

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

**ENERGY DIVISION**

**RESOLUTION E-3959**

**December 15, 2005**

**R E S O L U T I O N**

Resolution E-3959. San Joaquin Local Agency Formation Commission. Request for a Commission opinion on the effect of the application by Lathrop Irrigation District to annex 4,767 acres within PG&E's service territory.

Request made by letter dated September 6, 2005, and received by Energy Division on September 14, 2005.

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**SUMMARY**

**The Lathrop Irrigation District's proposal to annex property and serve electricity within Pacific Gas and Electric Company's (PG&E's) service territory will not substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory**

Lathrop Irrigation District (Lathrop) applied to the San Joaquin Local Agency Formation Commission (LAFCo) in July 2005 to annex property within the service territory of Pacific Gas and Electric Company (PG&E). Lathrop intends to provide electric service to future customers in this area. PG&E presently has approximately 20 electric customers in the area. PG&E asserts that the annexation proposed by Lathrop will substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

Considering criteria similar to those the Commission has relied on to evaluate prior LAFCo requests, we find that the annexation proposed by Lathrop will not substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory. Although Lathrop's proposal may potentially result in idled distribution facilities requiring that PG&E's remaining customers cover the costs of those facilities, the magnitude of those costs is not significant. Also, other costs quantified by PG&E associated with

Lathrop's proposal will not have a significant rate impact on PG&E's remaining customers.

## **BACKGROUND**

### **Lathrop proposes to annex property within PG&E's service territory and provide electricity service within the annexation area.**

In July 2005 Lathrop applied to the San Joaquin LAFCo to annex an area in the City of Lathrop. Lathrop submitted to the LAFCo a Statement of Operation and Plan for Service (Plan). According to the Plan, Lathrop intends to provide electrical services to future customers moving in to the service territory as a result of the River Islands development project. Lathrop expects the project to ultimately contain over 11,000 residential dwelling units and nearly 5 million square feet of commercial and office space. Lathrop would provide electric distribution services through underground facilities in the project. PG&E currently serves approximately 20 customers on the existing site with overhead distribution facilities.

**The San Joaquin LAFCo requested that the Commission investigate and report to the LAFCo whether electricity service proposed by Lathrop in PG&E's service territory will substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.**

By letter dated September 6, 2005, and received by Energy Division on September 14, 2005, the San Joaquin LAFCo sent to the Commission a request to investigate and report on Lathrop's application to annex 4,767 acres within PG&E's service territory. The California Government Code Section 56131 requires the Commission to investigate and report to the LAFCo whether in the Commission's opinion "the proposed service by the district within the territory will substantially impair the ability of the public utility to provide adequate service at reasonable rates within the remainder of the service area of the public utility."

**The CPUC has considered certain criteria in previous LAFCo requests when determining whether a district's proposal will substantially impair the utility's ability to provide adequate service at reasonable rates within the remainder of the utility's service territory.**

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

- 1) whether the customers of the proposed irrigation district will be able to bypass payment of 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 transition costs or idle distribution facilities covered by remaining PG&E customers, if any, would have a significant rate impact on remaining PG&E customers.

In response to a request by the Sacramento LAFCo, the Commission issued Resolution E-3876 on August 19, 2004 regarding the Sacramento Utility District's (SMUD's) proposal to annex a pump station operated by a sanitation district in PG&E's service territory. The Commission considered criteria similar to those noted above in evaluating SMUD's proposal. In that case the Commission evaluated the bypass of transition costs by reviewing the potential for bypass of the components of the cost responsibility surcharge (CRS). The components of the CRS are the California Department of Water Resources (DWR) power and bond charges, PG&E's regulatory asset charge which has since been replaced by the energy recovery bond (ERB) charge, and the on-going competition transition charge (CTC). The Commission also considered the effects of lost public purpose program, transmission, and distribution revenues in evaluating the rate impacts of SMUD's proposal.

In Resolution E-3876 the Commission found that SMUD's proposal would not substantially impair PG&E's ability to provide adequate service at reasonable rates in the remainder of its service territory. The Commission also found in that

case that the cumulative impact of such proposals may in the future pose a substantial impairment to the utilities' ability to provide adequate service at reasonable rates.

## **NOTICE**

**The San Joaquin LAFCo's letter was noticed in the Daily Calendar.**

San Joaquin LAFCo's letter, dated September 6, 2005, was received by Energy Division on September 14, 2005 and noticed by publication in the Commission's Daily Calendar on September 16, 2005.

## **PROTESTS**

**Energy Division requested information from PG&E on Lathrop's proposal.**

On September 15, 2005 Energy Division issued a request for information to PG&E regarding Lathrop's proposal. The request asked PG&E to address the criteria considered by the Commission in prior LAFCo cases and any additional costs and issues, as they relate to Lathrop's proposal. The request also asked for PG&E's opinion on whether Lathrop's proposal would substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory, and asked that PG&E address the cumulative impact of annexation proposals.

The San Joaquin LAFCo, Lathrop, and the Commission's Office of Ratepayer Advocates were served a copy of Energy Division's request to PG&E. These parties were given the opportunity to submit comments on PG&E's responses to the request.

**PG&E states that Lathrop's proposal would substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.**

PG&E responded to Energy Division's request on September 26, 2005. PG&E believes that Lathrop's proposal would substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

PG&E states that Lathrop's proposal will result in duplication of distribution facilities it uses to serve current customers in the area, and since it will presumably be selected to serve individual future developments there will be competing facilities. PG&E estimates that its remaining customers would have to pay approximately \$3.2 million annually if Lathrop's proposal is implemented, or a rate impact of 0.005 cents per kilowatt-hour (kWh). This amount represents PG&E's estimate of lost contribution to margin determined by estimating lost retail revenues, less PG&E's cost of serving the load that would be lost to Lathrop.

PG&E estimates the cumulative effects of Lathrop's proposal, pending proposals by SMUD to annex portions of Yolo County and the South San Joaquin County Irrigation District to annex areas in and around Manteca, and a potential proposal by the City of San Francisco to provide retail electric service, to be \$234 million per year. This would result in a system average increase of 0.4 cents/kWh according to PG&E's estimate.

PG&E also states in its response that the development project that Lathrop seeks to serve has a high load density in kWh delivered per square mile as compared to PG&E's entire service territory. PG&E notes that loss of all or a portion of this area this will result in a higher than average costs through the remainder of PG&E's service territory.

PG&E further states that Lathrop does not appear to have budgeted funds for public purpose programs, and expects that Lathrop will under perform in this area. Additionally PG&E states that Lathrop would have no obligation to follow energy policies that the Commission has developed on electric resource planning and rate protection for residential usage below 130% of baseline.

PG&E believes that the cost impact of Lathrop's proposal is significant on its own terms, that there would be duplication of distribution facilities, and the cumulative effects of the Lathrop proposal and others described above are significant.

**Lathrop states that its annexation does not have a negative effect on existing PG&E ratepayers.**

On October 4, 2005 Lathrop submitted comments on PG&E's response to Energy Division's request. In Lathrop's opinion, its annexation proposal does not have a

negative effect on existing PG&E ratepayers and that should be reflected in the Commission's response to the San Joaquin LAFCo's request.

Lathrop states that PG&E's contention that the annexation will result in duplicative facilities is false. Lathrop notes that most of the customers within the existing annexation area are rural (e.g., agricultural pumps) served by overhead facilities, and they will eventually be served by an underground distribution system. Lathrop believes that it will be the sole electric service provider for all new developments within its boundary which negates the possibility of any duplicated electrical service. Lathrop states that PG&E has no economic incentive to build facilities to serve new development in the area, and that PG&E will not have to upgrade its existing system which will gradually be removed as new development takes place.

Lathrop states that since there is no condemnation of existing PG&E facilities or forced conversion of PG&E customers to Lathrop, PG&E is not adversely affected. According to Lathrop PG&E ignored the costs of constructing new facilities to serve new developments in its rate analysis. Lathrop disputes PG&E's assertions regarding load density, notes that any urbanized area will have a higher load density than PG&E's entire service territory, and states that the impact of excluding River Islands from PG&E's service area is negligible.

Lathrop asserts that the cumulative rate impacts of various pending and potential proposals are impossible to quantify and it is not adding to any detrimental effects caused by other municipal power proposals. Lathrop notes that it will implement energy conservation and other public purpose programs mandated by California legislation. Lathrop also states that it will use Public Power Program funds to implement renewable resources on a time table similar to that required of the investor-owned utilities by the Commission and the legislature as those technologies become cost effective.

## **DISCUSSION**

**Lathrop's proposal is not expected to result in bypass of transition costs.**

Our evaluation of the effects of Lathrop's proposal on PG&E's ability to provide adequate service at reasonable rates in the remainder of its service territory uses the criteria considered in Resolutions E-3472 and E-3876. In Resolution E-3472, the first criterion was whether or not it would result in bypass of CTC charges.

In E-3876 we revised this criterion by considering whether the district's proposal would result not only in bypass of on-going CTC charges<sup>1</sup> but in bypass of the all components of the CRS. That is how we evaluate Lathrop's proposal. For purposes of evaluating Lathrop's proposal transition costs include all the current components of the CRS.

According to PG&E's response to Energy Division's request, PG&E does not expect that any existing municipal departing load (MDL) that transfers from PG&E service to Lathrop service would be exempt from payment of the DWR power or bond charges, on-going CTC, or the ERB charge. PG&E also does not expect that any new MDL served by Lathrop would be exempt from these charges.

PG&E notes that D.04-11-014 allows DWR power charge exemptions for transferred MDL for certain publicly owned utilities included in PG&E's 2000 Bypass Report, and some exemptions for entities providing service to at least 100 customers as of July 10, 2003. PG&E states that Commission decisions addressing new MDL allow exemptions from the DWR power charge and the ERB charge for new MDL customers served by an entity that was providing service to at least 100 customers as of July 10, 2003. PG&E states that since Lathrop was not included in its 2000 Bypass report or serving 100 customers on July 10, 2003, customers served by Lathrop would not be exempt from any components of the CRS.

Information provided by PG&E indicates that Lathrop's proposal will not result in bypass of transition costs.

**Lathrop's proposal will potentially result in idled distribution facilities requiring remaining customers to cover the costs of the idled facilities.**

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<sup>1</sup> "CTC" used in reference to Resolution E-3472, included both "on-going CTC" specified in Public Utilities Code Section (Section) 367 (a), and other competition transition costs cited in Section 367 that applied when that resolution was issued in 1996 but no longer apply. Only on-going CTC specified in Section 367(a) applied when we issued Resolution E-3876 in 2004.

The second criterion we consider in evaluating Lathrop's proposal is whether Lathrop 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.

Lathrop's Plan states that PG&E serves about 20 existing customers with overhead facilities in the area it intends to annex, and that Lathrop will not acquire PG&E's existing facilities in the area. The Plan states it is expected that as new development occurs, existing PG&E customers will likely disconnect from PG&E and eventually become customers of Lathrop.

In response to Energy Division's request PG&E states that it currently has distribution facilities in the area serving approximately 20 customers and notes that Lathrop will not condemn these facilities. PG&E states that Lathrop's proposal will result in duplication of distribution facilities it uses to serve current customers in the area. Lathrop disagrees and asserts that since existing customers will eventually vacate their facilities as development proceeds, all new facilities will be served by an underground distribution system.

Lathrop intends to install facilities to serve existing and future customers in the annexation area. PG&E currently has distribution facilities in the area to serve existing customers. Lathrop's Plan states that it will be necessary to remove all of the existing facilities as part of the development, but only do so as existing facilities are abandoned. Whether this means there would be "duplicative" facilities is debatable. It could be argued that there are duplicative facilities if both PG&E and Lathrop are each serving their own customers in the same area with different facilities. But if PG&E's facilities are removed as its customers disconnect from its system to take service from Lathrop, it could also be argued that the facilities are not "duplicative" since a customer could not switch back to service on PG&E's existing facilities after they are removed.

The relevant criterion is whether there will be duplicate distribution infrastructure, "potentially idling PG&E distribution facilities and requiring remaining PG&E customers to cover the costs of these idled facilities." Lathrop will not acquire PG&E's distribution facilities in the area, and expects that PG&E's current customers will disconnect from PG&E and become Lathrop's customers. Thus there is a potential that PG&E's existing facilities will become idle or unused when current customers are served by Lathrop. Further the remaining customers in PG&E's service territory would have to cover the

costs of any idled facilities, since they are not being acquired by Lathrop and there is no compensation for those facilities. The facilities may be removed by Lathrop, but they are still "idle" for purposes of our evaluation because their costs included in PG&E's rates would have to be covered by PG&E's remaining customers.

**The magnitude of the costs associated with potentially idling PG&E's existing distribution facilities, as well as other costs quantified by PG&E are not substantial and will not have a significant rate impact on PG&E's remaining customers.**

The third criterion considered in Resolution E-3472 to evaluate the LAFCo request is whether the amount of transition costs or costs of idle distribution facilities would have a significant rate impact on remaining PG&E customers. The magnitude of the costs currently in PG&E's rates associated with the distribution facilities PG&E serves its approximately 20 customers in the area Lathrop intends to annex is very small compared to PG&E's revenue requirements. A rough estimate of the annual costs of these facilities as provided by PG&E to the Energy Division is \$190,000. PG&E's total annual distribution revenue requirement is approximately \$2.5 billion, and its total annual system revenue requirement is nearly \$10 billion. Although there is a potential that PG&E's facilities will become idle and their costs covered by PG&E's remaining customers, the costs are not substantial and would not result in a substantial rate impact (e.g., see Resolution E-3528). PG&E's ability to provide adequate service at reasonable rates to its remaining customers would not be substantially impaired as a result of these facilities becoming idle.

PG&E analyzed potential additional costs that may be covered by remaining customers over a 20-year forecast period by estimating lost contribution to margin, and potential bypass of public purpose program revenues. Such an analysis is very uncertain given the long-term forecast period. PG&E's analysis shows that these costs would be \$33 million over 20 years, and on a net present value (NPV) basis the rate impact would be only 0.005 cents/kWh (\$3.2 million per year). That is not significant compared to PG&E's current system average rate for bundled service customers, 12.77 cents/kWh as shown in PG&E's advice letter 2706-E filed on September 1, 2005. Even considering that rate impact, in addition to the cost of potentially idled distribution facilities described above, there is no substantial impairment from Lathrop's proposal.

**Analysis of energy policy issues raised by PG&E is outside the scope of the Commission's review under Government Code Section 56131.**

In response to Energy Division's request PG&E raised concerns regarding the applicability to Lathrop of public purpose program funding, electric resource planning policies, and rate protection for residential usage below 130% of baseline. These concerns are not analyzed in this resolution.

Public purpose program funding, electric resource planning policies, rate protection for residential usage below 130% of baseline, and the state's energy policies as reflected in the Energy Action Plan (EAP) II are important matters. However, Government Code Section 56131 is narrowly drawn. The code directs us solely to investigate the effect of Lathrop's proposal on PG&E's ability to provide adequate service at reasonable rates to PG&E's remaining customers, and to do so on an expedited timeline. We confine our analysis to that directive.

Government Code Section 56131 does not provide that we analyze all of the policy issues that may relate to annexations. Such issues include whether annexations are consistent with State policy as articulated by the Energy Action Plan II that we jointly prepared with the California Energy Commission.

Municipal utilities, municipal districts, and irrigation districts are not subject to the same requirements as utilities regulated by the CPUC regarding implementation the state's energy policies, such as the greenhouse gas adder, the Renewables Portfolio Standard, the California Solar Initiative, and other activities related to climate change. However, as noted above, Government Code Section 56131 is narrowly drawn. It does not provide for us to conduct an analysis of whether annexations are, or are not, consistent with the state's energy policies. Nor does the statute provide for us to conduct an analysis in this resolution of whether and to what extent the economic feasibility of providing utility service pursuant to a proposed annexation is driven by the ability of a non-regulated utility to escape the costs of implementing Energy Action Plan II policies.

The Commission may choose to consider in a formal proceeding, such as PG&E's test year 2007 general rate case (GRC), A.05-12-002, energy policy program matters that are potentially related to the formation or expansion of public power within PG&E's service territory, with the goal of adopting a general policy

statement. These same matters may also be addressed in the other electric utilities' GRCs to the extent that they apply to the other utilities.

**Government Code Section 56131 does not address cumulative impacts.**

In response to Energy Division's request, PG&E estimated the cumulative effects of various proposals.

Analysis of the cumulative impacts of additional proposals is outside the scope of the review required by 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 proposal under review or potentially arising in the future. In Resolution E-3876, we recognized that the statute requires us to report to the LAFCo on the potential impacts only of the particular proposed municipal service. We also found that the cumulative impact of additional proposals may in the future pose a substantial impairment to the utilities' ability to provide adequate service at reasonable rates.

This resolution is our report to the San Joaquin LAFCo under Government Code Section 56131 on Lathrop's proposal, and is not the proper place to analyze the cumulative impacts of additional proposals. The Commission may choose in the future to analyze in a formal proceeding, such as PG&E's GRC, the cumulative impacts of formation or expansion of public power within PG&E's service territory.

**COMMENTS**

**A draft resolution was mailed to parties for comments at least 30 days prior to consideration by the CPUC.**

Public Utilities Code section 311(g)(1) provides that a draft 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. Accordingly, a draft resolution was issued to parties for comments. Lathrop and PG&E submitted comments on the draft resolution on November 16, 2005. On November 21, 2005 PG&E submitted a reply to Lathrop's comments.

**Lathrop suggests no modifications to the draft resolution.**

In its comments Lathrop stated its opinion that its proposal does not have a negative impact on existing PG&E ratepayers. Lathrop suggested no changes to the draft resolution.

**The draft resolution requires no clarification regarding how it determined that Lathrop's proposal does not "substantially impair the ability of the public utility to provide adequate service at reasonable rates."**

In its comments PG&E argues that the draft resolution, and recent resolutions addressing other LAFCo matters have focused on cents per kWh impacts of the individual district's proposal. PG&E states that the Commission has not clarified how it interprets the phrase "substantially impair the ability of the public utility to provide adequate service at reasonable rates." PG&E requests that the draft resolution be revised to resolve whether an impact of \$33 million, on a 20 year NPV basis as quantified by PG&E, would cause substantial impairment of PG&E's ability to provide service at reasonable rates. PG&E further requests that the Commission provide guidance on what level of margin loss, and/or loss of Commission oversight would matter, if the Commission concludes that PG&E's 20 year NPV estimate of margin loss "doesn't matter."

PG&E's comments raise no errors in the draft resolution and no revisions have been made based on these comments. The draft resolution determined that Lathrop's proposal will not substantially impair PG&E's ability to provide adequate service adequate service at reasonable rates within the remainder of its service territory based on the record in this matter, and the review required by Government Code Section 56131. No errors arise from any lack of clarity on how the determination was made in Lathrop's case.

**Government Code Section 56131 does not require an analysis of cumulative impacts; an analysis of energy policy program matters is outside the scope of the review required by the statute.**

PG&E states in its comments that the draft resolution is wrong as a matter of policy and law, to determine that the cumulative impacts are outside the scope of the Commission's statutory review. PG&E argues that the statute does not limit what factors the Commission may consider in its review under Government Code Section 56131.

In reply to Lathrop's comments PG&E asserts that the draft resolution should be modified to emphasize that the cumulative impact of public power expansions poses a serious risk to the "post energy crisis stability". PG&E also asserts that expansion of public power disrupts implementation of various Commission policies.

PG&E's comments and reply comments on cumulative impacts and energy policy program matters raise no errors in the draft resolution. The draft resolution stated that the analysis of cumulative impacts of additional proposals and energy policy program matters is outside the scope of the review authorized in Government Code Section 56131. That statute does not require that the Commission address cumulative impacts. An analysis of energy program policy matters potentially related to the formation or expansion of public power within the utility's service territory is not within the scope of our review of Lathrop's proposal under Government Code Section 56131. The Commission may choose in the future to address issues relating to cumulative impacts of various district proposals, and energy policy program matters potentially related to district proposals in a formal proceeding. For clarification we have made one minor change in the Discussion section to reflect that the analysis of cumulative impacts is outside the scope of the review "required" by Government Code Section 56131. Additionally we have clarified the draft resolution to note that cumulative impacts and energy policy program matters may in the future be considered in a formal proceeding.

**No changes are required to address PG&E's concerns about sending a message on municipal power.**

In comments and reply comments PG&E states that adoption of the draft resolution would send the message that the Commission is not concerned about municipal utilities' "taking over" electric distribution service within the Commission's jurisdiction.

PG&E's assertions on this point raise no errors and no revisions have been made as a result. The determination made by the draft resolution was properly developed by considering the record in this matter and the requirements of Government Code Section 56131.

## **FINDINGS**

1. Lathrop submitted an application to the San Joaquin LAFCo proposing to annex 4,767 acres within PG&E's service territory.
2. On September 14, 2005, Energy Division received a letter, dated September 6, 2005, from the San Joaquin LAFCo requesting the opinion of the CPUC regarding Lathrop's annexation proposal.
3. Under Government Code Section 56131, the Commission must investigate and submit a report to the LAFCo within 90 days stating whether, in its opinion, the proposed service by Lathrop within PG&E's service territory will substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service area.
4. In prior resolutions addressing LAFCo requests the Commission has considered the following criteria for evaluating the statutory provision: 1) whether the customers of the proposed district will be able to bypass payment of certain transition costs, 2) whether the proposed district will install duplicative distribution infrastructure potentially idling PG&E distribution facilities and requiring remaining PG&E customers to cover the costs of these idled facilities, and 3) the cost impact of these actions on remaining PG&E customers.
5. PG&E asserts that Lathrop's proposal would substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.
6. Lathrop asserts that its proposal does not have a negative effect on existing PG&E ratepayers.
7. Lathrop's proposal is not expected to result in the bypass of transition costs.
8. Lathrop's proposal will potentially result in idled distribution facilities requiring remaining PG&E customers to cover the costs of those idled facilities.

9. The cost of potentially idled facilities, and other costs associated with Lathrop's proposal quantified by PG&E are not significant compared to PG&E's revenue requirements, and will not have a substantial rate impact on PG&E's remaining customers.
10. Lathrop's proposal will not substantially impair PG&E's ability to provide adequate service at reasonable rates within the remainder of its service territory.

**THEREFORE IT IS ORDERED THAT:**

1. A certified copy of this Resolution shall be mailed to the Executive Officer of the San Joaquin Local Agency Formation Commission (LAFCo).
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 December 15, 2005; the following Commissioners voting favorably thereon:

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STEVE LARSON  
Executive Director

MICHAEL R. PEEVEY  
PRESIDENT  
GEOFFREY F. BROWN  
SUSAN P. KENNEDY  
DIAN M. GRUENEICH  
JOHN A. BOHN  
Commissioners