert the 8th zone of the Montebello Field to gas storage. Unocal would obtain from property owners all necessary rights to inject, store, and extract gas which would be required to operate the 8th Zone as a gas storage unit.[5]

On March 18, 1955, SCG filed Application 36809 to obtain CPUC authorization to enter into a contract with Unocal per the February agreement. In the application SCG stated that it would:

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[4] City of Montebello City Council Meeting Minutes, July 7, 1955
[5] Supra, Note 1

> Provide and install the necessary facilities for the injection and withdrawal of gas, including compressor plant and dehydration facilities; obtain the necessary land; install the necessary field and connecting pipelines; purchase the gas necessary for the cushion; and pay Union a consideration for the contract※. Applicant will own all the gas and all the facilities up to but not including the control valve on the well heads. Union will operate and maintain the field. Applicant will pay Union the expenses incurred in operating and maintaining the storage field and field piping. In addition, the applicant will pay Union a service charge based on the amount of gas withdrawn from the field.
>
> ※The contract is for a term of twenty years, with the applicant having the right to renew the contract for an additional twenty years. (*underlining added*)

On June 7, 1955, in Decision No. 51554, Application No. 36809, the Commission authorized the SCG-Unocal contract. In this Decision the Commission consistently refers to the project as one of delivering and retrieving natural gas with the assumption that Unocal is the owner and operator of the gas storage field. In 1955, there was no Commission requirement that SGC acquire ownership title to the 8th Zone of the Montebello oil fields.

Filing for Certificate of Public Convenience and Necessity

On September 23, 1955, SCG filed Application No. 37325 with the CPUC requesting a Certificate of Public Convenience and Necessity (CPCN) to build a gas storage facility at the storage area:

> In order for applicant to perform its part of the contract with Union Oil Company of California, applicant is acquiring the necessary land for the compressor plant on which applicant will install a compressor plant, dehydration, and other facilities for the injection and withdrawal of gas. (*underlining added*)
>
> The site for the compressor station is located near the northerly boundary line of the City of Montebello and comprises approximately 7.09 acres. Applicant has an exclusive option to purchase such property from the Monterey

> Park Land Corporation, which option is exercisable on or before May 1, 1956... .
>
> Wherefore, applicant, Pacific Lighting Gas Company respectfully prays that The Public Utilities Commission of the State of California duly give and make its decision...
>
> 1) Granting and conferring upon applicant all necessary permission and authority to acquire and operate an underground gas storage project in the 8th zone of the West Montebello Oil Field, to inject the necessary cushion gas, to construct, complete, operate and maintain and use the gas compressor plant storage facilities and other facilities useful in connection with the gas storage project described in this application;
>
> 2) Declaring that the public convenience and necessity now require the construction, completion, operation, maintenance, and use by applicant of said underground gas storage project, the compressor plant and facilities and the use by it of all lands, and rights in lands, and the exercise of all other rights, permits, easements, and franchises which may be used or useful in connection with the construction, completion, operation, maintenance and use of said project, compressor plant and facilities;
>
> 3) Issuing to applicant a certificate declaring that the present and future public convenience and necessity require and will require that such construction, completion, operation, maintenance and use be undertaken by applicant.[6]

Montebello Special Use Permit

Of interest, however, is that SCG's proposal to build the plant was rejected by the Montebello Planning Commission.[7] SCG appealed the decision to the Montebello City Council and the City of Montebello granted a Special Use Permit on August 1, 1955, subject to certain conditions set forth in its Resolution No. 5484. According to the City of Montebello Resolution No. 5484, the fee simple property

[6] Application No. 37325 (Atch 4)
[7] Resolution 5484, City of Montebello (Atch 5)

rights for the acreage to install the compressor plant were NOT transferred to SCG or Unocal.[8] This conflicts with SCG's statement to the CPUC that they had an option to purchase.

The absence of a copy of that option to purchase, any proof of exercise of that option, or any ownership documents at the time of this report warrants further investigation. A title search may show that SCG does *not* own the title to the main facility site or the mineral rights beneath the site which they are now proposing to sell.

Capital Outlay

In that 1955 Application No. 37325 to the CPUC, SCG stated that it would retain ownership of all gas stored in the reservoir and the facilities up to but not including the control valves on the well heads. The Commission itemized SCG's proposed capital outlay in its Decision 52219:

Storage Contract Consideration	$700,000
Station Site	35,000
Compressor Station, Dehydration Station And Pipeline Facilities	3,559,000
Injection Tests	51,000
Cushion Gas (26 Billion Cubic Feet)	5,063,000
Injection of Cushion Gas	991,000
TOTAL Estimated Capital	$10,339,000

In addition to these costs the Union Oil Company will expend up to $250,000 to condition an adequate number of wells for the injection and withdrawal of the gas in the volumes heretofore stated.

The Commission also identified SCG's annual operating expenses as $2,131.000. These expenses did not include capital to purchase storage and mineral rights. In fact, the Decision specifically isolates storage fees and service charges from project expenses:

> It should be pointed out that in addition to the above costs there is a storage fee, or service charge, based on

[8] ibid.

> the total number of Mcf of gas withdrawn from storage during any one contract year. Such fee covers the payments to the lessees and mineral rights owners of the storage field. (*emphasis added*)[9]

In 1955, the facts indicate that company did not envision purchasing or condemning storage and mineral rights of the gas storage field: 1) SCG did not purchase property rights from the City of Montebello for the main compressor facility site, 2) SCG signed a 40-year contract with Unocal that included lease storage rights, and 3) SCG told the CPUC that the storage and mineral rights would remain with the current property owners.

> All necessary rights to inject, store and extract gas will be obtained by Union Oil Company of California from fee owners, oil lessees and oil lessors to permit operation of the Eighth Zone in accordance with the terms of an agreement dated February 28, 1955.[10]

Granting of CPCN

In 1955, therefore, the CPUC formally considered SCG's Application and no parties contested the request for a CPCN. Had the acquisition of mineral rights been intended and necessary to operate the storage, SCG should have identified the requirement in its Application to give leaseholders, including Unocal, an opportunity to protest purchase or appropriation of their property. Instead, there was an implied understanding among all parties that the mineral rights were subject only to leases arranged by Unocal.

In answer to the filing, the Commission granted the CPCN certificate to SCG on November 14, 1955, and found:

> ⁂that public convenience and necessity require construction, operation, maintenance and use of an underground gas storage project in the Eighth Zone of the West Montebello Oil Field and appurtenant gas compressor plant and facilities in the

[9] CPUC Decision 52219, p.6, Sept 22, 1955 (Atch 6)
[10] ibid.

> area shown on Exhibit C attached to the Application, and the injection of the necessary cushion gas.[11]

Neither this opinion or the CPCN allowed for acquisition of fee simple storage and mineral rights that belonged to Unocal and other property owners. (SCG defines "fee simple" as ownership of all property rights from the surface to the center of the earth).

Operation Under Leases

Under agreement, therefore, between 1956 and 1966, Unocal operated the Montebello Gas Storage for SCG. However, in 1966, ten tears later, Unocal discontinued operation of the field for SCG, at which point SCG acquired from Union Oil all pre-existing leasehold interests to the subsurface rights[12] of the Montebello Storage facility and assumed operation of the gas storage field.[13] SCG has operated the facility since that time.

The leases were due to expire in 1996, unless renegotiated, but they contemplated the contingency of having storage gas remaining at the termination date and gave SCG three additional years (i.e., until 1999) to withdraw any remaining gas under the terms of the agreement.[14] Per the original agreement with Unocal:

> 16. WITHDRAWAL OF GAS AFTER EXPIRATION OF CONTRACT - DELAY PERIOD
>
> Notwithstanding the expiration of the original term of this contract (or the expiration of the extended term if the option provided in Article 13 hereof is exercised), or the expiration of this contract from any other cause, Pacific (now SCG) shall have the right to have withdrawn and

[11] Supra, Note 5

[12] As of January 1998, the cumulative production of oil and condensate from the 8th zone is reported to be 29.5 million barrels, most of which was produced by Union Oil prior to 1956. Thus, there should be significant amounts of oil remaining in the reservoir.

[13] Pete Sego Declaration, October 1, 1997, p. 3. (Atch 7)

[14] Supra, Note 1

> delivered to it in accordance with this agreement (for the period of time hereinafter set forth and referred to as the delay period) any gas which Pacific shall have in storage and that is returnable, and all of the provisions of the agreement relating to the withdrawal and delivery of storage gas to Pacific shall continue in full force and effect until Pacific has received all of such balance of storage gas that is returnable; provided that this Article 16 shall not be operative beyond, and the delay period shall not continue beyond, three years after the termination of this agreement, and provided further that the service charge to be paid during the delay period shall be calculated at the effective rate in the termination year, and the total minimum payment for such delay period shall be not less than the number of years in such delay period, multiplied by the minimum annual payment in force in said termination year.

1990 Actions

As the expiration of the 40-year leases approached, SCG began a concerted effort to acquire all property, including storage and full mineral rights, from the owners. Instead of seeking another leasehold interest which would enable SCG to continue gas storage in the 8th zone, SCG approached the property owners through purchase offers, and for those property owners who would not agree to sell, SCG began the process of seizure and condemnation by eminent domain.

Purchase efforts

> Point: SCG's gas storage operations were operated in a manner which served to temporarily devalue storage and mineral rights during their offers to purchase and condemnation proceedings

SCG operated the Montebello Storage Project in a manner which served to convince property owners that their mineral rights were probably near worthless. In 1992 Application 92-03-038, SCG stated it was still planning to use the Montebello storage. SCG asked to unbundle its storage service, revise its rates, and recover costs for its customer storage programs.[15]

[15] S.W. Miller testimony, March 18, 1992, p. Ins. 17-22 (Atch 8)

In the same year SCG reduced injection to the Montebello field by over 60%, which dropped the related production of oil to just 0.2 barrels per day per well. The oil production rate inexorably depends on reservoir pressure and the amount of gas SCG injects into the reservoir. Since SCG reduced the injection of gas, oil production dropped to almost negligible levels, which made it appear that oil reserves had been depleted.

But instead of notifying lease holders that SCG was closing down the storage project and that their leases would lapse, in August 1993 SCG sent letters to the owners of mineral rights in the 8th zone, proposing to purchase those mineral rights. The letter stated that continued production of oil was no longer economical for the leaseholder based on 1992 production figures (i.e. barely enough to cover taxes):

> Dear _____:
>
> Southern California Gas Company is in the process of purchasing all outstanding storage rights in its Montebello underground gas storage field. By agreement, The Gas Company makes payments to you in consideration for your interests in the Eighth Zone, which is used by the Gas Company to store natural gas for the benefit of its customers in Southern California.
>
> The agreement is expiring in the next few years, therefore, The Gas Company proposes to acquire any storage and mineral interests you may have and is prepared to offer $3,765 for those interests falling within the boundary of The Gas Company's Montebello storage field. This offer is based on a recent study which took into consideration the following factors: (1) historical data; (2) operational projections for the Montebello Field; and (3) the present value of your storage interest calculated on your ownership in relation to the whole field.
>
> For your information, oil production in the Eighth Zone has declined to such level that for the most recent period, March 1992 through March 1993, ad valorem taxes exceeded the amount of oil royalties. For the Community leases for which you receive royalties, ad valorem taxes exceed royalties by $21.00. (*emphasis added*)

> If you would like to accept this offer, so indicate in the space provided on the attached sheet and return to me.[16]

Furthering the inaccurate information from SCG, the figures SCG calculated and used in its offers to leaseholders were based on a "fair market value" which excluded normal quantification of the oil in place.[17] Instead, SCG used an appraisal of the Montebello mineral rights calculated as estimates of future value based on *recent* past production, which of course had been controlled by SCG to artificially lower levels.

Many of the property owners sold their storage and mineral rights to SCG for negligible amounts. Others refused to sell. Instead of negotiating extension of leases for those who did not want to sell, SCG initiated condemnation proceedings to force those owners to turn over their storage and mineral rights to SCG.

In 1994 SCG boosted gas injection and, not surprisingly, oil production more than doubled.[18] Then, in 1995, the year SCG proceeded with condemnation proceedings, it decreased injection again, which temporarily decreased production of oil to zero.[19]

Eminent Domain Efforts

Point: SCG condemned private property owner's gas storage and mineral rights by eminent domain based on 1955 Certificate of Public Convenience and Necessity which was never intended to extend to the ownership of such rights.

As mentioned, the application for the CPCN and the granting of same by the Commission in 1955 did not include

[16] Ltr from Jeanette S. Ingalls, SCG to Ruth Ann Burke, August 10, 1993 (Atch 9)
[17] Appraisal Report for SCG Montebello Gas Storage Field Eighth Zone, Christy J. Petrofanis, June 27, 1995. (Prepared for use in civil actions by SCG) (Atch 10)
[18] 1994 and 1995 Annual Reports of the State Oil & Gas Supervisor (Atch 11)

acquisition of mineral rights, indicating that ownership of storage and/or mineral rights is not necessary for operation of the gas storage facility.

SCG itself did not think acquisition of <u>all</u> the mineral rights was necessary to the continued operation of the Montebello field. In a 1991 internal memo, SCG states:

> Since two parties own approximately 35% of the outstanding storage and mineral rights in the Montebello Storage Field (Gerber and Needleman), the Law Department was requested to issue an opinion addressing whether we could condemn all the outstanding interests except Gerber's and Needleman's and attempt to extend their current agreements. I suggested this to conserve on the capital expenditure in this three-year period. The legal opinion indicates that there is no law, which would prohibit our condemning less than 100% of the outstanding interests. If this option is pursued, the projected capital costs of purchasing the storage and mineral rights decreases from $1.3 million to $700,000.
>
> It is more expedient to purchase or condemn the <u>small interests</u> since we would be eliminating a substantial amount of administrative time for Storage Operations and Accounting. *(emphasis added)*

Regardless, SCG proceeded on its course. In November 1995, SCG retained the law firm of Laskin & Graham to acquire through condemnation the mineral rights from the remaining leaseholders who did not accept SCG's offer. A letter to Mrs. Burke, a leaseholder, shows SCG's threat:

> While we recognize that you have leased your interest in the storage field for many years and would like to retain that ownership, it has been determined by the Gas Company that in order to serve the larger needs of the community effectively and efficiently, it needs to purchase those leasehold interests.
>
> Please be advised that we intend to file the Complaint in Eminent Domain by not later than December 1, 1996 should this property not be acquired by voluntary purchase.[20]

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[19] Id.

[20] Ltr Graham to R.A. Burke, Nov. 14, 1995. (Atch 12)

SCG did not explain to leaseholders why it needed to acquire full mineral rights, or why it could not, as it had in the past, acquire a lease interest for 8th zone storage and related oil production incidental to storage withdrawal.

Deception in Court

On January 16, 1996 SCG filed nine separate Complaints (lawsuits), each naming multiple parties, against property owners to acquire their storage and mineral rights in eminent domain.[21] Our investigation found that, in Los Angeles Superior Court, SCG advanced inaccurate authority to condemn properties under the (CPCN) issued in 1955 by the Commission.

The complaints used the **Certificate of Public Convenience and Necessity** issued by the California Public Utilities Commission in 1955, and incorrectly represented to the court that the CPUC had found it necessary for SCG to acquire the properties as far back as 1955. SCG stated:

> **This proceeding in eminent domain is brought, by Plaintiff *pursuant to a finding and determination of public interest*, convenience and necessity and authorization of its governing body to acquire the interest in the property.**
>
> **The subject property *is necessary and strategic to Plaintiff's present and future operations*, maintenance, and expansion of its gas storage and transmission system, and its service obligations relating to fluctuating seasonal demands and balancing of the gas loads in Plaintiff's overall gas storage and distribution system in Southern California.[22]** *(emphasis added)*

To complete its inaccurate representation, and evidently in an attempt to predispose the court, SCG also drew on a recent decision regarding another CPCN in which it had been determined that the Commission's

[21] Application 98-01-015 Report of SCG In Compliance with Scoping Memo and Ruling of Assigned Commissioner, Oct. 19, 1998. (Atch 13)
[22] Los Angeles Superior Court Case No. BC142514, Complaint in Eminent Domain, Jan. 16, 1996.

authority in such matters could not be overturned by a Superior Court addressing the issue of necessity. SCG's attorney, Arnold Graham keyed on *necessity*, and argued the following in Superior Court:

> "1. THE ISSUE OF NECESSITY HAS BEEN PREEMPTED BY THE PUBLIC UTILITIES COMMISSION[illegible]."
>
> "The PUC's authority and decision cannot be hampered, interfered with, or second guessed by a Superior Court addressing the same issue, i.e., the issue of necessity." {`[illegible]efforts to avoid such exclusive jurisdiction by `preemptive strikes' --- whether in the form of a complaint seeking declatory relief or one seeking an injunction --- have been rejected}'"
>
> "Pursuant to Public Utilities Code §1759, the Superior Court is precluded from jurisdiction over the review of the question of "necessity" in a condemnation case concerning this public utility:
>
> > `No Court of this state, except the Supreme[illegible]shall have jurisdiction to review, reverse, correct, or annul any order or decision of the commission, or to suspend or delay the execution or operation thereof, or to enjoin, restrain, or interfere with the commission in the performance of its official duties[illegible].'
>
> "Even if the PUC were to have made an invalid order, or even if a Superior Court were to attempt to determine the rights of parties, a later applicable decision by the PUC would supersede the prior Superior Court judgment. *Barnett, supra at 681.*"[23]

Mr. Graham went on to argue that SCG had absolute authority to determine what was necessary for its operations. In this case, SCG determined that owning rights to oil, gas and other minerals in the 8th Zone and all zones beneath the 8th zone of the Montebello field was necessary to the *continued operation* of its gas storage project.

Mr. Graham's statements purposely implied that SCG intended to continue operation of the gas field for public interest, and therefore SCG needed to own outright the

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(Atch 14)

storage and all mineral rights. However, at the time SCG made these claims in court, it had already discontinued the storage operations, apparently due to gas leakage and environmental issues, and was taking preliminary necessary steps to sell the property. The following statements appear during the same timeframe in two SCG commissioned environmental reports of subsurface investigation and soil remediation regarding the Montebello gas storage properties:

> The objective of the soil remediation activity was to remediate hydrocarbon-impacted soil to a level acceptable to The Gas Company in preparation for sale of the property.
>
> The purpose of the investigation and soil remediation at Well was to remove hydrocarbon impacted soil from the subsurface, if present, in order to mitigate potential environmental liability in preparation for the sale of the property.[24] (*emphasis added*)

CPUC Transactions

Continuing its strategy of misinformation, in the events outlined below (also see footnotes), SCG also was repeatedly inaccurate or made omissions in communications to the CPUC about its intent to operate the Montebello storage field:[25]

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[23] Transcript, Complaint in Eminent Domain, Case No BC142514 Los Angeles Superior Court (Atch 15)
[24] Report of Subsurface Investigation and Soil Remediation Well La Merced 34, ENV America Inc., May 24, 1996, p. 2 and 20. Report of Subsurface Investigation Well Montebello #2-16, ENV America Inc., May 24, 1996, p. 16 (Atch 16)

[25] May 15,1997 — CPUC received complaint from leaseholder and asked SCG to respond to the allegations (Atch 17)

June 4, 1997 — SCG representatives flew to CPUC, San Francisco and met with Paul Clanon & Staff – explained what company had done and why it believed its actions did not violate any CPUC decisions. (Atch 17)

June 6, 1997 — Letter from SCG to Greg Wilson, CPUC regarding Burke. (Atch 18)

June 6, 1997 — Memo – suggested talking points from SCG to Greg Wilson regarding Burke. (Atch 19)

June 18, 1997 — Letter from Pete Sego, SCG to Greg Wilson re Burke property. (Atch 20)

1) On June 24, 1997, Senator Charles Calderon wrote to the CPUC concerning constituent complaints he had received regarding SCG's condemnation actions. During a meeting with CPUC's Energy Division staff, SCG representatives apparently convinced Commission staff that SCG *intended to continue use* of the Montebello field and that acquisition of the mineral rights was necessary.[26] SCG failed to disclose that it had already taken the field out of service and had contracted for an appraisal and an environmental assessment in preparation for the sale of its property.[27]

2) On July 18, 1997, the CPUC staff told Senator Calderon that the issue had been referred to the Legal Division for review.

3) On October 20, 1997, Commission staff told Commissioners that "SoCalGas's continued public service obligation to serve core needs and load balancing may justify SoCalGas' continued operation of Montebello" *based on representations made by SoCalGas.* Staff supported SCG's acquisition of the properties *based on SCG's statement* that it already owned 98 to 99% of the property interests in

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June 24, 1997 — Letter to Greg Wilson, from Senator Calderon regarding condemnation actions (Atch 21)

July 18, 1997 — Memo from Paul Clanon, CPUC Energy Division, to Senator Calderon (relied on information provided by SCG in meetings and correspondence listed above) (Atch 22)

[26] Declarations of Brewster Fong and Greg Wilson (Atch 23)

> Montebello--"consequently, this is essentially a private dispute involving property interests, and does not warrant the intervention of the Commission . . ."[28]

Proof of SCG's real intentions, which included the preparation of environmental reports, and other pre-sale activities, came on January 6, 1998. It was on that day that SCG filed for CPUC approval to sell its West Montebello gas storage field, related gas storage, and other related assets, with no restrictions on use. In a presentation to the CPUC, SCG stated *"SoCalGas has no long-term need for Montebello."* [29]

Pertinent Information Regarding Sale

In final preparation for sale of the Montebello field, in September 1997, SCG contracted for environmental consultant services and began drafting a Preliminary Environmental Assessment (PEA), which was completed on June 29, 1998. Planning for the retention of consultants started before the contract was signed for services. The purpose of a PEA is to disclose potential environmental problems and liabilities to prospective buyers of the property. SCG did not tell the Commission that it was preparing a PEA. Instead, when it filed for approval to sell the property, it asked the Commission to verify that compliance with the California Environmental Quality Act (CEQA) was not required. When the Commission decided that compliance with CEQA was necessary SCG produced the PEA as "Proponent's Environmental Assessment."

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[27] Appraisal Report, Montebello Storage Field Land Plus 16 Related Parcels, October 10, 1997, prepared in connection with seeking CPUC approval of sale of property. (Atch 24)
[28] CPUC internal communication from Counsel to Commissioners and Director Conlon. (Atch 25)
[29] Montebello Storage Field Filing: 1998, Steve Watson, Jan. 5, 1998 (Atch 26)

Although SCG notes in the PEA that leachate from the Superfund site may be present under the property, any relationship between the Montebello gas storage leakage and the Monterey Park Landfill gas problems are not disclosed by SCG. The northern side of the SCG Montebello gas storage project borders on the Monterey Park Landfill, one of the worst Superfund sites in California. A major problem with the Superfund site has been the management of escaping contaminated gas, an issue the Commission is familiar with from a prior case.[30]

According to information obtained from the Division of Oil & Gas, it was during the 1980's that gas was discovered to be leaking into shallow zones beneath the City of Montebello, probably through old oil and gas wells that had not been properly abandoned. As a result, apparently SCG purchased properties and was required to install a gas collection system that has operated since that time.

SCG installed 24 gas monitoring wells, as well as a shallow gas collection system due to problems with gas leakage from the ground into homes. There apparently were lawsuits, which led to SCG's acquisition of some homes, demolition of at least one home, and the abandonment of at least one well.[31] Migration of gas is relative to the pressure of the gas in the reservoir and frequently occurs in older wells which are no longer completely sealed from shallower reservoirs. SCG's PEA treats the escaping gas as a non-issue, based on the assumption that all gas will be withdrawn from the reservoir.

Geologic Hazards: As stated in the PEA, small amounts of storage gas have seeped into shallower, non-storage zones, and from there seeped to the surface via active and abandoned wells. If cushion gas is removed from the storage

[30] Telecon with D. Sanchez, Division of Oil & Gas, Nov. 1998
[31] ibid

> field, field pressure will drop, which will substantially reduce the potential for gas from shallow zones to migrate.[32]

Any potential purchaser would need to deduce on his own that if he continues to use the reservoir for gas storage, not only will gas disappear from inventory, but there will also be an environmental liability requiring continuous management.

Due to continued costs associated with lost gas and collection of gas from shallow reservoirs, SCG's planning staff note that the overhead costs for Montebello are twice as high as those for its other gas storage areas.[33] The potential liability for gas leaking into residences creates a further incentive to permanently discontinuing use of the storage area.

Any new operator may find that the cost of using the 8th zone reservoir as a gas storage field is prohibitive. In addition to the liability for leakage into homes, according to Division of Oil & Gas, a new operator would be required to continue monitoring the gas migration problem, a responsibility not specifically disclosed in SCG's request for bids.

Potential Buyer's Responsibilities

SCG's past and prospective environmental costs and liabilities related to the Montebello site are very likely substantial. In the Proposed Sale Agreement, SCG provides its Environmental Assessment and proposes to transfer all liability to the new owner, with the bidder left to do due diligence review and discover any existing problems on its own. Section 10-4 of the proposed sale document states:

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[32] Proponent's Environmental Assessment, Amend. To App. No. 98-01-015, Jul.8, 1998, p.19 (Atch 27)
[33] SCG Engineering Analysis, prepared by SCG in 1996 (Atch 28)

> "As Is, Where Is" Purchase: In the event that this Agreement is not terminated as provided for in Section 11.3, then Purchaser shall acquire the Assets in an AS IS, WHERE IS" condition and shall assume the risk that the Assets may contain Hazardous Substances, that adverse physical conditions, including but not limited to the presence of Hazardous Substances or the presence of unknown abandoned oil and gas wells, water wells, sumps and pipelines may not have been revealed by Purchaser's investigation. As of the Transfer Date, all responsibility and liability related to all such conditions, whether known or unknown, is transferred from Seller to Purchaser. The Purchaser shall at its expense take whatever actions are necessary to reduce and concentration of any "Hazardous Substance" located on the surface or within the subsurface or the subsurface waters of the Property to a level of concentration that is at or below the most stringent level that from time to-time may be established by any federal, state, or local agency's applicable law, regulation, ordinance or rule ("Environmental Law"), applicable to the use of the Property for residential use ("Remediation", "Remediate", or "Remediated"). "Environmental Law" shall also include any legal requirement in relation to contamination, and/or protection and/or cleanup of the environment, exposure of persons, (including employees), to any Hazardous Substance and shall also include any laws or regulations pertaining to Hazardous Substances, or liability or duty created under any statute or under intentional tort, nuisance, trespass, negligence, or strict liability or common law theory or under any decision of a state or federal court.

Sections 10.5 and 10.6 of the Proposed Sale Agreement further elaborate on the indemnification and assumption of environmental liabilities. As written, SCG intends to sell its entire liability under State and Federal laws for the cleanup of leaking wells, abandoned oil and gas production wells, all surface facilities, contaminated soil and groundwater. Most of the contamination found at this site originated from production in the shallow zones and/or from other activities unrelated to gas storage. In its application, SCG does not distinguish environmental costs associated with the operation of the 8th zone from environmental costs associated with past oil and gas production activities on the properties. Although SCG identifies activities that will be associated with

abandonment, closure and cleanup of the gas storage facility, it does not specify how much of the cost is directly related to the 8th zone, which is the only liability that might reasonably be considered a cost that could be passed through to ratepayers.

Based on the Environmental Assessment provided by SCG, and applying experience with assessing environmental clean up options and associated costs, the potential cost of cleaning up the West Montebello Field could be extremely large. On the information available about the history of the facility, as much as 90% of the environmental costs may not be related to the use and operation of the gas storage facility.

SCG proposal to sell the property "AS IS, WHERE IS" with all the attendant environmental and title liabilities making it highly unlikely a buyer will be found. If the Commission approves the sale now without an understanding as to how environmental costs will be handled, ratepayers will be trapped into paying all the costs without the benefits of a reasonableness hearing, payments from other responsible parties to share the cleanup costs, or insurance recovery.

Reasons for Sale

SCG had several motives in acquiring full ownership of all mineral rights, then removing the Montebello storage project from service and seeking to sell the property:

1) SCG was facing high operational costs, due primarily to gas migration. For years, SCG reported to the CPUC that it had experienced gas losses due to "migration" or leakage from the storage area. At operating pressures between 1500 psig and 2450 psig, gas continuously leaked from the 8th zone into shallower

zones and into areas beneath homes, creating environmental and health hazards. When the gas storage project is abandoned, The California Department of Oil and Gas (DOG) will require the pressure in the reservoir to be reduced to 50 psig to prevent gas migration.[34] The only viable immediate solution to the gas migration problem is to reduce the gas pressure in the reservoir; a permanent solution would be to water flood the reservoir.

2) SCG knew of potential secondary production options that could be used to produce the remaining oil reserves, which might generate substantial income if SCG owned the mineral rights. Once the field is no longer producing gas and is no longer regulated by the CPUC, (whether from a sale or abandonment as a useful utility asset), SCG could produce the oil and claim all income from oil production for its stockholders. SCG's 1991 internal memo states:

> Another incentive to purchasing all rights in the Eighth Zone is that SoCal would then be entitled to the oil royalty payments which are now distributed to the current owners. The revenue (net taxes) for the period from 1988 through 1990 was $62,270.[35]

3) By condemning the properties before announcing closure of the facility, SCG could avoid paying fees under their leases for the final withdrawal of blanket gas.

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[34] supra, note 31

[35] Compare this 3 year figure of $62,270 to SCG's appraised value in the 1995 Appraisal of $43,771 based on the 5 years 1986-1991: SCG Interoffice Correspondence, J.S. Ingalls to R.D. Phillips, July 10, 1991, p.2 , SCG Interoffice Correspondence, J.S. Engalls to R.D. Phillips, July 10, 1991 (Atch 29) and Appraisal (Atch 10) this figure does not appear to contemplate the full potential of oil recovery from water-flooding.)

4) SCG is facing substantial environmental liabilities associated with aftermath cleanup of 60 years of oil and gas industry activities associated with the Montebello field. The ideal solution from the standpoint of SCG (and former Montebello field oil producers like Union Oil) would be to pass through all of those costs to the ratepayer.

5) Recognizing that the only permanent solution to the gas migration problem was to close down the storage project, SCG needed to find ways to get something of value from the project and properties it owned.

6) SCG realized that by acquiring the storage and mineral rights prior to closure of the field, it could cease paying a service charge and all costs associated with same. (Note: SCG failed to advise any of the leaseholders of the value of these rights in its assessment of fair value or its offers to purchase mineral rights.) Again, the 1991 internal memo states:

> **Although the revenue from oil production may not be significant and is declining, additional administrative hours would be saved by not having to distribute the royalty checks.**[36]

7) Besides storage rights, the only other asset associated with the Montebello Field is the mineral rights. If SCG could acquire the mineral rights, and in the event that the gas facility were not sold, SCG could lease the rights to a production company like Stocker Resources, which is a company currently producing oil from a shallower reservoir in the Montebello field (not part of SCG's lease area), and

[36] SCG Intereffice Correspondence, U.S. Ingalls to R.P. Phillips, April 19, 1991 (Atch 30)

benefit from a steady stream of oil royalties for years to come.

SCG ceased injecting (storing) gas into the reservoir in June 1997 and has been steadily drawing out the remaining gas since then. Production from the 8th zone dropped from 1,352,051 Mcf in February 1997 to 8018 Mcf in July 1998.[37]

It will be extremely difficult for SCG to find a buyer for the property given the conditions of the proposed sale as evidenced in its Application to the Commission, i.e. . acceptance of all environmental liability. Additionally, the Division of Oil & Gas will require any new operators of the gas storage field to continue the collection and management of escaping gas.

Instead, it appears from facts reviewed to date that the proposed sale appears to be stage one of a plan to secure Commission approval to pass-through to the ratepayers all of the environmental costs associated with the property. This plan not only benefits SCG, but also relieves all of the prior oil producers who operated on the site from their environmental liability.

OTHER PERTINENT FACTS

Other Eminent Domain Information

SCG may have also been motivated by rising oil prices, since by late 1997, the price of oil reached $20 per barrel. To insure complete ownership of all potentially valuable mineral rights, SCG sought not only to condemn the property in the 8th Zone (which is all it needs to operate the gas storage project), but to include

[37] Division of Oil & Gas data, November 6, 1998 (Atch 31)

> "that portion of the subsurface of the real property described herein in fee simple, including all oil, gas and other mineral interests if any contained therein, generally lying 7,000 feet below sea level thereof, in that subsurface area also sometimes referred to as the "Eighth Zone" and precluding all uses or rights of others to drill into, through, or to otherwise use or occupy all parts of said properties being acquired, but expressly excepting from acquisition and leaving and reserving to the owner(s) and all uses of said properties lying above the elevation of 7,000 feet below sea level, or generally above the "Eighth Zone."[38]

In essence, SCG sought to own <u>all</u> oil, gas, and other mineral rights below 7,000 feet, which is considerably more than the 8th Zone. In addition, SCG claimed it needed the mineral rights when the only real value to their utility business of storing gas was the empty space and having access to inject and withdraw gas (and oil recovery incidental to gas withdrawals).

Stocker Resources Role

It was well known in the industry that in February 1997, Plains Resources, parent company of Stocker Resources, completed its purchase of Chevron's interests in the Montebello field.[39] Stocker Resources is currently on-site, actively waterflooding in shallower zones:

> In March 1997, Plains Resources Inc. (Houston)[40] signed a definitive agreement to pay $25 million for all of Chevron Corp's interest in Montebello field. The assets acquired consist of a 100% working interest and a 99.2% net

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[38] Los Angeles Superior Court Case No. BC161855, Complaint in Eminent Domain, Dec. 3, 1996, p.5 (Atch 32)

[39] The assets acquired consist of 100% working and a 99.2 % net revenue interest in 55 producing oil wells and related facilities and also include approximately 450 acres of surface fee land. At the acquisition date, the Montebello Field. . . was producing approximately 800 barrels of oil and 800 Mcf of gas per day and added approximately 23 million barrels of oil equivalent to the Company's proved reserves... The Company intends to spend approximately $2.5 million during 1998 and 1999 to improve the quality of the gas through upgrading and refining the existing gas collection system, as well as adding additional processing capacity.
(Atch 33)

[40] Plains Resources, operating as subsidiary Stocker Resources in California, began operations in California in 1992.

> revenue interest in 55 producing oil wells and related facilities and also include approximately 450 acres of surface fee land. As a result of high inert content, the Company's gas production in the Montebello Field is difficult to market and currently is delivered for no value. To ensure that the Company is able to develop and produce its oil reserves without restriction due to lack of markets, the Company has made arrangements with the former owner of the Montebello Field to take its natural gas production volumes at no incremental value when the Company is unable to find a market for the gas. The Company intends to spend approximately $2.5 million during 1998 and 1999 to improve the quality of the gas through upgrading and refining the existing gas collection system, as well as adding additional processing capacity. [41]

In April 1997, Plains Resources Inc. (parent company of Stocker Resources) announced plans for an active exploitation program to hike recovery from the Montebello oil fields. Since then, the 500-acre field has produced more than 100 million barrels of 22-degree API gravity crude and 100 bcf of gas from two compartmentalized reservoirs at 1,500 to 4,000 feet. It produces 800 b/d on a 4-6%/year decline plus 800 Mcfd of gas from 55 wells. Water injection is 10,000 b/d. Plains hoped to boost production 20-30% by yearend via tubing rotators, pump-off controllers, stimulations/recompletions, and other remedial work. It also expected to drill 30 infill producing wells plus a number of injectors by yearend 1998. With oil in place estimated at 400 million barrels, Plains expects to recover at least 20 million bbl, including 9 million bbl proved developed. Ultimate recovery might be 30-40% of oil in place, the company said.[42]

The proximity and success of Stocker Resources in the Montebello field using secondary oil recovery techniques

[41] Plains Resources Inc Annual Report (SEC form 10-K). The purchaser of the produced gas is assumed to be SCG, which raises the question of what type of agreement SCG has signed with Plains Resources. Also, Plains Resources may be the primary contender for purchase of the 8th zone and gas facilities from SCG. (Plains Resources is also in the process of purchasing the Celeron All American Pipeline from Goodyear, which must be approved by the CPUC). The extent to which Plains Resources assets overlie or include SCG properties is unknown. (Atch 33)

indicates the likelihood of similar successes in oil and gas production in the SCG leasehold area below 7,000 feet.

Potential for Oil Production

SCG was aware of the potential for oil production, as evidenced by Mr. Watson's statements on cross examination during the recent CPUC hearing on A.98-01-015, held in the Fall of 1998, regarding the sale of the Montebello Gas Storage project:

> Q. Could you tell us a little bit about the Montebello field? It's my understanding that you operate something called the 8th zone and that there are a number of oil companies that have interests in oil fields that are physically above the 8th zone. Could you elaborate on that a little?
>
> A. The gas company has operated the - purchased the field actually from Union Oil. Most of the oil had been extracted, or at least Union we thought so at the time, but as - SoCalGas was interested in a depleted former oil zone called the 8th zone, that that cavity could be used to provide storage service, and that zone is about 8,000 - about 8,000 feet down, but there are other zones that can be potentially - that might have been uneconomic back in the `50s, but which may be economical using new drilling techniques such as horizontal drilling where you don't have to be right on top of the zone, but you might be able to go sideways to get at the zone, so there are new drilling techniques that might make the recovery of those oil reserves economic today, whereas they were deemed by Union to be uneconomic many years ago.

SCG's interest in secondary recovery of oil may now be significantly damped since oil prices dropped to about $10/bbl in 1998. Nevertheless, they did acquire the mineral rights, and eventually the price of oil will go up making production viable once again.

Other Montebello Interests

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[42] Oil & Gas Journal 95:15, April 14, 1997

In 1986 the following companies had interests in the Montebello field: Atlantic Oil Company, ARCO Oil and Gas Company, Chevron U.S.A., Inc., Davis Investment Company, Energy Production and Sales Company, Pacific Energy Resources, SCG, Texaco, Inc. And Watmac Oil Company. There were a total of 255 wells installed: 114 shut in and 141 producing.[43] As of Jan. 1998, there were 132 wells installed: 25 shut in, and 107 producing.[44]

Indemnification

In its reply brief in A.98-01-015 to the CPUC dated January 6, 1999, SCG states that it does not know whether there was any kind of hold harmless or indemnification language in SCG's purchase contract with Union Oil. However, termination of the contract reveals that there is no specific indemnification clause in the 1955 Pacific Lighting-Union Oil contract."[45]

Ratepayers At Risk

Since it does not appear to be economically feasible for anyone to purchase the gas storage area under the "as is, where is" conditions, SCG will probably be left with the responsibility of salvaging and cleaning up the site. Virtually all of the costs associated with the withdrawal of gas and abandonment of the facility could be classified as environmental. If SCG is successful in passing environmental costs along to ratepayers, Unocal and other prior producers will also benefit by not being held as Responsible Parties under CERCLA and other environmental laws.

Alternatively, SCG could sell the property but retain the environmental liability and pass cleanup costs on to the

[43] Annual Review, Conservation Committee of California Oil Producers, 1986 (Atch 34)
[44] 1997 Annual Report of the State Oil & Gas Supervisor. (Atch 35)
[45] There could be subsequent agreements not currently known to the CPUC or its consultants.

ratepayers. SCG has left the door open to negotiate the sale agreement with a qualified buyer. This situation would be a win-win for SCG, Unocal and other oil companies, but expensive for ratepayers.

Indications are that SCG's proposal to make an effort to try to sell the property is a step toward the salvage and cleanup of the property at ratepayer's expense so that later, when the property does not sell, SCG can say the Commission approved of the approach.

Whittier Gas Storage Actions

Misrepresenting facts about gas storage facilities to the CPUC appears to have occurred before. For instance, consider the history documented regarding SCG's Whittier gas storage field. In one document, SCG claims to have discontinued use of the Whittier gas storage field in 1986.[46] However, records at the CA Division of Oil and Gas records show the field was in service until 1989 when it became "mostly idle" and that SCG was considered "terminating the project" at that time.[47] This decision was apparently prompted by large losses of gas from the storage area and low demand for the storage space.

Instead of terminating the Wittier gas storage project, in 1990 SCG hired additional petroleum engineers and rolled the project into the total costs for the test year 1990 Rate Case before the CPUC. Thus rates to consumers were artificially increased by the inclusion of facilities not being used to serve utility customers.[48]

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[46] SCG Background Paper (Atch 36)
[47] 75th Annual Report of the State Oil & Gas Supervisor, 1989, California Department of Conservation Division of Oil & Gas, 1990, p. 13 (Atch 37)
[48] Testimony before the CPUC in the General Rate Case for Test Year 1990 (Atch 38)

After establishing base rates, in 1991 SCG took the Whittier Storage Project out of service.[49] No gas was injected into the project in 1992. and in fact, 28.3 million cubic feet of gas was withdrawn. Since that time, SCG has continued to draw off the remaining blanket gas. However, again providing inaccurate information to the Commission, SCG wrote in its Application to the CPUC to sell the Montebello field:

> SCG also owns the East Whittier field that it previously operated as an underground storage field. SCG removed East Whittier from service in 1989, and this fact was reflected in SCG's test Year 1990 general rate case Application A.88-12-047.[50]

CONCLUSIONS

Although additional formal discovery might add to the evidence already known, several conclusions are clear:

1. By its manipulation of gas storage at strategic time frames, SCG was able to proffer a deflated value of property owners' storage and mineral rights to leaseholders and the CPUC. The company also supplied inaccurate information to property owners, the CPUC and the courts about its current and future need for acquisition of the storage and mineral rights at the West Montebello Gas Storage Project.

2. SCG made fundamental misrepresentations to the Los Angeles Superior Court during eminent domain hearings when it stated that it had authority under a CPCN from the CPUC to condemn storage and mineral rights belonging to leaseholders of the 8th Zone of the West Montebello oil field. It also erroneously told the

[49] 1991 Annual Report of the State Oil & Gas Supervisor (Atch 39)
[50] Application 98-01-015, p.2, footnote 1 (Atch 40)

court that it needed the mineral rights to continue the public utility operation of the gas storage facility to serve the public interest, while at the same time making preparations for its sale.

3. Through its communications with the CPUC during June and July of 1997, by which SCG convinced the CPUC that they intended to continue use of the Montebello field, the company misrepresented facts about their on-going need for the storage facility to the CPUC Energy Division during an investigation of complaints by Montebello property owners, which led to State Senator Calderon being given a flawed analysis of events.

Further, counsel for the Commission, relying on these communications and reviewing the representations made by SCG on public utility need for the storage facility, and advanced by SCG in court filings, advised Commissioners that the condemnation actions seemed routine.

Table 1

SUMMARY OF SCG'S MISREPRESENTATIONS TO THE LOS ANGELES SUPERIOR COURT AND THE COMMISSION

In many instances since 1956, SCG advanced inaccurate information to the Commission, leaseholders, and the court. The left column of the following table summarizes representations made by SCG to the Los Angeles Superior Court, Defendants and the Commission. For each inaccurate representation made, the correct facts are entered in the right column.

SCG's Representations(to):	Correct Facts
(CPUC) In 1956 SCG claimed it had an option to purchase the site for the gas storage project from the City of Montebello, citing Resolution 5484.	Resolution 5484 gave SCG ONLY a Special Use Permit. Property was not transferred or offered for sale to SCG.

(Defendants) In 1993 SCG claimed oil production dropped to below cost of taxes in 1992	In 1992 SCG purposely decreased gas production, which decreased oil production.
(Court) In 1996 SCG claimed that the storage and mineral rights are necessary to operate for public interest.	SCG 1991 memo explicitly states that ownership of ALL storage and mineral rights is not necessary to serve the public interest.[51]
(Court) In 1997 SCG claimed that the 1956 CPCN granted storage and mineral rights.	Storage & Mineral rights were <u>not</u> included in the 1956 CPCN.
(Defendant) In June 1998 SCG claimed not to possess the 1955 Application or exhibits for CPCN.	In June 1998, SCG provided copies of the 1955 Application and several exhibits to the CPUC, specifically omitting a copy of Montebello Resolution No. 5484
(Court and CPUC) From 1996 through 1998 SCG suggested it intended to continue to operate storage.	SCG discontinued use of storage in 1997 and was taking steps to sell property as early as 1996
(Court, Defendant and CPUC) From 1992 through 1998 SCG claimed there was little or no residual value in mineral rights.	There is still oil in the reservoir capable of being produced. In addition, a SCG memo confirmed there is value in owning mineral rights to future oil production.[52]
(Defendant and CPUC) In 1998 SCG stated that it expected that a new buyer would have to operate the storage field as a public utility subject to CPUC regulation.	1998 Proposed sale agreement does not limit buyer's use of property to gas storage. And SCG's Environmental Assessment, which is provided to prospective purchasers, assumes gas storage operations will be discontinued to prevent continued gas migration.
(CPUC) In response to Commissioner Conlon's Oct 15, 1998 ruling: SCG justified the differences between its representations to the court and to the CPUC by saying, in part, that at the time it <u>filed</u> the condemnation actions, the facility was still in use.	However, AFTER SCG filed its application with the CPUC to sell the facility and stated to the CPUC that Montebello storage was no longer necessary, SCG continued to argue in court that the facility was still necessary.

[51] SCG Interoffice Correspondence, J.S. Ingalls to R.D. Phillips, July 10, 1991, p. 2 (Atch 29)
[52] SCG Interoffice Correspondence, U.S. Ingalls to R.D. Phillips, April 19, 1991. (Atch 30) In 1998 SCG states "with 23 Bcf of recoverable cushion gas and potential oil reserves, we believe the sale... will produce a high sales price." (Background Paper, Atch 36)

(CPUC) In response to Commissioner Conlon's Oct 15, 1998 ruling: SCG states "absent the filing of condemnation actions, that provided SCG with immediate right to use the 8th zone rights pending resolution of the actions, any gas SCG had in storage would have been in trespass with respect to any owner of the 8th zone rights ...	SCG failed to note that it did not ask any property owner for an extension of his/her lease, therefore, SCG came to its conclusion without exploring alternatives.
(CPUC) In response to Commissioner Conlon's Oct 15, 1998 ruling: SCG states that withdrawal of the cushion gas would have meant the gas storage field would have been seriously impaired or unusable for gas storage in the future.	SCG's own environmental assessment states that no damage will occur when the cushion gas is removed. From April 1997 through November 1998 (last date of data) SCG steadily drew cushion gas out of the Montebello field.
(CPUC) In response to Commissioner Conlon's Oct 15, 1998 ruling: SCG states that the purpose of not withdrawing the cushion gas is to preserve the facility for future gas storage.	SCG did not tell the Commissioner that problems with uncontrollable gas leakage appear to preclude further use of this field for gas storage.

DATE: April 7, 1999

BY: Margaret C. Felts

Investigative Consultant for California Public Utility Commissions' Consumer Services Division

ALJ/LTC/jac

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation into the operations and practices of the Southern California Gas Company, concerning the accuracy of information supplied to the Commission in connection with its Montebello Gas Storage Facility.	I.99-04-022

NOTICE OF ASSIGNMENT

Please be advised that Investigation 99-04-022 is being assigned to Commissioner Henry M. Duque and Administrative Law Judge Janet A. Economé.

Dated April 27, 1999, at San Francisco, California.

Lynn T. Carew by BC

Lynn T. Carew, Chief
Administrative Law Judge