

Decision 04-03-036 March 16, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company
for Authorization to Lease Certain Electric
Distribution Facilities Serving the Mountain
House Area of San Joaquin County, and to Sell
Certain Related Electric Distribution Facilities, to
the Modesto Irrigation District Pursuant to Public
Utilities Code Section 851.

(U 39 M)

Application 03-02-005
(Filed February 7, 2003)

**DECISION GRANTING AUTHORIZATION FOR PG&E
TO LEASE AND SELL CERTAIN ELECTRIC DISTRIBUTION FACILITIES
SERVING THE MOUNTAIN HOUSE AREA OF SAN JOAQUIN COUNTY
TO MODESTO IRRIGATION DISTRICT
PURSUANT TO PUBLIC UTILITIES CODE SECTION 851**

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**DECISION GRANTING AUTHORIZATION FOR PG&E
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TO MODESTO IRRIGATION DISTRICT
PURSUANT TO PUBLIC UTILITIES CODE SECTION 851**

1. Summary

This decision grants the application of Pacific Gas and Electric Company (PG&E) for Commission authorization to lease and sell certain electric distribution facilities to the Modesto Irrigation District (MOD)¹ and to lease MOD space on PG&E's wood transmission poles pursuant to Section 851.^{2 3 4} This transaction is necessary to implement § 9610, which provides that effective January 1, 2001, PG&E may no longer provide electric distribution service to customers in the Mountain House Area of San Joaquin County (Mountain House

¹ MOD is an irrigation district organized under California law. The Irrigation District Law (Water Code Sections 20500 *et seq.*) provides that an irrigation district (district) may purchase or lease electric power from any public or private entity and may acquire, operate, lease and control plants for the generation, transmission, distribution, sale and lease of electric power. (Water Code Sections 22115, 22120.) Districts may generally sell power to municipalities, public utility districts, or persons either within or outside of district boundaries, with certain limitations specified by law. (*Id.*; see also Pub. Util. Code §§ 8101, 9601(c), and 9607.)

² All Code references are to the Public Utilities Code, unless otherwise stated.

³ The application was filed on February 7, 2003. In Resolution ALJ 176-3107, dated February 13, 2003, we preliminarily categorized this proceeding as ratesetting and preliminarily determined that hearings were necessary.

⁴ On March 10, 2003, the Commission Office of Ratepayer Advocates (ORA) filed a protest, which addressed ratemaking aspects of the application only. PG&E and ORA subsequently filed a stipulation regarding certain factual issues and agreed to address the ratemaking issues through briefing. Therefore, no hearings were held in this proceeding.

Area).^{5 6} Under § 9610, MOD began serving electric distribution customers in the Mountain House Area on January 1, 2001, and needs to utilize the facilities that PG&E proposes to sell and lease in this application in order to provide service. MOD also needs to use space on PG&E's wood transmission poles for certain distribution assets sold to MOD that are attached to the poles.

PG&E will continue to provide gas service to customers in the Mountain House Area.

We defer our decision regarding the allocation of PG&E's gain resulting from the sale of assets to MOD to our upcoming gain on sale rulemaking, which shall be initiated in the near future.

2. Background

The Mountain House Area is the site of a planned community to be built in a mostly undeveloped portion of western San Joaquin County, north of Tracy,

⁵ Section 9610 was enacted as part of Assembly Bill (AB) 2638 (Stats. 2000, chapter 1042), which became effective January 1, 2001. Section 9610 expires by its own terms on December 31, 2025.

⁶ Under § 9610, from January 1, 2001 through December 31, 2025, no electric service corporation may provide electric distribution or transmission service to retail customers in either of the following areas:

- (1) The MOD electric service area as defined in the August 15, 1940, Purchase of Properties agreement between MOD and PG&E;
- (2) The Mountain House Community Services District.

MOD and PG&E may both provide electric transmission and distribution service to retail customers in the purchase zone described in Exhibit B of the Asset Sale Agreement by and between PG&E and MOD dated July 23, 1997, contained in Application 97-07-030. This area is considered to be within both PG&E's and MOD's service territories.

Except as stated above, MOD may not provide electric transmission or distribution service to retail customers in PG&E's service territory.

within the boundaries of the Mountain House Community Services District.⁷ Until recently, development of the Mountain House planned community has progressed slowly. At the end of 2000, the Mountain House Area had less than 140 electric service accounts, mostly widely dispersed residences and agricultural accounts, with a total peak load of less than 800 kilowatts. When construction of the planned community is completed, the area is expected to have more than 16,000 electric distribution customers.

PG&E previously provided electric and gas distribution and transmission services to customers in the Mountain House Area until 2001, when § 9610 became effective. PG&E utilized its 12 kV (kilovolt) main line (main line) from PG&E's Herdlyn substation and tap lines that branch off the main line to provide this electric distribution service. As of January 1, 2001, when MOD became responsible for electric distribution service in the area, MOD had no electric distribution lines in the area to serve the existing load. PG&E and MOD therefore entered into a license and lease agreement, which permits MOD to receive a limited amount of power from PG&E's main line and to use PG&E's tap lines to deliver electricity to customers.

According to the application, after the passage of AB 2638, MOD began constructing a substation and a 21 kV line running parallel to part of PG&E's main line in the Mountain House Area. MOD completed construction of these facilities in 2002. MOD has also constructed new lines to connect the new wastewater plant and sewage treatment plant to PG&E's electric distribution system and new lines to connect a domestic water plant to MOD's distribution

⁷ The boundaries of the Mountain House Community Services District are defined in the master specific plan adopted by the San Joaquin County Board of Supervisors on November 10, 1994.

system. However, MOD still needs to use PG&E's main line and certain tap lines to deliver electricity to customers. Since PG&E is no longer serving electric distribution customers in the Mountain House Area, it no longer needs these tap lines for utility purposes.

Some of the tap lines that PG&E proposes to sell to MOD are located on five PG&E wooden transmission poles. However, since PG&E does not wish to sell these transmission poles, PG&E has therefore agreed to lease space on the poles to MOD.

PG&E therefore seeks approval of the following agreements with MOD for the lease and sale of electric distribution facilities to MOD, so that MOD may provide electric distribution service in the Mountain House Area, pursuant to § 9610:

- The license and lease dated December 28, 2000 and amended on December 27, 2002 (the license /lease);
- The purchase and sale agreement dated December 27, 2002 (the sale agreement);
- The wood pole lease dated December 27, 2002 (the pole lease).

3. The Agreements

A. The License and Lease Agreement

This agreement is structured as a license under General Order (GO) 69-C,⁸ which will automatically convert to a lease upon Commission approval of

⁸ GO 69-C provides in pertinent part "...public utilities covered by the provisions of Section 851...are hereby authorized to grant easements, licenses, or permits for use or occupancy on, over or under any portion of the operative property of said utilities for rights of way, private roads, agricultural purposes or other limited uses of their several properties without further special authorization by the Commission whenever it shall appear that the exercise of such easement, license, or permit will not interfere with the

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the agreement. PG&E has retained the right to revoke the license at any time, upon Commission order or on PG&E's own motion whenever PG&E believes that use of the facilities by PG&E would be in the best interests of its customers.

The lease will terminate either:

- By no later than December 31, 2007; or
- On a date agreed to by the parties; or
- In the event of a default by one of the parties, a governmental order to terminate the agreement, or under certain other circumstances.

If the lease will expire on December 31, 2007 and MOD notifies PG&E that it still needs to use the facilities to serve customers in the Mountain House Area, the parties must meet and confer regarding a possible extension. However, PG&E is not obligated to agree to the extension, and any extension of the lease is subject to Commission approval.

PG&E has agreed to license or lease the electric distribution facilities in the Mountain House Area, with certain exclusions,⁹ to MOD, for use only to

operations, practices, and service of such public utilities to and for their several patrons or customers.” In order to grant an interest in property pursuant to GO 69-C, the public utility must retain the right to resume or continue use of the property when necessary or desirable to do so in the interest of its patrons or consumers or upon Commission order.

⁹ The license/lease specifically excludes the following facilities in the Mountain House Area: any gas or electric transmission facilities and associated equipment; the 12kV distribution facilities and associated equipment located along Wicklund Road, any gas distribution facilities, any land rights, any construction equipment, any materials or supplies in inventory, any business records, and any maps or diagrams.

provide electric distribution service to retail customers in the Mountain House Area.

PG&E has retained the right to use its main line to serve PG&E customers outside the Mountain House Area. Therefore, under the agreement, MOD cannot use more than one megawatt of capacity on the mainline. PG&E may use other facilities not being utilized by MOD as needed to serve PG&E customers.

PG&E shall have ongoing access to the facilities and the surrounding areas as necessary to carry out its contractual obligations or to meet legal requirements.

MOD agreed to pay PG&E a monthly rent of \$4,682.47 beginning on the effective date of the license /lease. Effective January 1, 2003, the monthly rate is reduced to \$4,172.00. The parties have agreed that if the Commission approves the sale agreement (discussed below), the monthly rent will be reduced to \$3,874.00 because MOD will be purchasing, rather than renting, certain facilities.

PG&E does not warrant that its land rights are sufficiently broad to permit MOD access to or use of the facilities. MOD is responsible for obtaining all rights, licenses, permits, and approvals necessary to utilize the facilities.

MOD is also responsible for all tasks necessary to act as an electric distribution provider in the Mountain House Area, including securing sufficient electricity to serve customers, performing revenue cycle services, and customer service. MOD will obtain transmission service under separate agreements and tariffs.

MOD will acquire and install the necessary bi-directional metering equipment at all delivery points at its own expense. MOD will also construct, maintain, control and operate lines and associated equipment connected to the facilities and may establish service connections from PG&E lines to serve

customers in the Mountain House Area. PG&E will perform all tie-in work at MOD's expense. PG&E and MOD will coordinate switching operations.

MOD will perform routine and emergency service from lines connected to the facilities. PG&E will maintain voltage standards at the connection points. MOD will notify PG&E of any outage or any service or emergency request, and PG&E will respond according to its normal service or emergency procedures.

PG&E shall make reasonable efforts to provide service to MOD under the agreement. However, PG&E shall not be liable for delays resulting from causes beyond its control. If PG&E does not have sufficient material or labor resources to accommodate all of its service requirements, PG&E may allocate its resources to best serve PG&E customers, as determined in PG&E's sole discretion.

MOD has agreed to accept the facilities on an "as is" basis, and has acknowledged that there may be hazardous wastes, asbestos, PCBs, lead paint, electromagnetic fields or other environmental hazards in or about the facilities. PG&E has disclaimed any representations or warranties regarding the facilities, including their fitness for a particular purpose.

Under the agreement, PG&E shall not be liable to MOD or MOD customers for any special, consequential, or indirect damages, including loss of use, loss of profits or revenue, loss of capital or increased operating costs, arising out of this transaction or from breach of this agreement. PG&E's total liability to MOD under any cause or action related to the use of PG&E facilities or the license/lease may not exceed the fees received by PG&E under the license/lease, except for actions based on PG&E's willful misconduct.

Disputes arising between PG&E and MOD shall be resolved through arbitration using the Commercial Arbitration Rules of the American Arbitration

Association. The prevailing party may enter the arbitrator's judgment in any court having jurisdiction over the dispute.

Under the agreement, PG&E will not collect nonbypassable charges (NBCs)¹⁰ from customers whose service was transferred to MOD pursuant to § 9610. Instead, MOD will pay NBCs on behalf of customers that departed PG&E's electric system before January 1, 2001, pursuant to § 9610 to PG&E annually. The amount paid will be determined according to PG&E tariffs, plus interest at the three-month commercial paper rate. PG&E will provide MOD with its calculations of the NBCs owed thirty days in advance. If the parties disagree on the amount owed, they shall invoke the dispute resolution process under the agreement. MOD's failure to timely pay these charges to PG&E is a material breach of the agreement. MOD's obligation to pay these NBCs will continue even after termination of the agreement.

MOD shall not assign the agreement or sublet the facilities without PG&E's consent. The agreement is binding on the successors and assigns of the parties. However, assignment of the agreement will not relieve MOD of its obligations under the agreement.

B. The Purchase and Sale Agreement

PG&E has agreed to sell certain distribution facilities described in the agreement to MOD for \$136,207. This price is based on the Replacement Cost Less New Depreciation. The purchase price may be adjusted if PG&E adds or retires facilities before the closing date.

¹⁰ The agreement defines "NBCs" to mean "nonbypassable charges PG&E is authorized to recover pursuant to its tariffs, including without limitation the competition transition charge, nuclear decommission charge, and trust transfer amount charge but excluding the public purpose charge."

This sale of facilities does not include:

- PG&E's transmission level voltage poles or facilities in the Mountain House Area, including the PG&E Westside Tap 60 kV Line;
- Telecommunications equipment, radio controllers equipment, radio frequency or SCADA equipment, gas facilities, software and computer programs, licenses and computer hardware, and trademarks, service marks or trade names under which PG&E has conducted business or offered programs; or
- Any fee simple estates in land, easements, permits, licenses, rights of way or other land rights related to the gas facilities.

PG&E will also retain all rectifiers on the poles in the Mountain House Area. PG&E has also reserved an easement to maintain, use and operate these rectifiers as necessary for the operation, use and maintenance of gas pipelines in the area and may use electricity from the facilities sold to MOD for this purpose. PG&E will pay for this service according to MOD's rate schedule GS-1 for non-metered accounts.

Under the agreement, PG&E has no duty to transfer any land right related to the facilities to MOD, if the transfer would violate any contractual obligation, the law, or any equitable obligation owed to a third party. PG&E has specifically disclaimed any representation or warranty that it possesses, or can transfer to MOD, land rights that will provide adequate or appropriate access to the facilities. MOD has assumed any risks and liabilities connected with the absence of these land rights.¹¹

¹¹ Schedule 2.1 of the sale agreement lists land rights related to operation, maintenance, and replacement of the facilities and ingress and egress to the facilities. Under the sale agreement, the purchase price will be reduced if the parties determine that any of these

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MOD will reimburse PG&E for the cost of physically separating the facilities sold from the rest of PG&E's distribution facilities.

MOD is generally responsible for taxes resulting from this transaction.

MOD agrees that it has had adequate opportunity to inspect and has inspected the facilities before entering into this agreement. PG&E has disclosed that hazardous substances, including PCBs, may be present at, in, on, under, about, contained in, or incorporated in the facilities or the land. However, except as disclosed in the agreement, to PG&E's current knowledge: (1) There has been no release of hazardous substances from or affecting any of the facilities that requires remediation, (2) PG&E is undertaking no remediation activities at the facilities, and (3) No governmental authority has notified PG&E of a pending hazardous substances investigation, proceeding, clean-up, abatement, or similar order related to the facilities. PG&E will confirm or modify these representations based on its then current knowledge on the closing date.

MOD is purchasing the facilities on an "as is" basis, in their existing condition on the closing date. PG&E has made no representations or warranties regarding the condition, value or quality of the facilities, the suitability of the facilities for the distribution of electricity, or the absence of hazardous materials or compliance with environmental laws.

With certain exceptions, MOD releases, discharges, and covenants not to sue PG&E for any or all losses (including reductions in the value of the land), costs, claims, actions, orders, debts, expenses, judgments or liability related to the facilities or the land rights transferred to MOD. MOD has also agreed to

land rights cannot be assigned or transferred to MOD or have been abandoned by PG&E.

indemnify, protect, defend and hold PG&E harmless from any claims or liability resulting from any inspection of the facilities or any activities conducted on the site (except when such claims result from the sole negligence or willful misconduct of PG&E), or which are related to MOD's ownership or use of the facilities or the land rights after the closing date. This indemnification includes claims or liability based on the presence or release of hazardous substances or PCBs at the facilities or on the land and the payment of response costs under CERCLA or other environmental laws. Since MOD has waived the protections of Civil Code Section 1542, the release and indemnification provisions also apply to claims of which MOD had no knowledge or did not suspect to exist at the time of executing the agreement.¹²

MOD has agreed that it is purchasing the facilities for its own use, not for resale, and will continue to use the facilities for electric distribution purposes. If MOD sells all or part of the facilities or land rights, MOD shall give the purchaser advance written notice of the potential presence of hazardous substances, including PCBs, in, on, under, about, contained in, or incorporated in the facilities or the land.

Any disputes between the parties shall be settled by binding arbitration according to the same procedures stated in the license / lease agreement.

¹² Civil Code Section 1542 states:

Section 1542. General Release

A general release does not extend to claims which a creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.

MOD is responsible for obtaining any governmental approvals, permits, or licenses necessary to implement the agreement and operate the facilities, except that PG&E will remove the mortgage on the facilities.

The agreement is binding on the successors and assigns of the parties. Although MOD may not assign the agreement, PG&E may assign all or part of the agreement to any company formed pursuant to PG&E's plan of reorganization confirmed by the Bankruptcy Court, without MOD's prior approval.

C. The Wood Pole Lease Agreement

This agreement permits MOD to lease space on certain wooden transmission poles in the Mountain House Area to use as the site for electric distribution facilities and equipment.

During the first year of the agreement, PG&E will charge MOD a monthly rent of \$75 per pole. In subsequent years, the rent will increase to 103.5 percent of the pole rent in effect during the prior year.

This agreement grants MOD the right to use corresponding space on any replacement pole if a particular pole is removed. Except in an emergency, PG&E will give MOD 90 days' notice of the relocation of any pole. Unless MOD objects, PG&E may move the MOD asset to the new pole without MOD's specific consent.

Under certain circumstances, PG&E may require MOD to remove its assets from the poles if PG&E needs the space for its own use, to accommodate preexisting third party rights, or to comply with legal requirements, or if the pole is taken by eminent domain.

MOD must identify all of its assets on PG&E poles with weatherproof and corrosive-resistant tags.

MOD is responsible for ensuring that it has the land rights needed to place and maintain assets on the poles, that the assets are in good working order, and that it complies with all permit and legal requirements. PG&E must maintain the poles in good working order.

The term of the agreement is ten years, unless one of the parties defaults. However, MOD may terminate the agreement upon giving 90 days' advance notice to PG&E.

The parties have agreed to mutual indemnification and limitations on liability. If disputes between PG&E and MOD arise, the parties will first attempt to resolve the issue through mediation. If mediation is unsuccessful, the dispute is subject to binding arbitration under the American Arbitration Association Rules of Commercial Arbitration.

With certain exceptions, neither party may assign or delegate the agreement without the prior written consent of the other.¹³

4. Environmental Review

The California Environmental Quality Act (Public Resources Code Sections 21000, et seq., hereafter "CEQA") applies to discretionary projects to be carried out or approved by public agencies. A basic purpose of CEQA is to "inform governmental decision-makers and the public about the potential, significant environmental effects of the proposed activities." (Title 14 of the California Code of Regulations, hereinafter "CEQA Guidelines," Section 15002.)

¹³ However, PG&E may assign the agreement to any corporation formed under PG&E's plan of reorganization confirmed by the Bankruptcy Court, without MOD's prior written consent.

Since the proposed project is subject to CEQA and the Commission must issue a discretionary decision without which the project cannot proceed (i.e., the Commission must act on the § 851 application), this Commission must act as either a Lead Agency or a Responsible Agency under CEQA. The Lead Agency is the public agency with the greatest responsibility for supervising or approving the project as a whole (CEQA Guidelines, Section 15051(b)).

Here, MOD is the Lead Agency for the project under CEQA. The Commission is a Responsible Agency for this proposed project under CEQA. CEQA requires that the Commission consider the environmental consequences of a project that is subject to its discretionary approval. In particular, the Commission must consider the Lead Agency's environmental documents and findings before acting upon or approving the project (CEQA Guidelines, Section 15050(b)). The specific duties of a Responsible Agency are contained in CEQA Guidelines, Section 15096.

MOD staff analyzed the purchase of PG&E electrical distribution equipment and addition of equipment necessary to connect the PG&E facilities to the MOD electrical system, and found the activities to be consistent with Categorical Exemptions pursuant to CEQA Guidelines, Sections 15301, 15303, and 15311.

On December 17, 2002, MOD staff presented their findings of exemption from CEQA to the MOD Board of Directors, who subsequently acted on their discretionary authority and approved the project under Resolution No. 2002-186.

On December 20, 2002, MOD filed a notice of exemption with the County of San Joaquin pursuant to CEQA Guidelines, Section 15062.

We have reviewed MOD's environmental documents and find them adequate for our decision-making purposes. We adopt MOD's finding that the project is exempt from CEQA for purposes of our approval.

5. Ratemaking Considerations

A. Allocation of PG&E's Gain on Sale and Lease Revenues Between Shareholders and Ratepayers

PG&E will receive the following revenues from MOD based on the above transactions:

- Revenues from the license/lease of electric distribution facilities to MOD;
- Payment by MOD of half of the costs of removing any stranded facilities upon expiration of the license/lease agreement;
- Revenues from the lease of PG&E's transmission assets, e.g., the wooden poles;
- PG&E's gain on sale resulting from the sale of certain distribution facilities to MOD.

The parties agree that PG&E should allocate revenues from the license and lease of electric distribution assets to MOD to Other Operating Revenue (OOR). We approve this allocation of license/lease revenues.¹⁴

The parties also agree that PG&E should credit MOD's payment of half of the costs of removing any stranded facilities upon the expiration of the license/lease agreement to the depreciation reserve to reduce rate base. We find this ratemaking treatment appropriate because ratepayers paid for those facilities while the facilities were in ratebase.

PG&E proposes to allocate its revenues from the wooden pole lease according to Federal Energy Regulatory Commission (FERC) ratemaking

¹⁴ Since lease revenues fall within an existing category of non-tariffed products and services under the applicable PG&E advice letter, it is appropriate to treat lease revenues as OOR. See Decision (D.) 03-04-032 at p. 28.

principles, because the poles are transmission assets. ORA contends that since MOD entered into the pole lease in order to place distribution assets on the poles and to accommodate distribution wires purchased from PG&E, the poles should not be treated as transmission assets and the lease revenues should be credited to OOR. In the alternative, ORA argues that even if the pole lease relates to electric transmission property for ratemaking purposes, the Commission should allocate lease revenues according to its own ratemaking principles, rather than FERC's Uniform System of Accounts (USOA), because the USOA is not binding on the Commission.

However, ORA has cited no authority to support its argument that the poles are not transmission assets because MOD is using space on the poles for distribution assets. In contrast, paragraph 14 of the Joint Statement of Stipulated Facts (stipulation) refers to the wooden poles as "transmission assets."¹⁵ Moreover, the Wood Pole Lease Agreement signed by both parties specifically refers to the poles leased to MOD as "transmission poles."¹⁶ The parties have

¹⁵ Paragraph 14 of the stipulation states: "No PG&E transmission assets are being sold to MOD ... and no PG&E transmission assets are being leased to MOD under the License and Lease Agreement In its Protest, the Office of Ratepayer Advocates (ORA) questioned PG&E's proposal concerning regulatory treatment of the revenues from the lease of transmission assets, i.e., the lease of space on five transmission poles under the Wood Pole Lease Agreement. At a meeting between ORA and PG&E on April 15, 2003, PG&E confirmed to ORA that no transmission assets were being sold to MOD and that the only revenue from lease of transmission assets would be the revenue from the lease of the space on the five transmission poles." (Emphasis added.)

¹⁶ For example, paragraph D. of the recitals states that "... PG&E is prepared to lease space on certain transmission poles in the Mountain House Area ..." and MOD "is prepared to lease space on transmission poles within the Mountain House Area from PG&E" Section 2.01(b) of the Wood Pole Lease Agreement further states: "This agreement shall only cover leasing space on wood transmission poles within the Mountain House Area." (Emphasis added.)

presented no further evidence related to the proper characterization of the poles for ratemaking purposes.

Under these circumstances, we believe that the wooden poles should be treated as transmission assets for ratemaking purposes. Revenues from the lease or sale of transmission assets are generally allocated pursuant to FERC ratemaking principles.¹⁷ PG&E shall therefore allocate revenues obtained from the wooden pole lease according to the applicable FERC requirements.¹⁸

PG&E and ORA agree that PG&E's gain resulting from the sale of distribution facilities to MOD should generally be allocated according to our Redding II decision (Redding II).¹⁹

In Redding II, we held that a utility's gain on the sale of all or part of a distribution system should be allocated to utility shareholders as non-utility income under the following four circumstances, provided that ratepayers did not contribute capital to the distribution system:

- The distribution system is sold to a public entity, such as a municipality or a special utility district;
- The distribution system consists of part or all of the utility's operating system located within a geographically defined area;
- Components of the system are or have been included in the utility's ratebase; and

¹⁷ See D.03-04-032 at p. 27.

¹⁸ We address the allocation of these revenues here, because they result from a lease, rather than a sale, of utility property. However, in doing so, we do not prejudice any issue that may arise in the upcoming gain on sale rulemaking.

¹⁹ D.89-07-016.

- The sale of the distribution system is concurrent with the utility's being relieved of its obligation to serve customers in the area served by the distribution system, and the public entity that purchased the distribution system assuming this obligation.

However, Redding II also provides that if a transfer of a utility distribution system will adversely impact the cost or quality of service for remaining utility ratepayers, the gain on sale should be allocated to ratepayers to the extent necessary to mitigate the adverse impacts.

Redding II was later extended to cover streetlight conveyances and other partial liquidations.²⁰

We agree with the parties that Redding II applies to this case, because (a) PG&E is selling certain distribution facilities in the Mountain House Area to a public agency, MOD, (b) PG&E's sale of the distribution facilities is a partial liquidation of PG&E's operating system in the area, (c) these distribution assets have previously been included in PG&E's ratebase, and (d) PG&E's sale of the distribution system to MOD is concurrent with PG&E's relief from its obligation to serve customers in the Mountain House Area pursuant to § 9610. However, the Commission will be initiating a rulemaking to examine issues related to the allocation of a utility's gain on sale in the near future. Although Redding II applies to PG&E's sale of distribution assets to MOD, the Commission wishes to reconsider the appropriate allocation of a utility's gain on sale in this type of transaction in the rulemaking.

ORA also argues that PG&E should allocate part of its gain resulting from the sale of distribution assets to ratepayers, because ratepayers have paid

²⁰ D.90-08-054.

an estimated \$46,590 for the revenue requirement for these facilities during the past three years, while PG&E also obtained license revenues from MOD. PG&E argues that removals of property from ratebase cannot occur instantly but must be accomplished through a general rate case. PG&E also contends that allocation of license/lease revenues received from MOD to OOR financially benefits ratepayers, because OOR is credited toward PG&E's overall revenue requirements, which relieves ratepayers of the obligation to pay a corresponding amount for PG&E's operational costs. We believe that consideration of this argument should also occur in the context of the rulemaking, so that we may decide this issue on a broad policy basis.

We therefore defer our decision on these ratemaking issues to the upcoming gain on sale rulemaking. In the meantime, we direct PG&E to track this revenue in its Real Property Gain/Loss on Sale Memorandum Account.

However, we will address ORA's argument regarding protection of PG&E's remaining ratepayers from a potential default by MOD on its obligation to pay NBCs for departing customers here. ORA claims that if MOD were to default on this obligation, PG&E would place an unfair financial burden on its remaining ratepayers by recovering the lost revenue from them. ORA therefore asks the Commission to require PG&E to place funds from its gain on sale in an amount equal to these NBCs in a holding account, to be utilized if MOD defaults on its obligation to pay these NBCs. ORA also requests that PG&E shareholders be held jointly and severally liable with MOD for the NBCs, as additional security. In the alternative, ORA requests that MOD subject itself to Commission jurisdiction for the purpose of enforcing MOD's contractual obligation to pay NBCs on behalf of these customers.

PG&E and MOD argue that ORA has not presented any evidence that MOD is likely to default on this obligation, and if a default occurs, PG&E may

address the issue through binding arbitration. We agree that a default by MOD on its obligations to pay NBCs on behalf of departing customers is unlikely. The parties have stipulated that MOD is a financially solvent irrigation district and has an A plus bond rating from two rating agencies, Standard and Poor's and Fitch.²¹ MOD is an established public entity that owns and operates an electric transmission and distribution service and serves customers in San Joaquin, Stanislaus and Tuolumne Counties.²² ORA has presented no evidence to show that MOD is financially unstable or has defaulted on similar obligations in the past.²³ If MOD were to default, PG&E could pursue the issue through binding arbitration and enter a judgment against MOD in any court having jurisdiction. Further, if MOD had not agreed to pay these NBCs for departing customers, PG&E would have to collect these NBCs directly from departing customers, which would be far more difficult and would involve a greater risk of non-payment. Therefore, we find it unnecessary to order PG&E to place a portion of its gain on sale equal to the amount that MOD has agreed to pay for NBCs otherwise owed by departing customers in a holding account or to require PG&E shareholders to be jointly and severally liable with MOD for these NBCs.²⁴

²¹ Stipulation, paragraph 12.

²² Stipulation, paragraph 1.

²³ In a Section 851 proceeding, the public utility bears the overall burden of proving that the transaction is in the public interest and will not interfere with the right of the public to receive adequate service at reasonable rates. D.75311, 69 CPUC 2d 298 (1969). However, ORA bears the burden of producing evidence in support of its affirmative recommendations. D.99-04-068, *mimeo.* at page 10. Here, ORA has failed to meet this burden.

²⁴ We also reject ORA's proposal that, in the alternative, MOD be required to submit to Commission jurisdiction for the purpose of enforcement of MOD's obligation to pay

However, as additional protection for remaining PG&E ratepayers, we direct PG&E to promptly pursue any default by MOD on its obligation to pay NBCs on behalf of departing customers through the dispute resolution process stated in the license/lease.

B. Requirement for Annual “True-Up” of NBCs Owed by MOD

ORA also asks the Commission to require PG&E to submit an annual “true-up” of the NBCs to be paid by MOD, in part because these charges may vary over time. We find ORA’s request reasonable. Exhibit A to the stipulation, which explains PG&E’s proposed methodology for calculating NBCs for departing Mountain House customers, states that certain NBCs will be fixed on an annual basis and will vary between schedules. Further, Table 1-1 of Exhibit A contains only an illustrative example of calculations of these NBCs, rather than calculations of the actual charges. We therefore order PG&E to file a revised statement of its methodology by advice letter no later than 90 days after the effective date of this decision.²⁵ PG&E shall also submit a statement of the proposed NBCs to be paid by MOD, which shows the specific calculations and methodologies used, by advice letter annually at least 90 days before the date on which MOD’s payment of the NBCs is due for approval by the Commission Energy Division.

NBCs under the agreement. We believe that this measure is unnecessary to protect ratepayers.

²⁵ Since the filing of this application, the Commission has adopted D.03-07-028, which imposed cost responsibility surcharges (CRS) on municipal departing load under certain circumstances. PG&E shall address the calculation of any applicable CRS and the payment of those charges in the advice letter, to the extent that any may apply to departing Mountain House customers.

6. Discussion

Section 851 provides that no public utility “shall ... sell ... or lease ... the whole or any part of ... property necessary or useful in the performance of its duties to the public, ... without first having secured from the Commission an order authorizing it to do so.” The primary question for the Commission in § 851 proceedings is whether the proposed transaction is in the public interest.²⁶ For example, pursuant to § 851, we consider whether a utility can continue to deliver adequate service at reasonable rates with only the remaining property.²⁷ The public interest is served when utility property is used for other productive purposes without interfering with the utility’s operation or affecting service to utility customers.²⁸ In reviewing a § 851 application, the Commission may “take such action, as a condition to the transfer, as the public interest may require.”²⁹

Here, since under § 9610, PG&E may no longer serve retail electric distribution customers in the Mountain House Area effective January 1, 2001, PG&E therefore no longer needs the facilities sold to MOD. MOD’s lease of certain electric distribution facilities and space on the wooden transmission poles therefore will not interfere with PG&E’s ability to serve its customers. The agreements fairly compensate PG&E for the sale and lease of the facilities and for any “stranded facilities” that may result from PG&E’s inability to serve customers in the Mountain House Area under § 9610. PG&E is adequately protected from any liability that may result from the agreements. In addition,

²⁶ D.02-05-008, *mimeo.*, pages 8-9.

²⁷ D.89-07-016.

²⁸ D.00-07-010, *mimeo.* at p. 6.

²⁹ D.3320, 10 CRRC 56, 63.

our approval of this transaction will eliminate the need for MOD to construct or acquire other duplicative facilities to serve the Mountain House Area at public expense. We therefore believe that these transactions are in the public interest.³⁰

We note that PG&E has structured the agreement with MOD for the lease of certain electric distribution facilities as a license, which will convert into a lease immediately upon our approval of this application. We generally disapprove of this type of agreement, because of the potential for the utility to enter into a license under GO 69-C in order to implement a lease transaction without undergoing environmental review or obtaining our prior approval under § 851.³¹ However, here, the transactions are exempt from CEQA review. Further, PG&E and MOD needed to quickly implement the agreements because of the Legislature's adoption of § 9610 and MOD's lack of the necessary distribution facilities to serve the Mountain House Area. Under these circumstances, we approve the license/lease.

For all of the foregoing reasons, we grant the application of PG&E, subject to the above conditions, effective immediately.

7. Final Categorization and Review and Comment Period

Based on our review of this application, we conclude that there is no need to alter the preliminary determination as to the ratesetting categorization made in Resolution ALJ 176-3107 (February 13, 2003). We modify our preliminary

³⁰ PG&E and ORA have also stipulated that the agreements are consistent with Section 9610, ensure uninterrupted electric distribution service to the Mountain House Area, avoid the need for MOD to construct costly duplicative facilities, and will not adversely affect PG&E's service to its own electric retail customers. Stipulation, paragraph 10.

³¹ See D.02-07-026.

determination that a hearing is necessary, because no hearing was necessary in this proceeding.

The draft decision of ALJ Prestidge was mailed to the parties in accordance with § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure on February 9, 2004. Timely comments were received from the parties.

We have reviewed the comments received from the parties and make no changes to the draft decision.

We have revised the draft decision on our own initiative to clarify that PG&E must track revenues resulting from the sale of distribution facilities to MOD in its Real Property Gain/Loss on Sale Memorandum Account, pending the outcome of the gain on sale rulemaking.

8. Assignment of Proceeding

Geoffrey Brown is the Assigned Commissioner and Myra J. Prestidge is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. MOD is an irrigation district organized under California law that may transmit, distribute, lease and sell electricity to customers, with certain limitations specified by law.
2. The Legislature enacted § 9610 effective January 1, 2001, through the adoption of AB 2638.
3. Under § 9610, PG&E may no longer serve retail electric distribution customers in the Mountain House Area effective January 1, 2001.
4. MOD assumed responsibility for serving electric distribution customers in the Mountain House Area effective January 1, 2001.
5. As of January 1, 2001, MOD did not have the necessary facilities to serve retail electric distribution customers in the Mountain House Area.

6. As of January 1, 2001, PG&E no longer needed the distribution facilities sold to MOD to serve its customers.

7. PG&E's license and lease of certain distribution facilities and space on wood transmission poles will not interfere with PG&E's ability to adequately serve its remaining customers at reasonable rates.

8. The compensation received by PG&E from MOD under the license/lease, the purchase and sale agreement, and the wood pole lease is reasonable.

9. The license/lease, sale agreement, and wood pole lease adequately protect PG&E from liability based on these transactions.

10. MOD is a Lead Agency for the project under CEQA.

11. The Commission is a Responsible Agency for the project under CEQA.

12. On December 17, 2002, MOD presented its findings that the project was categorically exempt from CEQA review under CEQA Guidelines Sections 15301, 15303, and 15311 to the MOD Board of Directors, who subsequently exercised its discretionary authority and approved the project under Resolution No. 2002-186.

13. As a Responsible Agency, the Commission finds that MOD's environmental documents are adequate for our decision-making purposes.

14. Lease revenues fall within an existing non-tariffed products and services category under the applicable PG&E advice letter.

15. It is reasonable for PG&E to credit MOD's payment of half of the cost of removing any stranded facilities upon the expiration of the license/lease to the depreciation reserve to reduce ratebase.

16. Applying the facts presented in this case, the wood transmission poles, on which PG&E has leased space to MOD for its distribution assets, are electric transmission property.

17. PG&E's sale of distribution assets to MOD falls within Redding II for ratemaking purposes because: a) PG&E is selling certain distribution facilities in

the Mountain House Area to a public agency, MOD, b) the sale of these distribution facilities is a partial liquidation of PG&E's operating system in the area, c) the distribution facilities have previously been included in PG&E's ratebase, and d) PG&E's sale of the distribution facilities to MOD is concurrent with PG&E's relief from its obligation to serve electric distribution customers in the Mountain House Area.

18. The Commission wishes to consider the allocation of PG&E's gain on sale between shareholders and ratepayers on a broad, policy basis in the upcoming gain on sale rulemaking.

19. MOD is an established, financially solvent irrigation district and has an A plus bond rating from two rating agencies, Standard and Poor's and Fitch.

20. It is unlikely that MOD will default on its contractual obligations to pay PG&E for NBCs on behalf of customers whose electric distribution service was transferred to MOD pursuant to § 9610.

21. ORA has presented no evidence to show that MOD is likely to default on its obligations to pay NBCs on behalf of departing customers or has defaulted on a similar obligation in the past.

22. ORA's proposed mitigation measures, which would have involved: requiring PG&E to place a portion of its gain on sale in holding accounts to be utilized if MOD were to default on its obligation to pay NBCs on behalf of departing customers; holding PG&E jointly and severally liable with MOD for payment of the NBCs; or requiring MOD to agree to ongoing Commission jurisdiction for the purpose of enforcing MOD's contractual obligation to pay NBCs, are unnecessary to protect PG&E ratepayers from potentially adverse financial effects of this transaction.

23. The amount of the NBCs to be paid by MOD may vary annually.

24. PG&E's proposed methodology for calculating NBCs to be paid by MOD on behalf of departing customers and proposed calculations of these amounts require further clarification through an advice letter to be filed by PG&E and an annual true-up.

25. PG&E and MOD needed to quickly implement the license/lease agreement in January 2001, because MOD did not have the necessary electric distribution facilities to serve customers in the Mountain House Area pursuant to § 9610.

26. The entry of PG&E and MOD into a license of certain electric distribution facilities, pending our approval of this application, did not circumvent environmental review in this case.

27. Our approval of the license/lease, sale agreement, and wood pole lease will eliminate the need for MOD to construct duplicative facilities in the Mountain House Area at public expense.

28. Approval of the license/lease, sale agreement, and wood pole lease are in the public interest.

Conclusions of Law

1. In a § 851 proceeding, the public utility bears the overall burden of proof that the proposed transaction is in the public interest and will not interfere with the right of the public to adequate service at reasonable rates, but ORA bears the burden of producing evidence in support of its affirmative recommendations.

2. Approval of the license/lease, sale agreement and wood pole lease is in the public interest.

3. We adopt MOD's determination that the project is categorically exempt from environmental review under CEQA.

4. PG&E should treat revenues received from license/lease of distribution facilities to MOD as OOR.

5. PG&E should allocate revenues received from the lease of space on wooden transmission poles to MOD according to FERC ratemaking principles.

O R D E R

IT IS ORDERED that:

1. The license and lease agreement, the purchase and sale agreement, and the wood pole lease agreement by and between Pacific Gas and Electric Company (PG&E) and Modesto Irrigation District (MOD) are approved.
2. PG&E shall treat revenues received from the license/lease of electric distribution facilities to MOD as Other Operating Revenue.
3. PG&E shall allocate revenues received from the lease of space on wood transmission poles to MOD according to applicable Federal Energy Regulatory Commission ratemaking principles.
4. Our determination regarding the allocation of PG&E's gain resulting from the sale of distribution facilities to MOD is deferred to a gain on sale rulemaking, so that we may address these issues on a broad policy level. In the meantime, PG&E shall track these revenues in its Real Property Gain / Loss on Sale Memorandum Account.
5. PG&E shall file an advice letter that clarifies its calculations and methodologies for determining the annual amount to be paid by MOD for nonbypassible charges (NBCs) on behalf of customers whose electric distribution service was transferred to MOD pursuant to Pub. Util. Code § 9610 (departing customers) and addresses the calculation and payment of any applicable cost responsibility surcharges for municipal departing load imposed by Decision 03-07-028, with the Commission Energy Division no later than 90 days after the effective date of this decision.
6. PG&E shall annually file an advice letter that contains the proposed calculations and methodologies used to determine the amount of NBCs to be

paid by MOD for that year at least 90 days before the due date for MOD's payment of the NBCs for approval by the Commission Energy Division.

7. If MOD defaults on its contractual obligations to pay NBCs on behalf of departing customers, PG&E shall promptly enforce this obligation through the dispute resolution process set forth in the license/lease agreement.

8. Application 03-02-005 is closed.

This order is effective today.

Dated March 16, 2004, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

I dissent.

/s/ LORETTA M. LYNCH
Commissioner