PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Item 6, I. D. #5825

ENERGY DIVISION **RESOLUTION E-4001**

August 24, 2006

RESOLUTION

Resolution E-4001. The Commission on its own motion extends to all electric investor-owned utilities (IOUs) the policies discussed and adopted for San Diego Gas and Electric (SDG&E) on April 13, 2006 in Resolution E-3968 intended to cap the cost of ratepayer funded Electric Rule 20 projects that a utility may agree to fund in a community for overhead to underground conversions.

SUMMARY

The Commission adopts policies related to Electric Rule 20 Advice Letter filings and the use of Rule 20A funds for projects to convert existing electric and communication conductors and facilities from overhead construction to underground. Specifically, electric utilities may not commit ratepayers to projects that require borrowing more than five years of a community's expected future Electric Rule 20 allocations. Utilities may file for authority 3 months in advance of construction when known excess costs will be recovered from pre-arranged community funds or from shareholders. However after starting a project a utility may file an Advice Letter where it could not have foreseen costs that would exceed the 5-year cap. This Resolution does not apply to current Rule 20 projects or those scheduled to begin within 90 days of the effective date.

BACKGROUND

Utilities annually allocate funds under Rule 20 to communities, either cities or unincorporated areas of counties, to convert overhead electric and telecommunication facilities to underground. The recipient communities may either bank (accumulate) their allotments, or borrow (mortgage) future undergrounding allocations for five years at most.

The Commission instituted the current undergrounding program in 1967. It consists of two parts. The first part, under Tariff Rules 15 and 16, requires new subdivisions (and those that were already undergrounded) to provide underground service for all new connections.

The second part of the program governs both when and where a utility may remove overhead lines and replace them with new underground service, and who shall bear the cost of the conversion. Tariff Rule 20 is the vehicle for the implementation of the underground conversion programs. Rule 20 provides three levels, A, B, and C, of progressively diminishing ratepayer funding for the projects.

Under Rule 20, the Commission requires the utility to allocate a certain amount of money each year for conversion projects. Upon completion of an undergrounding project, the utility records its cost in its electric plant account for inclusion in its rate base.[1] Then the Commission authorizes the utility to recover the cost from ratepayers until the project is fully depreciated.

Because ratepayers contribute the bulk of the costs of Rule 20A programs through utility rates, the projects must be in the public interest by meeting one or more of the following criteria:

- Eliminate an unusually heavy concentration of overhead lines;
- Involve a street or road with a high volume of public traffic;
- Benefit a civic or public recreation area or area of unusual scenic interest;
- Be listed as an arterial street or major collector as defined in the Governor's Office of Planning and Research (OPR) Guidelines.

On January 6, 2000, the Commission opened Order Instituting Rulemaking (OIR) 00-01-005 to implement Assembly Bill 1149 regarding undergrounding of electric and telecommunication facilities. On December 11, 2001, the Commission issued Decision (D.) 01-12-009 in Phase I of the OIR directing expanded use of Rule 20 funds. Once a community has established a master undergrounding plan and identified specific projects, it may spend its accumulated allocations plus an amount equal to its estimated allocations for the next five years. Utilities may file Advice Letters to request exemptions from Rule 20.

NOTICE

No notice of this Resolution instituted on the Commission's own motion was made in the Commission's Daily Calendar.

PROTESTS

No Advice Letter was filed and no protests received.

[1] Utilities have an annual budget for undergrounding for each community (city or the unincorporated area of a county). Details of allocation formulas are shown in Electric Rule 20.A.2 of the tariffs.

DISCUSSION

In the April 13, 2006 Commission Meeting the Commission adopted Resolution E-3968 for San Diego Gas and Electric Company. While it granted a one-time approval of San Diego Gas and Electric's (SDG&E's) request to allow the City of San Marcos to borrow 19 years into its future Rule 20A allocation, it set a new policy to deter similar filings in the future and which are intended to cap the cost of ratepayer funded Electric Rule 20 projects that a utility may agree to fund in a community for overhead to underground conversions. This Resolution extends and applies those same policies to all other jurisdictional electric IOUs.

The electric utility manages whether all of the community's projects taken together remain within the community's available Rule 20 balance including the next 5 years' expected allocations. It reviews and approves a community's proposed projects each year under the existing Rule 20 program. Because actual costs of ongoing projects during the prior 12 months are known, the utility can approve fewer or less costly new projects for an upcoming year as needed to maintain the balance within the 5-year cap. In cases where actual costs are emerging higher than projected costs the ability to stay within the cap assumes that any cost increase for a community's project or projects is less than its new Rule 20 budget allocation for that year.

Project costs may grow for a variety of reasons, both within and outside the control of the utility. A community typically has several Rule 20 conversion projects underway at the same time. A given project is often coordinated with other community projects such as street widening or sewer line replacement in order to reduce construction costs such as for trenching. However when multiple jurisdictions are involved projects may take more than a year from start to finish due to scheduling conflicts. Moreover a community's vision of its future infrastructure may grow in scope and scale with time. These factors offset one another but without this Resolution there is no clear cap on how much cost growth is reasonable or allowable.

The effects on communities, ratepayers and shareholders of granting a cost over-run are the same whether the action is taken before the project starts of after the funds are committed.
If the Commission grants recovery the community receives a one-time increase of its allocation. When the project or projects are complete and added to the utility's ratebase every ratepayer throughout the service territory contributes to that community's more costly project. The local project is built above the cost cap imposed by the uniform allocation formula, and other projects in the community are deferred while the over-run is paid down below the 5-year cap.

The effects on communities, ratepayers and shareholders of denying authority for a cost over-run differ and depend on whether the over-run can be avoided or has already occurred.
Before a utility commits to the costs of a project that will exceed the 5-year cap the Commission may specifically deny authority for such an over-run if notified. The utility then may avoid the over-run by re-negotiating the project with the community and other parties if necessary. The project size or features may be reduced to lower costs or the project start date may be deferred until sufficient future allocations have accumulated.

After project funds are committed or spent however, additional funding must be found. Three sources are to suspend construction for years until additional annual allocations cover the additional costs, assess community taxpayers, and charge utility shareholders.

All customers in a community should have a fair chance to participate in overhead conversion projects. While all projects must meet minimum criteria for being in the public interest individual projects may benefit some neighborhoods more than others. The existing policy of a 5-year cap is a balance. Its disadvantage is to further delay other overhead conversion projects in the same community when one project borrows allocations from years 6 or more in the future. The advantage is the savings in cost and project administration associated with undertaking a comprehensive overhead conversion project in a single phase.

Current Commission policy allowing up to 5 years of borrowing already accommodates the possible savings from combining current and future projects. Additional years of borrowing only further divert from other customers within the community Rule 20 funds otherwise available to them, in years 6 and beyond, for Rule 20 conversion projects in other parts of the community.

As a practical matter the disadvantage of delay is a voluntary one because a community receives another year's allocation every year whether it maintains its loan balance near zero or chooses to leave it near the 4 to 5 year maximum indefinitely. Fiscally moderate or conservative communities instead may choose to start no new underground conversion projects until annual allocations accumulate back to a zero balance, or further to a positive balance where a future project is estimated to cost more than 5 years worth of allocations.

For these reasons Energy Division recommends the Commission maintain and extend the policy adopted in Res. E-3968 of denying utility exemption requests for authority to commit funds or to begin construction of a project having foreseeable project cost over-runs that require mortgaging more than 5 years of a community's Rule 20 estimated allocations. Foreseeable excess costs not approved by the Commission would not be paid by ratepayers but through pre-arranged community funds, or by utility shareholders.

If an electric utility nevertheless files an Advice Letter requesting a decision for such authority in advance it should do so no later than three months before the project commencement date to allow time for staff analysis, Resolution drafting if necessary and lead time for the Commission Agenda. Project commencement date is defined as the date construction begins.

After a utility commits to a project however, and construction has started or been completed, and costs exceed the 5-year cap, the over-run may not be avoidable.
If the Commission grants such an over-run it still unevenly benefits and burdens ratepayers but this outcome may be the fair outcome if the excess costs resulted from unanticipated conditions encountered during construction.

On the other hand if Energy Division review establishes that the utility could or should have foreseen and avoided the over-run then the fair outcome appears to be to spare ratepayers and charge shareholders instead.

Provisions adopted in this resolution only apply to projects where construction is scheduled to begin more than 90 days after the effective date and do not apply where construction is already in progress.

COMMENTS

Public Utilities Code section 311(g) (1) provides that this resolution 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, this draft resolution was mailed to parties for comments, and was placed on the Commission's agenda no earlier than 30 days from the mail date of July 6, 2006.

PacifiCorp submitted the following comments/questions to the Energy Division on July 17, 2006:

- Certain communities may have requested and received more assistance than their accumulated allocation in the past. Therefore, they have "negative balances".
- Is the intent that all requests from these communities require an advice filing for as long as the credit requested exceeds the sum of the past expenditures in excess of allocations plus 5 years of future-borrowing? Or is the intent to treat these overdrafts as zero, and require an advice letter request based on just the 5 years of future borrowing?

Communities which have received more Rule 20A funds than their accumulated allocation in essence have borrowed forward into their future allocations. A utility may not approve new Rule 20A projects for a community until allocations have restored its balance to less than 5 years negative. Utilities may not nullify these overdraft balances.

Southern California Edison (SCE) submitted the following comments on July 17, 2006:

- The final resolution should include a statement indicating that the new requirements will only apply to projects where construction is scheduled to begin more than 90 days after the date the Commission adopts the final resolution and that such final resolution does not apply to current projects. This permits SCE ample time to file any necessary Advice Letters at least three months before commencing the affected projects.
- Project commencement date should be the date construction begins.
- Rule 20A provisions do not govern franchise agreements. Therefore, the original Ordering Paragraph related to overhead conversion projects resulting from franchise agreement improvement projects should be stricken from the final resolution.

Energy Division agrees that the new requirements only apply prospectively and that the project commencement date should be defined as the date construction begins.

The link between franchise improvement projects and cost over-runs however, should be explained in an Advice Letter where the franchise project is used as a justification for the over-run. The Commission should decide whether the franchise project caused the over-run, not the utility.

<u>Pacific Gas and Electric (PG&E) submitted the following comments on July 28, 2006:</u>

Resolution E-4001 should be applied prospectively.

There may be some communities that mortgaged future Rule 20A allocations beyond the current limit of five years. PG&E recommends that the proposed resolution be applied prospectively and should not disturb those long-standing agreements.

The proposed advice letter deadline needs to be more flexible.

It may not be apparent 90 days prior to the project commencement date that the project will need additional funding beyond the five-year mortgage limit. Not all of the circumstances can be known in advance because the construction site is hidden. Difficult soil conditions, hazardous materials, and unanticipated abandoned facilities may have to be traversed or removed. Delays by other project participants could delay the project schedule and also raise costs above initial estimates.

Once construction starts however the pre-construction deadline is past and the utility would be precluded from filing an advice letter to seek additional mortgage authority. The alternatives would be to suspend construction until new annual allocations cover the additional costs or establish a property assessment to shift the additional costs to local taxpayers, and neither one seems reasonable or fair.

Therefore, PG&E recommends that if it was known from the outset that a project, as designed, would require more than five years of Rule 20A allocation mortgaging, the utility must file an advice letter seeking additional authority in advance of construction. Additionally, if the legislative body proposes to change the project boundary or change the scope of the work in such a way as to exceed the five-year mortgage limit, the utility may not agree to such changes without first obtaining CPUC authority so to do.

However, where cost increases are the result of circumstances discovered after construction has commenced and which could not reasonably have been foreseen by the utility, such utility should be able to continue construction provided it files an advice letter within 90 days that the circumstance became manifest and the costs become known.

An undergrounding project undertaken in-lieu of franchise relocation should be exempted from the mortgage limit.

A community may have a road widening or storm drain, or scenic highway project that requires the relocation of utilities and it may cost less to place them underground during construction than after completion. However, if the community has exhausted its accumulated allocations and mortgaging capacity, it would not be able to take advantage of the engineering efficiencies to underground in lieu of relocating overhead. The alternatives would be to either relocate the facilities overhead or to delay the public improvement (e.g. road widening) until additional Rule 20A allocations have accumulated.

PG&E recommends that in cases where state law, efficient engineering or other

circumstances dictates that relocated utility facilities be placed underground, the cost of this mandated undergrounding should be exempt from the five-year mortgage limit.
The utility would still be required to file an Advice Letter as soon as practicable after the decision by the local agency so there is a documented record of the additional allocation borrowing but the increase in the mortgage authority would be automatically authorized in order to comply with the franchise or other statutory requirements in the most efficient manner.

Energy Division responds to PG&E as it did to PacifiCorp's comment/question above, namely that a utility may not approve new Rule 20A projects for a community until allocations have restored its balance to less than 5 years negative, and utilities may not nullify overdraft balances.

The utility is expected to conduct adequate investigation and planning prior to committing funds to an overhead conversion project, and should include a greater or lesser amount for contingencies appropriate to the conditions known at the time.

Energy Division agrees with PG&E that if it is known from the outset that a project, as designed, would require more than five years of Rule 20A allocation mortgaging, the utility must file an advice letter seeking additional authority in advance of construction. For reasons given under Discussion above the authority would be denied under the current policy of a 5 year maximum, absent persuasive arguments that no alternative solutions could be applied.

Further, if the community proposes to change the project boundary or change the scope of the work in such a way as to exceed the five-year mortgage limit, the utility may not agree to such changes without first obtaining CPUC authority so to do.

Where cost increases are the result of circumstances discovered after construction has commenced and which could not reasonably have been foreseen by the utility, Energy Division recommends the utility should be able to file an advice letter within 30 days to justify the estimated additional costs and to continue construction unless denied.

Energy Division recommends the Commission consider approving such requests up to a maximum of 10 years of estimated allocations when the unforeseen exceptional circumstances are sufficiently documented in an advice letter. If 10 years of estimated allocations are still not enough to complete the project then a blend of additional financing should be considered including local tax assessments especially where a project is combined with a local public improvement project, as well as phasing part of the project so as to credit an additional year of normal allocations.

Accordingly the requirement to file Advice Letter requests 90 days in advance for exemption from the 5-year cap should be revised to permit them conditionally at any time with justification.

The Commission also acknowledges PG&E's advice to take advantage of the engineering efficiencies to underground in lieu of relocating overhead. However, as discussed above, the Commission cannot allow unlimited borrowing by communities and spreading of costs to all ratepayers. The efficiency argument is already accommodated by the policy of permitting 5 years of borrowing future allocations to fund current projects. Alone as a justification for exemption from the 5-year cap efficiency will not be persuasive. Demonstration that the community had established plans to place subject utilities underground in advance of a currently associated public improvement project will be needed for Energy Division to consider recommending that the Commission approve an exemption.

FINDINGS

1. The Commission instituted the current undergrounding program in 1967.

2. Tariff Rule 20 is the vehicle for the implementation of the underground conversion programs and provides three levels, A, B, and C, of progressively diminishing ratepayer funding for conversion projects.

3. Annually and cumulatively utilities allocate under a Rule 20 formula funds to a city or unincorporated area of a county (a community in its service territory) for conversion projects that are added to ratebase when complete.

4. Rule 20A projects must be in public interest.

5. The community may apply (mortgage) up to a maximum of 5 years' estimated future allocations to funding of a current project.

6. Ratepayers collectively pay through utility rates the bulk of the costs of Rule 20A projects.

7. The Commission should extend its policy of maintaining opportunities for all customers in a community to benefit from conversion projects on a regular basis.

8. The Commission should maintain and extend the policy adopted in Res. E-3968 of denying utility exemption requests for authority to commit funds or to begin construction of a project having foreseeable project cost over-runs that require mortgaging more than 5 years of a community's Rule 20 estimated allocations.

9. Where cost increases are the result of circumstances discovered after construction has commenced and which could not reasonably have been foreseen by the utility, Energy Division recommends the utility should be able to file an advice letter within 30 days to justify the estimated additional costs and to continue construction unless denied.

10. Foreseeable excess costs not approved by the Commission should not be paid by ratepayers but through pre-arranged community funds, or by utility shareholders.

11. The Commission should consider late-filed requests for exemption from the 5-year cap only in the case of unforeseen circumstances encountered during construction.

12. This resolution applies only to overhead conversion projects where construction is scheduled to begin more than 90 days after the date the Commission adopts this resolution and this resolution does not apply to projects where construction is already in progress.

THEREFORE, IT IS ORDERED THAT:

1. Electric utilities shall not commit ratepayers to the costs of an Electric Rule 20 overhead conversion project that requires borrowing more than five years of a community's Electric Rule 20A allocations without Commission's approval. Excess costs not approved by the Commission, will be paid either by pre-arranged community funds or by the utility shareholders. An exception may be made for excess costs resulting from unanticipated conditions encountered during construction.
2. Electric utilities shall file Advice Letters for exemption from the 5 year cap no later than three months before the date construction begins except where the excess costs result from unanticipated conditions encountered during construction.
3. This Resolution does not apply to current overhead conversion projects or those scheduled to begin less than 90 days after the effective date.
4. This Resolution is effective today.

I hereby certify that the Public Utilities Commission adopted this Resolution at its regular meeting on August 24, 2006. The following Commissioners voting favorably thereon:

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STEVE LARSON
Executive Director