PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Item 37 I. D. #5030

ENERGY DIVISION **RESOLUTION E-3952**

NOVEMBER 18, 2005

R E S O L U T I O N

Resolution E-3952. Concludes that the Sacramento Municipal Utility District's proposal to annex the Cities of Davis, West Sacramento, Woodland, and other portions of Yolo County, located in Pacific Gas and Electric Company's service territory, will not substantially impair Pacific Gas and Electric Company's ability to provide adequate service at reasonable rates within the remainder of its service territory.

Request made by letter, effective August 22, 2005, from Sacramento Local Agency Formation Commission to the California Public Utilities Commission.

SUMMARY

The proposal by the Sacramento Municipal Utility District (SMUD) to expand into Yolo County to serve Pacific Gas and Electric Company (PG&E) customers in Davis, West Sacramento, Woodland, and adjacent unincorporated areas, will not substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

- Annexed customers are expected to pay most of the transition costs although there may be some costs to remaining PG&E ratepayers from specified exceptions.
- Even though SMUD's proposed new integration facilities potentially may duplicate existing PG&E infrastructure, there are no claims that any PG&E facilities will become idle as a result.
- To the extent SMUD plans to compensate PG&E for "acquired" and "stranded" facilities in accordance with an asset valuation determination, no costs associated with those facilities will be shifted to PG&E's remaining ratepayers.

- If "remaining" facilities associated with SMUD's acquisition and severance proposal become idle because they can not be reconfigured as SMUD proposes, PG&E remaining customers must cover the costs of these idled facilities.
- A conservative estimate of all costs due to bypass of transition costs, idle facilities, and lost revenues results in a de minimis overall rate impact to PG&E's remaining ratepayers.

Some issues are outside the scope of the CPUC's review of the proposal under Government Code Section 56131.

- Broader energy policy issues raised by PG&E are not relevant to the CPUC's inquiry.
- Cumulative impacts of additional annexation proposals go beyond the CPUC's statutory reporting requirements but could be considered in a separate CPUC proceeding.

BACKGROUND

SMUD proposes to expand into Yolo County to serve PG&E customers in Davis, West Sacramento, Woodland, and adjacent unincorporated areas.

SMUD currently generates, transmits, and distributes electric power throughout a 900 square mile service area that includes Sacramento County and a small portion of Placer County.[1] In early 2003, the Cities of West Sacramento, Davis, Woodland (the Cities) and the County of Yolo requested that SMUD consider annexation to replace existing PG&E electric service with SMUD service for approximately 70,000 customers in the Cities and adjacent unincorporated areas between and surrounding the Cities.[2] Based on a feasibility study, these communities believed there was the potential for lower rates, the ability to participate in decision-making on energy-related issues at the local level, and the

[1] Additionally, SMUD annexed and now serves a small area in Yolo County.

[2] The proposed annexation territory does not include the University of California located in Davis.

potential for improved reliability and customer service. Additional feasibility studies were conducted in 2004 which concluded that annexation was technically and financially viable, and demonstrated economic benefits to both SMUD's existing customers and customers within the annexation area. After consideration of the studies and a formal joint resolution requesting annexation from the Cities and Yolo County, the SMUD Board of Directors authorized its staff to proceed with annexation. On July 29, 2005, SMUD submitted its application proposing annexation to the Sacramento LAFCo for approval.

The CPUC is responsible for investigating SMUD's annexation proposal and issuing its advisory report to the LAFCo on whether the annexation will have substantial impact upon PG&E's remaining customers.

By letter, effective August 22, 2005, the Sacramento LAFCo submitted SMUD's annexation proposal to the CPUC. Government Code Section 56131 requires the CPUC to investigate the proposal and report its opinion to the LAFCo within 90 days whether the proposed service within the proposal territory will substantially impair the ability of the public utility to provide adequate service at reasonable rates within the remainder of its service area.

The CPUC has relied on certain criteria in the past to evaluate and make its determination concerning substantial impairment to PG&E's remaining ratepayers.

In Resolution E-3472 dated November 26, 1996, the CPUC addressed the formation of Crossroads Irrigation District as requested by the San Joaquin County LAFCo. In that resolution, the CPUC used the following three criteria for evaluating the proposed service and making a determination:

1) whether the customers of the proposed irrigation district will be able to bypass payment of generation-related transition costs, which would require the remaining PG&E customers to cover these costs,

2) whether the proposed irrigation district will install duplicate distribution infrastructure, potentially idling PG&E distribution facilities and requiring remaining PG&E customers to cover the costs of these idled facilities, and

3) whether the amount of generation-related transition costs or idle distribution facilities shifted to remaining PG&E customers, if any, would have a significant rate impact on remaining PG&E customers.

To perform its review, Energy Division asked for and received additional information from PG&E concerning SMUD's annexation proposal.

On August 18, 2005, the Energy Division requested that PG&E 1) address the above criteria and respond to some specific questions, 2) raise any related issues, 3) explain whether, in PG&E's opinion, the proposed service by SMUD would substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory, and 4) address any cumulative impacts of additional such proposals.

NOTICE

The Sacramento LAFCo's letter was noticed in the Daily Calendar.

The letter from Sacramento LAFCo to the CPUC, effective August 22, 2005, was noticed by publication in the Commission's Daily Calendar on August 24, 2005.

PROTESTS

PG&E asserts SMUD's proposed annexation will substantially impair its ability to provide adequate service at reasonable rates within the remainder of its service territory. SMUD disagrees with PG&E's assertion.

PG&E responded to the Energy Division's request for information on August 29, 2005. In summary, PG&E believes that the proposed annexation will substantially impair its ability to provide adequate service at reasonable rates within the remainder of its service territory. SMUD disagrees and addressed PG&E's response in comments filed on September 12th. Specific issues are discussed below.

On October 13th, PG&E filed a lengthy reply to SMUD's September 12th comments. Because a draft of this Resolution had to be mailed for public comment by October 19th in order to meet the 90 day statutory deadline, the

Energy Division did not have sufficient time to substantively review PG&E's reply. To the extent applicable, PG&E should submit its response to SMUD's comments by way of comments on the Draft Resolution. SMUD may respond to PG&E by way of reply comments.

DISCUSSION

Energy Division evaluates SMUD's annexation proposal utilizing modified CPUC criteria.

In Resolution E-3472, the CPUC used three criteria for evaluating the Government Code Section 56131 provision of whether the district's proposed service would "substantially impair the ability of the public utility to provide adequate service at reasonable rates within the reminder of the service area of the public utility." The criteria were used to assess whether there are any costs to PG&E's remaining ratepayers from customer bypass of transition costs and/or from the installation of duplicative infrastructure causing idle facilities, and if so whether such costs would have a significant rate impact. It would be reasonable to apply these criteria to the SMUD proposed annexation. However, these criteria should be expanded as discussed in more detail below in order to identify and properly evaluate <u>all</u> quantifiable costs associated with the proposed service that would be shifted to remaining PG&E customers. In doing this, the CPUC should also determine whether there are any positive quantifiable benefits which would offset any of these costs.

Unless specifically exempted by the CPUC, customers in the proposed annexation territory will not be able to bypass payment of applicable transition costs.

For purposes of evaluating SMUD's annexation proposal, transition costs include all components currently included in the Cost Responsibility Surcharge (CRS)[3].

[3] Transition costs do not include the Nuclear Decommissioning Charge (NDC), the Fixed Transition Amount (FTA), or the Public Purpose Program (PPP) charge.

In a series of decisions issued over the last two years[4], the CPUC has ruled on the obligations of Municipal Departing Load (MDL) customers to pay the following components of the CRS: the DWR bond charge (DWRBC), the DWR power charge (DWRPC), the ongoing competition transition charge (CTC), and the energy cost recovery amount (ECRA) charge.[5]

PG&E and SMUD agree that the net result of the aforementioned CPUC decisions is that transferred and new MDL sales in the annexation area would continue to be responsible for payment of the DWRBC and the ongoing CTC. However, a portion of the transferred load MDL sales, and all new MDL (subject to a specified cap) would be exempt from the DWRPC per D.04-11-014 and D.04-12-059. Moreover, Public Utilities Code Section 848.1(c) and D. 05-08-035 require that all new MDL sales that are eligible for the DWR exemption also receive an exemption from the ECRA charge.

As a result of the annexation, PG&E's remaining customers will assume costs resulting from the DWRPC and ECRA payment exceptions previously adopted by the CPUC for MDL customers in the annexed area.

Although PG&E and SMUD agree that some annexed customers may be exempt from the DWRPC and the ECRA charge, they disagree as to whether PG&E's remaining customers would have to cover any costs associated with the exemptions. PG&E estimates a total cost impact of $74 million (over a 20-year period), or approximately $7.3 million per year on an annualized basis, in lost revenues resulting from the DWRPC and ECRA charge exemptions that would

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[4] See Decision (D.) 03-07-028, D.03-08-076, D.04-11-014, D.04-12-059, D.05-07-038, and D.05-08-035.

[5] The DWRBC covers the costs associated with the bonds DWR issued in 2002 to recover the costs it incurred to procure power during the energy crisis. The DWRPC covers the above-market costs associated with the contracts entered into by DWR. The on-going CTC covers the above-market portion of the contracts that PG&E executed with qualifying facilities, as authorized via Assembly Bill 1890. The ECRA charge, sometimes referred to as the Energy Recovery Bond charge or the Dedicated Rate Component, collects the costs associated with the energy recovery bonds issued to finance PG&E's bankruptcy-related costs

have to be covered by remaining PG&E customers[6]. SMUD argues that the CPUC determined that since DWR did not incur costs to serve the exempted load, the exemptions will not result in any costs to PG&E's remaining ratepayers.

Transition costs, by way of the CRS components, are to be recovered from all PG&E bundled service customers and all non-exempt direct access customers, customer generation departing load customers and MDL customers. The overall cost obligation is a fixed amount. To the extent annexed load is excepted from any of this cost obligation, that portion they would have otherwise paid now must be assumed by PG&E's remaining ratepayers and other non-exempt direct access and departing load customers.

SMUD's proposed new integration facilities may duplicate but do not idle existing PG&E facilities.

SMUD proposes construction of an 18-mile transmission line and a new substation to integrate the annexed electric system into the SMUD grid. PG&E asserts that these new integration facilities duplicate PG&E infrastructure that adequately serves load in the area.

SMUD responds that the proposed new facilities are not duplicative of PG&E facilities. Instead, they are supplemental facilities required to remedy long-standing reliability and load-serving issues. SMUD alleges that PG&E has failed to maintain adequate transmission capacity in the area and that a number of upgrades and modifications would be necessary in the area even in the absence of SMUD's annexation proposal. SMUD supports its allegations with references to consultant studies and historical reliability data

PG&E alleges that there are no deficiencies in the area. It asserts that the consultant analysis SMUD relied upon was flawed, and that SMUD's arguments ignore the fact that relevant reinforcement projects will be completed and/or

[6] PG&E states there is a possibility that SMUD may argue for a CTC "stand-alone" exemption per Public Utilities Code Section 369 in the future which it believes would shift additional costs to PG&E's remaining ratepayers, if granted. SMUD does not believe its customers in Yolo County would qualify for the CTC "stand-alone" exemption per Public Utilities Code Section 369 on any broad scale.

substantially in progress prior to SMUD's proposed acquisition date. PG&E maintains that the new facilities SMUD proposes will serve no purpose other than to integrate the system with SMUD's, and are therefore duplicate facilities.

With such a discrepancy of factual information, it is indeed debatable whether or not SMUD's proposed integration facilities would result in the installation of duplicative infrastructure. Nonetheless, our main concern regarding duplicative facilities is whether PG&E facilities would become idle as a result requiring PG&E customers to cover the costs of the idled facilities. There is the potential that SMUD's new integration facilities may be duplicative of PG&E's existing facilities assuming that PG&E information is correct. However, PG&E does not claim that any of its facilities would become idled or stranded as a result of SMUD's proposal to build these new facilities. Accordingly, no costs would be shifted to PG&E's remaining ratepayers as result of their construction.

Other aspects of SMUD's annexation proposal result in the stranding of PG&E facilities.

Although we conclude that SMUD's proposed new integration facilities, in and by themselves, do not idle PG&E's existing facilities, a few of PG&E's assets will be stranded as a result of SMUD's proposed acquisition and severance plans. With this in mind, we believe our second criterion perhaps narrowly spoke only to idle facilities/cost impacts resulting from duplicative infrastructure, and instead should more broadly assess whether any aspects of the proposal would result in idle facilities and whether remaining PG&E customers would be required to cover the costs of those idled/stranded facilities.

SMUD has identified approximately 10.7 miles of existing PG&E transmission line[7] and two line taps that will be "stranded" by its acquisition and severance proposals. SMUD states that it will provide compensation to PG&E for these few facilities. In addition to these stranded assets, PG&E states portions of its Rio Oso-West Sacramento and Brighton-West Sacramento transmission lines will be stranded resulting in a $21 million (Net PresentValue) cost to remaining ratepayers or approximately $2.1 million per year on an annualized basis.

[7] This is comprised of an 8.16 mile portion of the Woodland-Rio Oso #1 and a 2.5 mile portion of the Brighton-Davis line.

SMUD responds that these additional PG&E facilities will be not be stranded and PG&E customers will not suffer a loss because SMUD proposes to pay compensation for the "acquired" portions of these transmission lines, and allows the "remaining" portions to be reconfigured for PG&E's use.

To the extent SMUD compensates PG&E for "acquired" and "stranded" facilities in accordance with a court or CPUC/FERC asset valuation decision, no cost impacts associated with those facilities will be shifted to PG&E's remaining ratepayers.

In Resolution E-3472, regarding duplicative facilities, we stated that if a district were to purchase or lease existing infrastructure from PG&E, then the costs associated with those facilities would not be shifted to remaining PG&E customers. SMUD plans to condemn PG&E property and pay PG&E compensation for "acquired" and "stranded" facilities through negotiated agreement, or if that does not succeed, through eminent domain. This is akin to a purchase arrangement, irrespective of whether the arrangement is effected by a condemnation judgment or by mutual agreement. Assuming the price paid fully compensates PG&E for the facilities, then no costs will be shifted to remaining ratepayers, and thus ratepayers are indifferent.

PG&E argues that the amount proposed by SMUD grossly understates the actual value[8] and has grave concerns that in an eminent domain proceeding, the court may not require SMUD to fully compensate PG&E causing its remaining ratepayers to bear the shortfall. SMUD, on the other hand, states that if an eminent domain action is necessary, the compensation determined by a final, non-appealable judgment will constitute full compensation, and therefore, there will be no shortfall to be borne by PG&E's remaining ratepayers.

We agree with SMUD. Under eminent domain laws, the court will assess evidence regarding the valuation of utility assets and the amount of

[8] SMUD believes compensation for the facilities should be based on what PG&E actually paid for the facilities using the Original Cost Less Depreciation (OCLD) valuation methodology. PG&E believes it is entitled to current fair market value for its facilities using the Replacement Cost New Less Depreciation (RCNLD) methodology.

compensation owed in order to fully compensate PG&E for those assets. This is a matter best left to the Court.[9]

If SMUD does not file an eminent domain action but rather PG&E and SMUD reach agreement on the terms of the transfer of facilities, including the sale price, PG&E would be required to seek CPUC approval of the proposed transaction pursuant to Public Utilities Code § 851 for any distribution assets and Federal Energy Regulatory Commission (FERC) approval for any transmission assets. It is through this process, that asset valuation methodologies will be debated and the reasonableness of the provisions of the proposed asset sale/transfer agreement will be decided. The CPUC and/or FERC approved sale price amount will constitute reasonable compensation.

If"remaining" transmission lines resulting from SMUD's acquisition and severance plans become idle because they cannot be reconfigured for PG&E's use as SMUD proposes, PG&E's remaining customers must cover the costs of the idled facilities.

SMUD argues that given reliability concerns in the area, PG&E would need to upgrade, modify or construct new facilities in the annexation area in order to continue reliable service. Instead, SMUD states the "remaining" portions of the Rio Oso-West Sacramento and Brighton-West Sacramento transmission lines can be reconfigured to serve PG&E's remaining load more reliably without additional infrastructure upgrades.

[9] Under Public Utilities Code § 1401 *et seq*., SMUD has the option to seek this Commission's determination of the just compensation to be paid for any PG&E assets that it seeks to acquire in connection with its annexation proposal. If, after their initial negotiations, PG&E and SMUD cannot reach agreement on the terms of the transfer of the facilities necessary to effectuate the proposed annexation, we would encourage SMUD to utilize the auspices of this Commission under that law in order to resolve this disagreement. However, resort to this Commission's procedures under Public Utilities Code § 1401 *et seq* is not mandatory, and SMUD always retains the option of initiating an eminent domain proceeding in the courts if it and PG&E are unable to negotiate an agreed-on set of terms for the transfer of facilities.

PG&E responds that SMUD's proposed reconfiguration is of no use to PG&E. PG&E alleges that Brighton substation, which would be the only substation connected to SMUD's proposed reconfigured line, is already connected to the bulk transmission system via two 230 kV lines from Rio Oso and Bellota. PG&E asserts that these lines have more than adequate capacity for the 35 MW load served via the Grand Island substation, which would be the only load directly served from Brighton. In the unlikely event of an outage of both 230 kV lines, PG&E states that Grand Island has the option of being served from the south via two 115 kV lines that are normally operated open. Thus, it concludes that there is no need for a 115 kV line connecting Rio Oso and Brighton and as a result the "remaining" portions resulting from SMUD's proposed acquisition and severance plans will be stranded.

We are faced with disparate assertions from PG&E and SMUD that need further detailed technical analysis beyond that allowed through this Resolution process to verify the accuracy of their claims. Given the disparity of the facts, we must take a conservative approach and assume that there is the possibility that the reconfiguration will not work and will result in additional stranded facilities. Accordingly, utilizing PG&E's estimate, approximately $2.1 million per year may be shifted to PG&E's remaining customers.

Other quantifiable costs and benefits associated with the annexation proposal should be considered in the rate impact analysis.

In addition to the cost impacts to remaining customers from any transition cost exemptions and/or idled facilities, the Energy Division requested PG&E to identify any other costs associated with the proposed annexation. In response, PG&E states that its remaining customers would be adversely affected by lost transmission and distribution (T&D) revenues[10], lost lease agreement revenues, and additional costs to reinforce various high voltage assets to wheel power to SMUD. While SMUD believes it is neither appropriate nor necessary to expand the criteria used by the CPUC in Resolution E-3472, SMUD responds to each of PG&E's cost/revenue loss claims and includes estimated benefits of the

[10] This includes revenues from T&D rate components as well as revenues from some non-bypassable charges.

annexation. We believe it is appropriate to consider the quantifiable costs and benefits of the proposed annexation proposal as identified by PG&E and SMUD.

PG&E asserts that its remaining customers must pay more to cover the lost T&D revenues that otherwise PG&E would have collected from the customers in the area. PG&E agrees it would avoid some T&D-related costs should the annexation occur; however, it estimates that the lost revenue will exceed the avoided costs. Furthermore, PG&E admits lost revenues would partly be offset by the compensation ultimately provided by SMUD for the T&D assets, up to their book value, since this value would be removed from PG&E's rate base. PG&E's calculations result in Contribution to Margin (CTM) losses[11] of $439 million (Net Present Value), or approximately $43.4 million per year on an annualized basis.

SMUD believes PG&E's loss estimates are inflated. In its own "worst case" analysis, SMUD believes the maximum potential loss would be approximately $17 million annually. SMUD asserts this impact will be entirely offset by six to nine months of load growth on PG&E's system. Ignoring this assertion, SMUD maintains that the "worst case" impact can be reduced by approximately $12.7 million per year if you factor in the benefit that additional low cost hydroelectric and nuclear generation will be available for reallocation to PG&E's remaining customers as a result of the annexation.

In addition to CTM losses, PG&E states that the proposed annexation will also result in a reduction of revenues that PG&E receives for leasing space on its transmission facilities. This includes various types of telecommunications and fiber assets owned by others, for which PG&E receives a revenue contribution that is shared with its ratepayers. PG&E has not yet quantified these impacts. In response, SMUD states that it plans to compensate PG&E for the value of such leases and thus its acquisition of these assets will not impact PG&E's remaining ratepayers.

PG&E estimates that it will also incur costs necessary to reinforce various high voltage (230 KV and 500 KV) transmission assets that it owns that are used, in

[11] PG&E calculates the loss of CTM as the difference between the lost revenues and the sum of avoided costs and book value.

part, to wheel power to SMUD. It claims if the Yolo load plus the UC Davis load is added to the SMUD area, the power to serve this load will flow over a different path than is presently the case. PG&E believes that as a result, facilities south of Rio Oso Substation would be come overloaded and need to be upgraded. PG&E currently estimates the costs to upgrade these facilities at roughly $20 million (Net Present Value), or approximately $2 million per year on an annualized basis[12]. SMUD disagrees that PG&E would be required to reinforce and expand the capacity of its current transmission interconnections with SMUD because load flow studies confirm that SMUD has sufficient load serving capability in place to serve the annexed load.

Even a conservative estimate of all costs due to bypass of transition costs, idle facilities, and other lost revenues results in a de minimis overall rate impact to PG&E's remaining ratepayers.

As discussed above, there is a wide variance between PG&E and SMUD estimates of lost revenues, additional costs and benefits. PG&E estimates a total annualized cost of $54.8 million ($7.3 million for transition cost exceptions plus $2.1 million for stranded facilities plus $43.4 million for CTM losses plus $2 million for high voltage transmission upgrade costs) which would translate into a 0.091 cents per kilowatt-hour (kWh) rate impact. SMUD calculates a much lower figure of $4.3 million ($17 million for CTM losses less $12.7 million for low cost power benefits) which would translate into a rate impact of 0.005 cents per kWh.

Due to the significant difference in estimates and our inability to validate these disputed issues of fact within the timeframe allowed, we believe it is appropriate to be conservative and use PG&E's estimate. We note that PG&E's current system average rate is 12.77 cents per kWh for bundled service customers[13]. Using PG&E's calculations, this current system average rate would increase by less than a tenth of a cent. PG&E asserts that although the amount of this rate

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[12] PG&E notes this is a preliminary estimate because more analysis is needed for more precision and to determine the extent to which these investments might be required absent SMUD's annexation.

[13] PG&E Advice Letter 2706-E filed on September 1, 2005.

impact on individual customers may be small, the cost shift substantially affects the reasonableness of the resulting rates. We conclude that a potential rate impact of this magnitude would not substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

Furthermore, we agree with SMUD that it is appropriate to net out any quantifiable annexation benefits, which has the effect of significantly reducing PG&E's rate impact figure.

Broader energy policy issues raised by PG&E are beyond the scope of CPUC's required statutory review.

In addition to the quantifiable cost/benefit related issues discussed above, PG&E also raised some energy policy issues that it believes will place additional burdens upon its remaining ratepayers. In particular, PG&E believes that SMUD's annexation proposal 1) fosters continued "balkanization" of the CAISO grid, 2) removes load from CPUC oversight thereby eliminating requirements for adherence to CPUC and State Energy Action Plan policies, and 3) takes away AB 1X rate increase protections.

Although SMUD responded to each issue raised by PG&E, it believes none of these matters are relevant to the CPUC's inquiry under Government Code Section 56131. We are concerned about the risks posed by fragmentation of the CAISO grid on the reliability of the Western Interconnection[14], and acknowledge the importance of AB 1X rate protections and adherence to the State's Energy Action Plan policies. Nevertheless, these issues are not within the scope of our review of SMUD's proposal under Government Code Section 56131. Accordingly, we do not expand the scope of our review to consider them.

Cumulative impacts of additional annexation proposals are outside the scope of the CPUC's statutory reporting requirements but could be considered in a separate CPUC proceeding.

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[14] Detailed concerns were articulated to Spencer Abraham (then Secretary of the U.S. Department of Energy) on July 29, 2004 in a letter from CPUC President Peevey.

In Resolution E-3876 dated August 19, 2004, the CPUC found that an individual annexation proposal did not have a significant impact on the regulated utility's ability to serve its remaining customers but that the cumulative impact of additional such proposals in the future may pose a substantial impairment to the utility's ability to provide adequate service at reasonable rates. The Energy Division requested PG&E to address cumulative impact issues. In response, PG&E summarized other potential annexation proposals in the near future and estimated that an additional $175.9 million per year would be shifted to PG&E's remaining ratepayers should they occur.

SMUD argues that consideration of the cumulative impacts of additional proposals is outside the scope of the review authorized in Government Code Section 56131. That statute speaks only to the particular proposal under review and says nothing about potential service by another publicly owned utility, whether existing at the time of the service proposal under review or potentially arising in the future. In Resolution E-3876, we expressly agreed that "[t]he statute requires us to report to the LAFCo on the potential impacts only of the particular proposed municipal service" but expressed concern regarding cumulative impact of additional proposals. We agree with SMUD that it would not be appropriate, in the context of our report under Government Code Section 56131, to analyze cumulative impacts of additional proposals. This type of analysis could be the subject of a CPUC issued Order Instituting Rulemaking (OIR) to comprehensively address energy policy issues associated with the formation of or expansion of public power within a public utility's service territory.

COMMENTS

Per statutory requirement, the Draft Resolution was mailed to parties for comment at least 30 days prior to consideration by the Commission.

Public Utilities Code section 311(g)(1) provides that this Resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this Resolution was neither waived nor reduced. Accordingly, a Draft Resolution was mailed to parties for comment on October 19, 2005. PG&E and SMUD submitted comments on November 3rd. SMUD and PG&E replied to each other's comments on November 8th.

The Draft Resolution correctly concluded that PG&E's ratepayers would have to pay more to cover the costs resulting from specified CRS component exceptions.

SMUD disagrees with the Draft Resolution's conclusion that implementation of certain CRS component exceptions would cause PG&E's remaining customers to assume any costs. SMUD believes the CPUC has determined that certain CRS exceptions for MDL are justified precisely because they do not shift costs to other utility customers.

SMUD's comments do not offer additional information but merely reargue its position already reflected in the Draft Resolution. Therefore, no changes were made.

Based on additional information provided by PG&E, the Draft Resolution was revised to conclude that there is a possibility that SMUD's new integration facilities may duplicate existing PG&E facilities.

PG&E asserts that the Draft Resolution incorrectly concluded that SMUD's proposed new facilities do not duplicate PG&E's existing facilities but rather are needed to resolve alleged reliability deficiencies. SMUD responds that despite PG&E's claims, the new facilities would be required even in the absence of SMUD's annexation.

In the Draft Resolution, we relied upon SMUD's assessment that due to reliability concerns in the area PG&E would need to upgrade, modify or construct new facilities in the annexation area in order to continue reliable service. We agreed with SMUD that the "remaining" lines would not be stranded as they could be reconfigured to serve PG&E's remaining load more reliably without additional infrastructure upgrades. PG&E now states, in comments to the Draft Resolution, that there are no reliability deficiencies in the area. As a result, the new facilities proposed by SMUD would not be required in the absence of annexation and would duplicate PG&E's existing facilities. PG&E asserts the Draft Resolution reaches false conclusions because it relies upon

SMUD references to analysis which it alleges is based on incorrect extrapolations and selective use of incomplete information. PG&E asserts that SMUD's studies are outdated and ignore the fact that relevant reinforcement projects will be completed and/or substantially in progress prior to SMUD's proposed acquisition date.

Based on the additional information provided by PG&E concerning the completion of additional upgrades to address reliability deficiencies prior to the annexation date, the Draft Resolution was revised to conclude that it is possible that SMUD's new facilities may duplicate PG&E's existing facilities. However, PG&E did not provide any additional information claiming that any of its facilities would become idle as a result. Thus, no changes were made to the Draft Resolution's conclusion regarding the cost impact to PG&E's remaining ratepayers.

The Draft Resolution was revised to reflect that the remaining portions of the Rio Oso-West Sacramento and Brighton-West Sacramento transmission lines may become stranded with additional potential costs to PG&E's remaining customers because it might not be possible to reconfigure them as SMUD proposes.

Relying upon SMUD's assessment of the reliability concerns in the area and its reconfiguration proposal, the Draft Resolution concluded that there would be no cost impacts to PG&E's remaining customers as a result of SMUD's acquisition and severance plans. PG&E responded in comments to the Draft Resolution that SMUD's proposed reconfiguration is of no use to PG&E and that the "remaining " portions of its transmission lines will become stranded.

Based on the additional information provided by PG&E, the Draft Resolution was revised to account for the possibility that reconfiguration may not be a viable option and thus additional facilities could be stranded. Accordingly, an additional $2.1 million was factored into the rate impact analysis.

SMUD's suggested point of clarification regarding the amount of stranded facilities was incorporated into the Draft Resolution.

SMUD requested that Finding 6 of the Draft Resolution be modified for clarity and consistency with the discussion concerning the amount of stranded facilities

resulting from its acquisition and severance plans. The Draft Resolution was revised to ensure consistency between the finding and relative discussion.

The Draft Resolution was revised to state that the use of PG&E's numbers is a conservative approach rather than a"worst case" scenario.

PG&E takes issue with the Draft Resolution's use of the term "worst case" to describe its cost estimates. PG&E believes that its analysis is the "most accurate case".

Given the wide variance between PG&E and SMUD estimates and the limited timeframe for validation, it cannot be confirmed that PG&E's numbers are the most accurate case. Nonetheless, the Draft Resolution was clarified to reflect the fact that using PG&E's numbers results in a conservative approach.

Some changes to the Draft Resolution regarding substantial impairment were warranted to better reflect PG&E's position.

PG&E alleges that the Draft Resolution errs in concluding that the rate impact is de minimis and does not constitute substantial impairment. PG&E believes that the approximate 0.09 cent per kWh rate impact is significant given that it is brought about not as a result of cost increases necessary to serve customers but rather due to the discretionary decision of a governmental entity to pick and choose which CPUC-jurisdictional customers it wishes to serve based on profitability criteria. PG&E asserts the additional costs from SMUD's annexation will result in higher rates for PG&E's remaining customers which interfere with PG&E's ability to provide service at *reasonable* rates.

Although we considered PG&E's position before reaching our conclusion regarding substantial impairment in the Draft Resolution, it was not summarized in sufficient detail. The Draft Resolution was revised to more accurately articulate PG&E's position.

The Draft Resolution was revised to acknowledge the importance of broader policy issues but the overall conclusion remains that these issues are outside the scope of the statutorily required review.

PG&E comments that the policy issues raised by PG&E are not "ancillary" and that the Draft Resolution should be revised to include statements regarding the

adverse impact of the proposed annexation on the achievement of state energy policy goals.

It was not our intention to downplay the importance of the policy issues but rather to conclude that such issues are outside the scope of the review specified in Government Code Section 56131. The Draft Resolution was clarified on this matter.

No changes were warranted to the Draft Resolution's discussion of cumulative impacts.

PG&E asserts there is nothing in the statute that limits the CPUC's ability to consider and express its opinion on the cumulative impact of impacts of additional annexation proposals. SMUD maintains its position that analysis of cumulative impacts is beyond Government Code Section 56131 reporting requirements.

The Draft Resolution adequately considered the limitations of the statute and correctly concluded that the cumulative impacts are outside the scope but could be considered in a separate CPUC proceeding.

FINDINGS

1. By letter, effective August 22, 2005, the Sacramento LAFCo submitted SMUD's annexation proposal to the CPUC for an opinion under Government Code Section 56131.

2. The following are reasonable criteria for determining whether the annexation will substantially impact of the utility's ability to provide adequate service at reasonable rates within the remainder of its service territory: a) whether the customers of the proposed district will be able to bypass payment of transition costs, which would require the remaining PG&E customers to cover these costs, b) whether any aspect of the district's proposal will potentially idle PG&E facilities requiring remaining PG&E customers to cover the costs of these idled facilities, c) whether there are any other quantifiable costs and/or offsetting benefits that would affect remaining PG&E customers, and d) whether the

resulting cost impact, if any, would have a significant rate impact on remaining PG&E customers.

3. Customers in the proposed annexation territory will not be able to bypass payment of the DWRBC and the ongoing CTC but some would be exempt from the DWRPC and the ECRA charge, in accordance with Commission decisions and statutes.

4. To the extent annexed load has previously received exceptions from having to pay the DWRPC and ECRA charge, PG&E's remaining ratepayers will assume responsibility for some of those costs once this annexed load no longer takes service from PG&E.

5. SMUD's proposed new integration facilities may duplicate but do not idle existing PG&E facilities.

6. SMUD's acquisition and severance proposals result in the stranding of a few of PG&E's facilities in the area proposed for annexation.

7. To the extent, SMUD compensates PG&E for "acquired" and "stranded" facilities in accordance with a court or CPUC/FERC asset valuation determination, no cost impacts associated with those facilities will be shifted to PG&E's remaining ratepayers.

8. If "remaining" portions of PG&E's transmission lines resulting from SMUD's acquisition and severance plans become idle because they cannot be reconfigured for PG&E's use, PG&E remaining customers must cover the costs of the idled facilities.

9. In addition to the cost impacts from any transition cost exceptions and/or idled facilities, other quantifiable costs and benefits identified by PG&E and SMUD should be considered in the rate impact analysis.

10. A conservative estimate of all costs due to bypass of transition costs, idle facilities, and lost revenues results in a 0.091 cents per kWh rate impact to PG&E's remaining ratepayers.

11. A potential rate impact of this magnitude would not substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its territory.

12. Other broader energy policy issues raised by PG&E are not within the scope of the review authorized in Government Code Section 56131.

13. Cumulative impacts of additional annexation proposals are outside the scope of the CPUC's statutory reporting requirements but could be considered in a separate CPUC proceeding.

THEREFORE IT IS ORDERED THAT:

1. A certified copy of this Resolution shall be mailed to the Executive Officer of the Sacramento Local Agency Formation Commission.

2. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on November 18, 2005; the following Commissioners voting favorably thereon:

_____
STEVE LARSON
Executive Director