

Decision 07-12-005 December 6, 2007

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

Application of Pacific Gas and Electric  
Company for Pre-Approval of Exceptional  
Case Contracts Pursuant to Electric Rules  
15.I.3 and 16.G. (U39E)

Application 06-07-027  
(Filed July 31, 2006)

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**OPINION DENYING PACIFIC GAS AND ELECTRIC COMPANY'S REQUEST  
FOR PRE-APPROVAL OF EXCEPTIONAL CASE LINE EXTENSION  
CONTRACTS**

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Attachment A - List of Acronyms

**OPINION DENYING PACIFIC GAS AND ELECTRIC COMPANY'S REQUEST  
FOR PRE-APPROVAL OF EXCEPTIONAL CASE LINE EXTENSION  
CONTRACTS**

**1. Summary**

In this application, Pacific Gas and Electric Company (PG&E) requests approval of a proposed incentive program. Under the incentive program, PG&E would offer pre-approved exceptional case electric line extension contracts (contracts) for residential and commercial line extensions in portions of its service territory where publicly-owned utilities (POUs) are offering electric distribution service under more generous terms than PG&E is otherwise able to offer. The contracts would include an incentive amount in addition to the line extension allowance PG&E would normally offer. By this decision, we deny the application because the proposed incentive program is not needed, could disadvantage some new customers, and is not practical to implement.

**2. Line Extension Allowance Background**

When a residential or non-residential building is constructed, the entity that owns the building (applicant) will have to apply to PG&E to be connected to the PG&E's system.<sup>1</sup> The facilities that will have to be built to make the connection are of two kinds. First, PG&E's distribution line will have to be extended to the edge of the applicant's property if not already there. This is called a line extension. Second, PG&E's distribution line will have to be connected to the building's meter. This is called a service extension. As used

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<sup>1</sup> The term "applicant," as used herein, refers to the applicant for the line extension, rather than PG&E.

herein, the term “line extension” refers to both the line and service extension unless specified otherwise.

The cost of a line extension is divided into two parts: non-refundable and refundable. The non-refundable costs (trenching, conduit, etc.) are paid by the applicant. The refundable costs are covered in whole or in part by the line extension allowance.

PG&E’s residential line extension allowance is currently fixed at \$1,313 per dwelling expected to be connected within six months from the date PG&E’s facilities are first available to provide service. The refundable costs (electric wire, etc.), in excess of the allowance, are advanced by the applicant to PG&E. Refunds are paid to the applicant due to additional services subsequently connected to the line extension and continue for up to 10 years from the date PG&E is first ready to serve.<sup>2</sup> In most cases, the applicant will be the developer who constructs the dwelling, not the customer who ultimately occupies it.

The allowance goes into PG&E’s rate base. PG&E is responsible for the operation, maintenance, and replacement of the line extension facilities. For any portion of the refundable amount that has not been refunded to the applicant after 12 months, the applicant is charged a monthly cost of ownership (COO) charge to recover the operations and maintenance (O&M) costs and other costs of the facilities.<sup>3</sup> The COO charge is deducted from the refundable amount. After the 10-year period, any unrefunded amount becomes PG&E’s property.

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<sup>2</sup> Refunds are made on line extensions, not service extensions.

<sup>3</sup> The COO charge does not apply to individual applicants, such as a person building his or her own home.

The residential line extension allowance is calculated using the following general formula:

$$\text{Allowance} = \frac{\text{Net Revenue}}{\text{COS factor}}$$

The net revenue is the annual revenue expected to be received by the utility from the customer residing in the building. It is calculated based on PG&E's average annual distribution revenue per residential customer.

Associated with the cost of the line extension facilities that go into rate base are costs for such things as depreciation, return, income taxes, property taxes, O&M costs, administrative and general (A&G) costs, and franchise fees and uncollectibles (FF&U). The cost of service (COS) factor is the ratio of such costs to the cost of the line extension. Thus, a COS factor of 0.16 means that for every \$100 of line extension cost, \$16 in revenues is needed to recover the associated costs. Using this hypothetical example, if the net revenue is \$160 and the COS factor is 0.16, the allowance would be \$1,000.

Non-residential line extensions are calculated in the same general manner. However, the net revenue is based on an estimate of the anticipated revenues from loads to be connected and in use within 12 months.

If a residential building for which an allowance was given does not take service from PG&E within six months, the allowance for that building will be recovered from the applicant. Similarly, if the estimated load for a non-residential building does not materialize within 12 months, a portion of the allowance will be recovered from the applicant based on the amount of load that did not materialize. The allowance recovery is referred to herein as deficiency billing. The six-month and 12-month periods are referred to herein as compliance periods.

Under PG&E's 50% nonrefundable discount option, the developer has the option of paying only half of the refundable costs of the line extension, but the developer would not be eligible for a refund. This option allows the developer to have lower up-front costs.

Under PG&E's third-party installation option, the developer can have the line extension installed by a third party rather than PG&E. Depending on the availability of third party installers, this option may allow the developer quicker or lower cost installation.

PG&E's tariff rules regarding line extension allowances are found in Electric Rules (Rules) 15 and 16. Rule 15 governs distribution line extensions and Rule 16 governs service extensions.

A list of the acronyms used in this decision is included in Attachment A.

### **3. PG&E's Request**

PG&E's Rules 15.I.3 and 16.G (exceptional case) provide that when application of the rule appears impractical or unjust to either party (PG&E or the applicant) or the ratepayers, PG&E or the applicant may refer the matter to the Commission for a special ruling or for special conditions which may be mutually agreed upon that allow PG&E to deviate from its standard line extension requirements. PG&E contends that the delay inherent in this process (applying for Commission advance approval) causes developers to take service with POUs since POUs can react faster because they do not need such approval. PG&E also claims that the POUs can offer more attractive line extension allowances and terms than it is able to offer through Rules 15 and 16.

In this application, PG&E requests approval of its incentive program whereby it would offer pre-approved contracts for residential and commercial line extensions in the limited areas where POUs are extending distribution

facilities in PG&E's service territory and offering service to new developments under more generous terms than PG&E is able to offer under the standard provisions of Rules 15 and 16. The contracts would provide a project-specific new load incentive (incentive) over and above the standard line extension allowance. PG&E states that the standard line extension allowance with the incentive is intended to match, but not exceed, the POU's financial offer.

When PG&E's standard allowance is not enough to make it comparable to the POU's standard tariff amount, or a bona fide line extension offer from the POU different from the POU's tariff amount, PG&E would calculate the difference between the developer's cost under the POU's tariff or offer and under PG&E's standard allowance. The calculation would factor in PG&E's estimated costs, refundable and non-refundable, including the Income Tax Component of Contributions (ITCC), so that the overall cost to the applicant, most likely a developer, will be comparable to the costs under the POU's offer.<sup>4</sup>

The incentive would be the cost difference adjusted so that the revenue gained from the development exceeds the marginal costs of providing service, thus providing a positive contribution to margin (CTM) that would ultimately result in rates being lower than would otherwise be the case. The incentive could include an extension of the compliance period up to five years, as needed, on a case-by-case basis. As discussed previously, the current compliance period is six months for residential loads and 12 months for non-residential loads.

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<sup>4</sup> A portion of the line extension costs paid by the applicant becomes PG&E's property. The value of this contributed property is treated as taxable income for income tax purposes. The ITCC covers the income tax PG&E will pay on the contributed facilities.

If the POU's offer is not based on its standard tariffs, PG&E proposes to require the developer to provide a sworn affidavit affirming the POU's offer and providing details of the offer.<sup>5</sup>

The areas in which PG&E proposes to offer such contracts include the Cities of Ripon, Escalon, Riverbank, Oakdale and surrounding areas where Modesto Irrigation District offers electric distribution service, the Cities of Merced, Atwater, and Livingston and surrounding areas where Merced Irrigation District offers electric distribution service, and the Cities of Hercules and Santa Maria. PG&E also proposes to offer the incentives in areas served by the City and County of San Francisco (CCSF) as well as those served by the following POU's adjacent to PG&E's service territory.<sup>6</sup>

- Alameda Power and Telecom
- Biggs Electrical Department
- Gridley Municipal Utilities
- Healdsburg Municipal Electric Department
- Lassen Municipal Utility District
- Lodi Municipal Electric System
- Lompoc Utility Services/Electrical
- Palo Alto Electric Utility
- Redding Electric Utility
- Roseville Electric Department

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<sup>5</sup> PG&E initially proposed to use a letter but changed the requirement to an affidavit.

<sup>6</sup> CCSF was not specifically identified in the application as covered by the incentive. However, CCSF was addressed in the body of the application. At hearings, PG&E clarified its intent that CCSF be covered by the incentive.

- Santa Clara Electric Department
- Ukiah Municipal Utility District

PG&E also proposes to request authority to provide the incentive, in other geographic areas where a POU is offering service, by advice letter.

For backbone-only electric main line extensions (where no services are added by the developer) PG&E proposes not to apply any allowance. Instead, PG&E proposes to calculate a project-specific incentive. The developer would be required to sign an agreement ensuring that new services in the development will be connected to PG&E's distribution system for the period of years, not to exceed five years, required to justify the incentive. The incentive would be adjusted as necessary to ensure that the revenue to be gained from the development exceeds the marginal cost of providing service to the development.

At the end of the compliance period, if there are any remaining units not connected to the backbone system, the developer will be billed (deficiency billing) for the portion of the allowance, including the incentive, attributable to the units not connected during the compliance period.<sup>7</sup>

PG&E proposes that the exceptional case contracts be reviewed in an annual reasonableness review. The reasonableness review would address the contracts entered into in the previous calendar year. PG&E proposes that the review address the reasonableness of the contracts based on the information PG&E had available at the time the contracts were entered into.

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<sup>7</sup> Deficiency billing occurs when, at the end of the compliance period, the load (number of services for residential) is less than the projected load the allowance was based on. The developer would be billed for the portion of the allowance, including the incentive, which corresponds to the amount of load that was not connected.

PG&E proposes that, during the annual reasonableness review, the POU's whose bona fide offers were matched by PG&E would be allowed to request copies of the applicant's affidavit subject to confidentiality limitations.

If the Commission, as the result of a reasonableness review, determines that PG&E's provision of an incentive was wholly unreasonable, and the developer has made no physical connection to PG&E's system at the end of the compliance period, the applicant would be allowed to reconsider whether it would take service from PG&E under the standard tariff conditions or to take service from the POU.<sup>8</sup>

PG&E says it is not seeking any changes to Rules 15 and 16. Instead, it asserts that a decision granting this application would constitute a special ruling under the exceptional case provisions of Rules 15 and 16. Public Utilities Code Section 783 (§ 783) requires the Commission to make certain findings whenever the Commission considers an order amending line extension rules.<sup>9</sup> PG&E contends that since this application falls under the exceptional case provisions of Rules 15 and 16, it does not require changes to those rules and does not trigger § 783.

#### **4. Procedural Background**

On July 31, 2006, PG&E filed this application. On October 3, 2006, the assigned administrative law judge (ALJ) issued a ruling requiring PG&E to provide information on instances where the Commission has addressed the

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<sup>8</sup> The period for interconnection (up to five years) may not have expired when the reasonableness review takes place.

<sup>9</sup> All section (§) references are to the Public Utilities Code unless specified otherwise.

exceptional case provisions of PG&E's Rules 15 and 16. On November 22, 2006, the ALJ issued a ruling requiring PG&E to provide an exhibit addressing the issues identified in § 783. A prehearing conference was held on February 8, 2007. On February 13, 2007, the ALJ issued a ruling requiring PG&E to provide additional prepared testimony on a number of questions. Among other things, the questions addressed uneconomic bypass, the effect of its proposal on new customers residing in the developments PG&E's proposal is aimed at, a comparison of POU versus PG&E customer bills, and the reasonableness review process. Hearings were held on May 22-25, 2007. The matter was submitted on July 19, 2007, after receipt of briefs.

## **5. Analytical Approach and Conclusion**

PG&E proposes its incentive program as a solution to a problem. It identifies the problem as an increase in future rates, over what they would otherwise be, caused by new customers being acquired by POU's rather than PG&E. PG&E alleges that the increase in future rates will be due to the loss of CTM that such new customers would provide. In order for us to evaluate PG&E's proposal, we need to consider whether it makes sense from a policy perspective. It also must be practical to implement since the proposal would have no value as a solution to the alleged problem if it can't be implemented.

In the following sections, we first address the policy issues of whether there is a need for the incentives and the effect of PG&E's proposal on new customers. As discussed later in this decision, we find:

- There is no significant need for the incentive proposal. (See Section 6.2 of this decision.)
- The incentives would likely disadvantage some new customers and PG&E has not demonstrated why it would be good public policy to do so. (See Section 7.2 of this decision.)

Thus we find it would not be good public policy to grant PG&E's proposal.

In subsequent sections we examine the practical aspects of the incentive proposal including the CTM calculation, implementation and the proposed reasonableness review process. We find:

- PG&E's CTM calculation contains flaws that make it unreasonable. (See Section 8.2 of this decision.)
- A minimum amount of CTM (threshold CTM) would be necessary in order to provide some assurance that the incentives will result in a positive CTM. However, PG&E has not proposed one and the record is insufficient to determine what it should be. (See Section 9.2 of this decision.)
- One way to assure a positive CTM, in addition to or instead of a threshold CTM, would be to have shareholders bear some of the costs. However, the record does not provide sufficient information for us to consider such a requirement. (See Section 10.2 of this decision.)
- PG&E proposes that the applicant not be required to obtain a written offer from the POU or include a copy of it with the affidavit. PG&E's proposal would make it difficult, at best, to verify in the reasonableness review that a bona fide offer was made and that the applicant accurately represented the POU offer. Since this would make the reasonableness review more controversial, complex and expensive, it would reduce the resulting CTM and make the proposal less practical to implement. Requiring the applicant to obtain a written offer from the POU and include a copy of it with the affidavit would attract fewer developers and provide less CTM. (See Section 11.1.2 of this decision.)
- PG&E has not explained how the extended compliance period and the absence of deficiency billing by the POU could be analyzed to ascertain the reasonableness of PG&E's offer. (See Section 11.2.2 of this decision.)
- PG&E's proposal to increase the compliance period increases the risk that the development will not provide a positive CTM and

- supports the need for a threshold CTM and/or a contribution by shareholders to the cost of the incentives. (See Section 11.2.2 of this decision.)
- PG&E does not propose to offer the incentive as a standard tariff offering to qualified applicants. Instead it requests authority to use its discretion regarding the compliance period. PG&E also requests authority to use its discretion as to whether to offer the incentive when it has reason to believe the offer should not be made, even though the customer otherwise meets the eligibility criteria. Since PG&E has not explained in any detail what criteria it would use in exercising its discretion, we cannot determine whether its proposal would lead to unreasonable discrimination. (See Section 11.3.2 of this decision.)
  - There may be some applicants who would qualify for the incentive, but would take service from PG&E without the incentive or should not be offered the incentive or extended compliance period for other reasons. Offering the incentive in such instances would incur costs with diminished or no corresponding benefits thus reducing the overall CTM provided by the proposal. PG&E has not addressed these possibilities in its CTM calculation and it is unclear whether its request for discretion could eliminate these possibilities without unreasonable discrimination. (See Section 11.3.2 of this decision.)
  - PG&E's proposal, to conduct the reasonableness reviews as part of the Energy Resource Recovery Account (ERRA) proceeding, is unreasonable because the ERRA proceeding already has a significant number of issues and a limited time frame. Since there is no other available proceeding, the reasonableness review would have to be conducted in a separate proceeding. However, the record does not demonstrate that initiation of such proceedings would be the best use of the parties' or the Commission's resources. (See Section 12.1.2 of this decision.)
  - PG&E's proposal regarding the consequences of a finding of unreasonableness does not address the range of possible outcomes and could leave ratepayers worse off due to an error by PG&E. (See Section 12.2.2 of this decision.)

- PG&E has not demonstrated that its proposal for provision of incentives for backbone-only services is reasonable. (See Section 13.1 of this decision.)

Because of the above flaws in PG&E's proposal, we find it impractical to implement. Because PG&E's proposal would not be good public policy and would not be practical to implement, we deny the application.

In the course of this proceeding, the parties addressed a number of issues that would require resolution if we were to grant this application. Since we do not grant the application, these issues are moot and we do not address them herein. Our exclusion of such issues from this decision does not mean that we would approve PG&E's position regarding those issues if we were to grant the application. We also note that PG&E's incentive proposal does not fall within the exceptional case provisions of Rules 15 and 16. If we were to grant PG&E's application, it would require a change to PG&E's rules, triggering § 783. (See Section 14.2 of this decision.)

## **6. Need for the Incentives**

### **6.1. Positions of Parties**

PG&E states that it has been unable to attract new developments that have the option of being served by a POU. PG&E alleges that POUs originally cherry-picked PG&E's larger and more profitable existing customers (usually commercial and industrial) but have more recently gone after new residential subdivisions and commercial developments. PG&E states that POUs have succeeded in attracting virtually all new development in those portions of PG&E's service territories where they are extending service. PG&E claims that, in the last few years, over 11,000 customers (approximately \$18 million in annual revenues) have chosen to take service from POUs rather than PG&E.

PG&E argues that the POUs have the ability to offer more financially attractive line extension costs and terms to developers because they have significant financial advantages. PG&E states that the rules applicable to PG&E and POUs are different. In particular, it represents that because POUs do not pay federal or state income taxes, they are not required to impose ITCC or an equivalent on developers. Thus, PG&E must pass through costs to the developer that the POU does not incur. PG&E states that its inability to offer more financially attractive line extension costs and terms to developers is a primary cause of the uneconomic bypass at issue here.

PG&E also states that POUs have the advantage that they are not regulated by a third party (the Commission). PG&E represents that, when it comes to deviations from standard tariff line extension offerings, the POU can respond more quickly to developers than PG&E because PG&E must seek the Commission's advance approval whereas the POUs do not have third-party regulators whose approval they must seek. PG&E states that in seeking Commission approval, it must file an application that would cause PG&E to incur additional costs, consume many months of regulatory litigation and allow the POUs to oppose the application. PG&E represents that developers are not willing to wait for such approval or assume the risk that approval will not be granted.

PG&E states that service to developers is one of a number of important factors that developers consider in choosing an electric distribution provider. PG&E represents that it has taken and continues to take steps to improve the quality and timeliness of its service to developers, but that cost is a critical factor for developers. PG&E argues that if service was the central subject matter at

issue in this proceeding, the POUs would be confident that their service is superior to PG&E's service and would not be participating in this proceeding.

PG&E argues that, due to its inability to attract these new developments, uneconomic bypass has occurred with the result that existing customers' rates will be higher than would have been the case had PG&E gained the new developments. PG&E also represents that its inability to attract new developments means that the POUs control the gateways to subsequent expansion of the new developments making it more costly and, therefore, less attractive to developers to choose PG&E to serve such subsequent expansions.

PG&E states that its proposed incentives will avoid the resulting uneconomic bypass and provide a positive CTM that will result in existing ratepayers' rates being less than they would otherwise be.

The Division of Ratepayer Advocates (DRA) states that PG&E's proposal is not necessary because line extension allowances have been around for decades and this is the first request of this type.

The Utility Reform Network (TURN) states that PG&E failed to address the availability of the 50% nonrefundable discount option and third party installation as ways of competing with POUs.

CCSF states that PG&E has failed to measure or quantify any advantages the POUs have over PG&E. CCSF also states that uneconomic bypass occurs when a customer leaves the utility system, not when new in-state load can be served by PG&E or a POU. Additionally, CCSF states that the Commission's criteria for approval of proposals related to the threat of uneconomic bypass are: (1) the threat of bypass must be imminent, (2) the bypass must be uneconomic, and (3) the proposed contract must have reasonable terms and conditions.

Hercules Municipal Utility (Hercules) states that PG&E has not shown that it has lost new customers to POU's because it could not match the POU's line extension offer.

The Merced Irrigation District and the Modesto Irrigation District (collectively MID) state that PG&E has not shown that the load it lost to POU's was due to financial reasons as opposed to service reasons. MID argues that PG&E has failed to measure or quantify any advantages the POU's have over PG&E, and that competition by POU's is not new and has been going on for almost a century. MID also represents that PG&E's poor service to developers is one of the reasons that developers choose POU's.

MID states that the Commission's determinations regarding uneconomic bypass have been in situations where the ultimate customer is the one making the choice rather than a developer as is the case in this application.

The Northern California Power Agency (NCPA) states that uneconomic bypass occurs when a customer leaves the utility system.<sup>10</sup> NCPA argues that PG&E's proposal is not intended to retain customers or entice them to locate in California, but is intended to discriminate between customers to further its business growth. Additionally, NCPA states that the Commission's criteria for approval of proposals related to uneconomic bypass are: (1) the threat of bypass

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<sup>10</sup> NCPA is a Joint Powers Agency whose members include the Cities of Alameda, Biggs, Gridley, Healdsburg, Lodi, Lompoc, Palo Alto, Redding, Roseville, Santa Clara and Ukiah, as well as the Bay Area Rapid Transit District, the Port of Oakland, the Truckee Donner Public Utility District, and the Turlock Irrigation District. NCPA's associate members are the Plumas-Sierra Rural Electric Cooperative and the Placer County Water Agency.

must be imminent, (2) the bypass must be uneconomic, and (3) the proposed contract must have reasonable terms and conditions.

## **6.2. Discussion**

PG&E has provided no estimate of the amount of revenues it will fail to obtain in future years due to developers choosing a POU over PG&E or the revenues it will gain if this application is approved. Therefore, we look to the record to examine a range of possible results if the incentives are authorized.

The amount of revenues from customers PG&E claims to have failed to obtain over the last few years amounts to 0.17% of its total annual revenues as pointed out by TURN. The record does not indicate the exact number of years over which the 0.17% loss of revenues occurred but it appears to be between 2001 and 2005, or about 0.034% per year. If we assume that the potential for developers to choose a POU over PG&E will remain at roughly this level, and that the incentive proposal would allow PG&E to attract all new developments that could choose a POU, it would take approximately 29 years for the incentives to have a 1% effect on PG&E's annual revenues. If the amount of revenues is increased to 0.05% per year (a 47% increase), it will take approximately 20 years to have a 1% effect on PG&E's revenues. However, PG&E does not claim that the incentives would capture all new developments. If PG&E were able to attract half of such new developments, it would take approximately 40-58 years to have a 1% effect on PG&E's revenues using the above assumptions.

PG&E has provided no estimate of the CTM it will fail to obtain in future years due to developers choosing a POU over PG&E or the CTM it will gain if this application is approved. If we assume that the CTM per customer from the customers the incentive is intended to attract is the same as from existing

customers, the above analysis would indicate that with a 50% success rate, it would take approximately 40-58 years to have a 1% effect on PG&E's CTM.<sup>11</sup>

The above analysis, though rough, is sufficient for us to find the CTM PG&E will fail to obtain in future years due to developers choosing a POU over PG&E or gain if this application is approved will not be significant. As a result, the record does not indicate that the lack of the incentives would have a significant adverse effect on revenues or CTM, or that the incentives would have a significant positive effect. Since a significant positive effect on CTM is necessary to have a significant positive effect on rates, we have no reason to believe the incentives would have a significant positive effect on rates.

PG&E alleges that its failure to attract new developments is primarily due to the POU's ability to offer more attractive line extension terms. While the record demonstrates that this is an important factor, there are other things PG&E can do to compete with the POUs.

As pointed out by the parties, PG&E has tools available to attract developments in addition to its line extension allowances. One tool is the 50% non-refundable discount option. Normally refundable costs of the line extension are paid by the developer to the utility. Under the 50% nonrefundable discount option, the developer has the option of paying only half of the refundable costs of the line extension, but the developer would not be eligible for a refund. This option allows the developer to have lower up-front costs. PG&E represents that this tool has not been successful in persuading developers to take service from

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<sup>11</sup> This assumes that a change in revenues results in the same percentage change in CTM.

PG&E rather than a POU. However, PG&E has not addressed what improvements to this tool or the promotion of this tool could help it compete with the POUs. Thus, the record does not indicate the degree to which the 50% nonrefundable discount option could reduce or eliminate the alleged need for the incentive proposal.

Another tool is third-party installation, which allows the developer to have the line extension installed by a third party rather than the utility. Depending on the availability of third-party installers, this may allow the developer faster or lower cost installation than PG&E can provide. PG&E represents that this tool has not been successful in persuading developers to take service from PG&E rather than a POU. However, PG&E has not addressed what improvements to this tool or the promotion of this tool could help it compete with the POUs. Thus the record does not indicate the degree to which third-party installation could reduce or eliminate the alleged need for the incentive proposal.

The record demonstrates that service to developers is an important factor in competing with the POUs. The record contains some anecdotal evidence indicating that at least some developers have been dissatisfied with PG&E's service and that PG&E intends to improve such service. Improving service to developers is a tool PG&E could use to compete with POUs. However, PG&E has not addressed the degree to which service to developers can be improved, and to what degree such improvement would attract developers who would otherwise elect to take service from a POU. Thus the record does not indicate the degree to which improved customer service could reduce or eliminate the alleged need for the incentive proposal.

The record demonstrates that PG&E and the POUs have different advantages and disadvantages over each other. For example, PG&E pays

income taxes whereas the POU's do not. PG&E charges developers ITCC whereas POU's do not. PG&E must get Commission authorization to offer exceptional case contracts while POU's must get the authorization of their boards of directors to deviate from their tariffs. Since POU's are much smaller than PG&E, they do not have the economies of scale that PG&E has. POU's provide revenues to cities and counties that PG&E is not required to provide. Overall, PG&E has provided evidence that there are differences between it and POU's, but it has not provided evidence that quantifies or otherwise demonstrates that POU's have a significant overall net advantage over PG&E. Thus, the record does not support PG&E's claim that the incentives are necessary to overcome any significant advantage held by the POU's.

PG&E correctly asserts that it must seek Commission approval to deviate from its line extension rules. PG&E states that the resulting delay causes developers to choose the POU rather than PG&E. The record also shows that approval of the POU's governing board is necessary for the POU to vary from its tariffs. It seems possible, especially if the application is opposed, that it could take some time for PG&E to obtain the Commission's approval of a deviation. However, it is reasonable to assume that there would be some delay inherent in the POU getting its board to approve a deviation from its tariffs. PG&E has not provided evidence that demonstrates that the delay it may encounter is significantly greater than the delay the POU may encounter. Additionally,

PG&E has not demonstrated that any such difference has been a significant factor in developers choosing the POU rather than PG&E.<sup>12</sup>

In Decision (D.) 92-11-052, the Commission stated “Bypass is uneconomic when a customer leaves the utility system even though its cost to bypass is more than the marginal cost of utility service.” Thus, the term uneconomic bypass applies to the loss of an existing customer.

D.92-11-052 pertained to rate discounts for the transportation of natural gas. In the decision, the Commission stated “Discounts to prevent uneconomic bypass can attract or retain incremental load which would otherwise be lost, and thus help to keep other rates down.” This means that discounts intended to deter uneconomic bypass could also have the effect of attracting incremental load. Thus we do not interpret D.92-11-052 to define uneconomic bypass as necessarily including new customers taking service from a POU rather than PG&E.

Uneconomic bypass has been used in connection with rate discounts offered to certain large customers as an incentive to continue taking service from the utility. In those cases the customer is the direct recipient of the discount. An important element in determining whether to offer a discount is finding whether the customer's cost to bypass is greater than the utility's marginal cost to provide service. An additional requirement has been that the incentive must result in a specified amount of positive CTM. In this case, the developer makes the decision about whether to take service from PG&E, but the developer is not ultimately the

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<sup>12</sup> PG&E described one instance where it claims the delay in getting Commission approval for a deviation contributed in large part to the developer's decision to take service from the POU.

customer. PG&E's application, even though it bases its CTM analysis on revenues from the customers in a development over a 30-year period, does not address the costs to the new customer to bypass. Therefore, even if we were to accept PG&E's assertion that its proposal is aimed to prevent uneconomic bypass, PG&E has not done the necessary analysis to demonstrate that new customers being served by a POU rather than PG&E constitute uneconomic bypass.

In D.92-11-052, the Commission stated that "Bypass should only be prevented if it is uneconomic." Thus, rate discounts should not be offered in the case of economic bypass, which occurs when the customer's cost to bypass is less than the utility's marginal cost to provide service. The record shows that POU rates are in some cases significantly lower than PG&E's rates. Thus, if we were to accept PG&E's claim that developers choosing a POU over PG&E could fit within the definition of uneconomic bypass, there could also be economic bypass in some circumstances. Here again, PG&E has not done the necessary analysis, and we find that PG&E has not demonstrated that this application addresses uneconomic bypass.

Overall, PG&E has not demonstrated that its proposal will have a significant positive effect on CTM or rates, that it is effectively using other tools available to it to compete with POUs, that POUs have significant advantages over PG&E, or that its proposal will reduce uneconomic bypass. Thus, PG&E has not demonstrated a need for its proposed incentives.

## **7. Consideration of New Customer Costs**

The new customers who are relevant to this proceeding are those who would occupy the developments PG&E's proposal is intended to attract. Such

new customers would not be the recipients of the incentives, but would be the ratepayers that provide the CTM necessary to justify the proposed incentives.<sup>13</sup>

### **7.1. Positions of Parties**

PG&E states that the Ratepayer Impact Measure (RIM) test is appropriate for evaluating its proposal. The RIM test is described in the California Standard Practice Manual: Economic Analysis of Demand-Side Programs and Projects dated July 2002 (manual). The RIM test evaluates cost-effectiveness by measuring the effects of a program on rates. PG&E states that the RIM test has been used for years by the Commission to evaluate demand-side management programs. PG&E further argues that the manual demonstrates that different cost-effectiveness tests apply to different types of programs. Specifically, PG&E says the manual specifies the RIM test for load building programs such as its proposal.

The Total Resource Cost (TRC) test evaluates the cost-effectiveness of a demand side management program based on the total program costs, including the participant's and utility's costs. PG&E says the manual provides that the TRC test cannot be meaningfully applied to load building programs.

DRA states that neither the RIM test nor the TRC test calculates the effect on new and existing customers and there is no specific test that does so. DRA proposes that the Commission adopt a test that considers both new and existing customers. It included in its exhibits a modified TRC test to illustrate what might be done.

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<sup>13</sup> The incentives would be given primarily to developers who will not occupy the development.

TURN states that the RIM test is generally appropriate for use in determining the effect on non-participants. TURN states that the TRC test is usually used for programs that reduce load, which is not the case with PG&E's proposal, and would not produce meaningful results in this case.

## **7.2. Discussion**

The RIM test is generally used for evaluating load building programs. Most load building programs offer an incentive to the customer the utility is trying to attract or retain. The participating customer is offered the incentive and can choose whether to participate in the program. Therefore, a customer who chooses to participate can be assumed to benefit from the program. The question then becomes whether it makes sense for existing customers to pay for the program. This is addressed by the RIM test, which calculates the effect of the program on ratepayers who pay for the program through rates, but do not participate. However, in this case the incentive is not usually paid to the new customer. Instead, the incentive is paid to the developer. Thus, the new customer can not be assumed to benefit from the program. While the RIM test is still appropriate for determining the effect on the existing ratepayers, it does not address the effect on the new customers.

The TRC test determines the effect on existing and new customers in the aggregate. Thus, the TRC test could indicate that the program is beneficial to customers as a whole, even though new customers could be worse off. As we stated in D.82-04-069: "any request or proposal which ostensibly promotes the benefit of the majority at the expense of a minority interest requires substantial

justification.”<sup>14</sup> The TRC test, since it aggregates new and existing customers, does not provide such justification.

PG&E states that it is possible some new customers would pay higher rates than if they were served by a POU. PG&E points out that the relative rates of PG&E and POUs may change over time. PG&E then concludes that it makes good sense and is sound policy to have a relatively small number of customers pay a modestly higher rate while millions of PG&E’s distribution customers benefit from a positive CTM. PG&E has presented no analysis or quantification of the effect of the incentives on new customers or existing customers. Thus PG&E has not shown how modest the effect on new customers would be or how substantial the effect on existing customers would be.

The record shows that in many cases the POU rates are lower than PG&E’s rates. In some cases they are quite a bit lower. For example, a residential summer month electric bill for MID in Baseline Territory R as compared to PG&E would be about the same for a usage of 500 kilowatt hours (kWh), 1% lower for a usage of 750 kWh and 5% lower for a usage of 1,000 kWh. The same comparison for Redding Electric Utility would be 5% lower, 17% lower, and 32% lower. A comparison of average monthly bills for small commercial customers shows that bills from POUs range from 5% higher to 39% lower than PG&E.<sup>15</sup> A comparison of average monthly bills for medium commercial customers shows that POU bills range from 9% higher to 31% lower than PG&E.<sup>16</sup> Thus the adverse effect on

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<sup>14</sup> D.82-04-069, p. 24.

<sup>15</sup> For 10,000 kWh.

<sup>16</sup> For 100 kW demand.

some new customers may not be minimal and could be substantial. As discussed previously, PG&E has not demonstrated that existing customers will receive any substantial benefit. Thus, PG&E has not demonstrated that it would be good policy to disadvantage some new customers to achieve a minimal advantage to existing customers.

## **8. CTM Calculation**

Under PG&E's proposal, the incentive must yield a positive CTM. PG&E uses a model to calculate the CTM for each year in a 30-year analysis period. The CTM is calculated as the revenue from the new customers less the incremental cost to serve them. The model then calculates the net present value (NPV) of the stream of annual CTM values. The NPV is the current value of a future revenue or expense. A positive NPV of the CTM stream means that the current value of the revenues exceeds the current value of the costs. Thus, there is a positive CTM.

The details of the CTM calculation (ex. a single family home subdivision) are as follows.

- Annual energy usage would be based on single-family homes constructed in the same local area within the last five years. PG&E assumes that usage would be constant once a home is built.
- Demand would be estimated by applying a class-specific load factor to the expected sales for each customer class. For residential sales, the demand would be calculated by dividing the annual usage by the number of hours in the year (8,760). This

would then be divided by PG&E's most recent load factor for the residential class.<sup>17</sup>

- The average rate would be the average rate in effect at the time the incentive offer is made.
- PG&E assumes no escalation in rates or marginal costs over the 30-year analysis period.
- Incremental revenue is calculated as the annual energy usage times the average rate.
- Non-bypassable charges are removed from the revenue because they would be recovered from the customer even if the POU provides service.<sup>18</sup>
- Marginal costs would be the most recent Commission-adopted marginal costs escalated at the rate of inflation to the date the incentive offer is made. PG&E proposes to use the most geographically-specific marginal costs the Commission has approved. The marginal costs would include the one-time costs of connecting the customer, including the incentive, as well as ongoing costs.
- The incremental cost of serving the new development would be calculated by applying the unit marginal costs to the expected billing determinants (number of customers, annual energy usage, and demand).
- The CTM for each year is the incremental revenue less the incremental cost.
- The NPV is calculated using PG&E's after-tax weighted cost of capital as the discount rate.

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<sup>17</sup> The load factor is the customer's average demand divided by the customer's maximum demand.

<sup>18</sup> Non-bypassable charges include the Department of Water Resources Bond Charge, Competition Transition Charge, Nuclear Decommissioning Charge, and Trust Transfer Amount (for residential and small commercial customers only).

- The compliance period would be up to five years.

The parties do not appear to disagree with PG&E's general calculation methodology. However, they do disagree on some of the inputs to the calculation. As stated previously, we do not address all of the issues raised by the parties because they are moot due to the fact that we are denying the application. The issues we discuss below contribute to our denial of the application. If we were to grant the application, additional issues regarding the incentive calculation would have to be addressed. The fact that we do not address them herein does not mean that we would make no changes to the incentive calculation or the inputs thereto or that further analysis would not reveal additional reasons to deny the application.

### **8.1. Positions of Parties**

TURN states that PG&E's 2007 general rate case (GRC) settlement (settlement) was not intended to constitute a precedent regarding any principal or issue in any other proceeding. Thus the Commission is not required to use the marginal costs adopted in the settlement in this proceeding. Additionally, TURN states that it does not support the use of marginal costs resulting from a GRC settlement because the settlement process does not adopt a specific set of marginal costs that have been vetted by the Commission or other parties.

For public purpose program (PPP) revenues, TURN states that PG&E assumed that the new customers will provide PPP program revenue and that there will be no PPP costs associated with the new customers because such costs are fixed during each program cycle (the addition of new customers would not add new costs). TURN states that over the 30-year CTM evaluation period there will be many PPP funding cycles and the new customers will take advantage of them. Thus, there will be PPP costs.

TURN states that it does not dispute PG&E's contention that line extension facilities could last 30 years. However, it argues PG&E's assumption that costs and revenues will remain static over that period increases the risk that the incentive will produce a negative CTM.

TURN states that PG&E's assumption that none of the new customers will participate in the California Alternative Rates for Energy (CARE) program may be reasonable for the first few years. However, TURN argues that single-family homes and multi-family homes will likely be rented over the 30-year analysis period increasing the likelihood that they will be occupied by customers who qualify for the CARE program. CARE customers receive a 20% discount on their energy bills and are exempt from paying Department of Water Resources Bond Charges, the CARE surcharge, or any California Solar Initiative costs. Thus, TURN represents that inclusion of CARE customers in the analysis would result in a lower CTM.

## **8.2. Discussion**

In D.07-09-004, in PG&E's 2007 GRC, the Commission adopted a settlement regarding marginal costs. Settlements are not generally intended to constitute a precedent regarding any principal or issue for use in any other proceeding. PG&E represents that the settlement specifies that one of the agreed-upon purposes of the marginal costs adopted in the settlement is for establishing "customer-specific contract rate floors for customer retention and attraction." In this proceeding we are not dealing with rates, much less rate floors, and the incentive would primarily be offered to developers who are not customers. Thus the record does not indicate that the marginal costs adopted in the settlement were intended by the parties to the settlement or the Commission for use in this proceeding or in calculating the incentives. Therefore, the

reasonableness of their use in calculating CTM is not proven. Thus marginal costs would be a potential issue in the reasonableness review that could add significantly more controversy and complexity to the reasonableness review.

No party disputes that there will be PPP revenues. The PPP revenue requirement is determined in GRC's, and does not change until the next GRC. As a result, incremental PPP costs may not be reflected in rates until the first GRC after the incentive is awarded. In subsequent GRCs such costs would be included in the historical costs on which the GRC forecasts would be made. Thus, PPP costs would be recognized in the rates resulting from subsequent GRCs. Therefore, we agree with TURN that PPP costs should be included in the CTM calculation. However, the record does not indicate how to do so.

PG&E claims that its assumption that costs and revenues will remain static over the 30-year period tends to understate the CTM because if the revenues and marginal costs are escalated at the same rate, the difference between them would increase resulting in a greater CTM, all else being the same. This would be true under PG&E's assumption that both escalate at the same rate. However, the record contains no study that demonstrates how revenues and marginal costs have escalated historically or how they will do so in the future. Therefore, PG&E's assumption that costs and revenues will remain static over the 30-year period has not been shown to be reasonable or to understate the CTM.

We agree with TURN that PG&E's assumption that none of the customers will participate in the CARE program may be reasonable for the first few years. We also agree with TURN that at least some single-family homes and multi-family homes will likely be rented over the 30-year period to customers who qualify for the CARE program. PG&E states that, in the case of a CARE customer or a multi-family development, it would include the effect of the CARE

program in its CTM calculation. PG&E's statement applies to initial residents of a residential development. However, TURN's argument applies to residents later in the analysis period as the development ages. PG&E did not address this possibility. Additionally, the record does not reflect how sizable this effect would be. Furthermore, since the incentive calculations would be specific to each development, this is a matter that would have to be addressed in the reasonableness review adding to the complexity of such proceedings.

PG&E's proposal will have to be administered, which means there will be administrative costs. PG&E's exhibits do not address administrative costs. In the hearings, a PG&E witness represented that costs related to determining whether the applicant qualifies for the incentive and whether PG&E will offer the incentive have been charged to Federal Energy Regulatory Commission Account 912 (Account 912), which has not been funded by the Commission in a number of GRCs, and are paid by shareholders. The record does not indicate whether the revenue requirement adopted in PG&E's 2007 GRC excluded Account 912 costs or whether all costs related to administration of the proposal would be charged to Account 912. In addition, PG&E has not proposed in this proceeding that administration costs related to this proposal, whether charged to Account 912 or not, be born exclusively by shareholders in the future. Thus, PG&E has not demonstrated that there would be no administrative costs that should be included in the CTM calculation or otherwise addressed in its proposal.

There will be costs associated with the reasonableness review. The Commission's costs, at least part of PG&E's costs, and costs incurred by intervenors eligible for intervenor compensation are recovered from ratepayers. Thus the reasonableness review costs would be paid, at least in part, by PG&E's

ratepayers. These reasonableness review costs will reduce any CTM generated by the incentives. However, PG&E has provided no estimate of such costs and does not include them in its CTM calculation or otherwise address them in its proposal.

Given the above flaws in PG&E's CTM calculation, we find PG&E has not demonstrated that it is reasonable. Without a reasonable CTM calculation, the proposed incentive program can not be implemented.

## **9. Threshold CTM**

### **9.1. Positions of Parties**

PG&E states that a NPV CTM of one dollar would be sufficient to merit provision of the incentive.

TURN states that if the Commission approves PG&E's proposal, there should be a threshold amount of CTM. TURN recommends that the threshold amount be sufficient to overcome any potential margin of error in the CTM analysis, including the margin of error in the inputs to the calculation, and sufficient to ensure that the current ratepayers will begin to see a positive CTM.

CCSF states that there should be a threshold CTM if for no other reason than to cover the administrative costs.

Hercules states that there is a substantial risk to ratepayers that the incentive will result in a negative CTM due to the lack of a threshold amount of CTM and the margin of error in the CTM calculation. Hercules also points out that PG&E's calculations do not take into account the costs of administering the proposal, including the reasonableness review.

MID recommends a threshold CTM of 20% above marginal cost to overcome the margin of error in the CTM calculation and any time lag between provision of the allowance and the realization of revenues from the new

customers. MID states that the Commission adopted a 20% of marginal cost threshold CTM in D.95-10-033 for rate discounts.

## **9.2. Discussion**

Under PG&E's proposal, it could provide an incentive for a development that would be estimated to produce a CTM as low as \$1 over a 30-year period. Under such circumstances existing ratepayers would essentially break even over a 30-year period. In such a case, since there would be essentially no net benefit to existing ratepayers over the 30-year period, there would be no reason to offer the incentive and assume the attendant risk that a negative CTM will result.

In any forecast of costs and revenues going 30 years into the future, there is a significant margin of error. If a CTM estimate falls within the margin of error it essentially means that there is no real certainty that a positive CTM will be realized. If the estimated CTM is significantly above the margin of error it is more likely that the CTM will be positive. If the ratepayers are to fund the proposed incentives, they should have a reasonable assurance that there will be a positive CTM. Therefore, it is reasonable to set a minimum level of CTM at or above the margin of error. However, PG&E has provided no forecast of the CTM it believes the incentives are likely to produce or the likely margin of error in its estimates.

As discussed previously, PG&E's proposal does not address administrative costs or reasonableness review costs. The existence of such costs will reduce any CTM generated by PG&E's proposal and supports the need for a threshold CTM.

Overall, we find a threshold CTM necessary. However, PG&E has not proposed one and the record is insufficient to determine what it should be.

## **10. Whether PG&E's Shareholders Should Contribute to Program Costs**

### **10.1. Positions of Parties**

PG&E states that its shareholders do not benefit from the proposal. Rather, they are given an opportunity to invest. Additionally, PG&E says that the risk of disallowances will provide a check on PG&E's actions.

DRA states that shareholders should not be required to contribute, but there must be some assurance that the CTM will remain positive for a reasonable period of time.

TURN states that while it would be fair for shareholders to contribute, it does not recommend doing so because it would be difficult to manage and track.

CCSF states that since shareholders would benefit from the incentives, they should share in the costs.

Hercules argues that, rather than requiring shareholders to contribute, the public interest would be better served by requiring shareholders to improve the quality of service or decrease the cost to ratepayers of expensive corporate perks.

MID says PG&E's shareholders should pay for 25% of the costs of the proposal because they will benefit from it.

### **10.2. Discussion**

PG&E justifies its incentive proposal by saying that incentives will only be offered if they would provide a positive CTM when analyzed for a 30-year period. There is a risk, particularly when forecasting costs and benefits 30 years into the future, that the forecast could be wrong. In addition, the forecast NPV of the CTM could be as low as \$1 for any individual project. Thus, the proposed incentives would impose a risk on ratepayers.

Shareholders will benefit from the incentives because they will have the opportunity to earn a return on their capital investment made to serve the resulting new customers. There is some risk to shareholders regarding the return on investment. However, their risk is not directly associated with whether the incentives generate a positive CTM. In addition, the record does not indicate that the risk faced by shareholders due to the incentives is as great as the risk faced by ratepayers.

One way to reduce the risk to ratepayers, in addition to or instead of a threshold CTM as discussed previously, would be to have shareholders bear some of the costs. CCSF and MID both propose that if the application is approved, shareholders bear some of the costs. Only MID makes a specific recommendation of 25% of the cost of the incentive. However, neither CCSF or MID propose how the sharing would be implemented. Therefore, although having shareholders bear some of the costs associated with the incentives merits consideration as a reasonable way to lessen the risk on ratepayers, the record is not sufficient for us to do so.

## **11. Administration Issues**

### **11.1. Affidavit Requirement**

#### **11.1.1. Positions of Parties**

PG&E's original proposal included a requirement for a letter from the applicant rather than an affidavit. PG&E states that, based on concerns raised by parties during hearings, it will require a sworn affidavit. However, PG&E proposes that the affidavit requirement not require the applicant to provide a written POU offer because the POUs are not required to put their offers in writing. PG&E also states that requiring a written offer would undermine the utility of its proposal.

TURN recommends use of a sworn affidavit if the proposal is approved.

Hercules states that if the developer's request is based on the POU's tariffs or a written offer, the affidavit should require that the documents be attached to the affidavit so that the claim can be verified. Hercules recommends that all bona fide offers be in writing, and that if verbal offers are allowed they should be fully described in the affidavit including the name of the person providing the offer and the date on which the offer was made. Hercules also states that its recommendations would facilitate the reasonableness review. Hercules represents that, for an offer from Hercules to be a bona fide offer, it would have to be in writing.

MID states that any bona fide offer should be in writing, and attached to the affidavit. MID asserts that, for an offer to be bona fide, it should specify the allowances and costs applicable to the specific development or premises.

MID states that PG&E should specify exactly what information must be included in the affidavit, but has not done so.

#### **11.1.2. Discussion**

PG&E proposes to offer an incentive when the POU's standard tariff amount or a bona fide line extension offer from the POU, that is different from the POU's tariffs, exceeds PG&E's tariff offering. If the POU's offer is based on the POU's tariffs, they are a matter of public record and readily available to PG&E and intervenors to evaluate the reasonableness of the incentive. However, when the POU's offer is different from its tariffs something else is needed.

The parties agree that the developer should provide a sworn affidavit indicating that a bona fide offer has been made by the POU, and this requirement appears reasonable. However, the parties disagree as to what

constitutes a bona fide offer and whether a copy of the POU's written offer should be included as part of the affidavit.

Under PG&E's proposal, the incentive contract would be subject to a reasonableness review. Key elements of the review are determining whether a bona fide POU offer was made and whether PG&E's offer matched, but did not exceed, the POU offer. A copy of the POU's written offer is the best evidence that the offer is bona fide. It is also the best evidence of the details of the offer. Therefore, in the case of a written offer from a POU that is different from its tariffs, a copy of the written POU offer should be required.

In support of its proposal that the affidavit not be required to include a copy of a written POU offer whether one was provided to the applicant or not, PG&E alleges that some bona fide POU offers are verbal. In that case, there would be no written document to include in the affidavit. The record does not indicate how many POU offers are verbal. However, if the applicant wants to qualify for an incentive, we see no reason why the applicant could not request a written offer from the POU. More importantly, without such a document, the applicant's representation of the POU offer could not be verified by PG&E in administering the program or by the Commission and parties in the reasonableness review. Thus, PG&E's proposal that the applicant should not be required to obtain a written offer from the POU and include a copy of it with the affidavit is unreasonable.

According to PG&E, requiring a copy of a written offer would adversely affect the utility of the program. This means that the incentive program would attract fewer developers and provide less CTM. This tends to support denial of the application. If the requirement is not imposed, the reasonableness review would likely be more controversial, complex and expensive to implement

because of the increased difficulty of verifying the POU's offer, especially if it is not in writing. Since this would make the proposal less practical to implement and decrease the resulting CTM, it too tends to support denial of the application.

## **11.2. Compliance Period**

### **11.2.1. Positions of Parties**

PG&E states that the developers are currently allowed six months to connect residential developments to PG&E (12 months for non-residential developments). After the compliance period, the developer would be subjected to deficiency billing for the portion of the development that is not connected. Under PG&E's proposal, PG&E would have the discretion to allow developers up to five years to connect. PG&E would base the compliance period for each developer on considerations such as the size of the development, the geographic area, the characteristics of the development, how quickly homes are being built in the area, and the overall financial value of the line extension contract. PG&E represents that POU's do not do deficiency billing.

TURN states that PG&E does not consider the lag between revenues and costs in its CTM calculation when the compliance period is extended for up to five years.

Hercules states that PG&E has not stated whether it intends to match or exceed the POU's compliance period. Hercules also represents that PG&E has not demonstrated that it needs the ability to offer an extended compliance period in order to match the POU's offer.

MID states that PG&E has not proven that it needs the compliance period to be up to five years. MID says that if the Commission approves PG&E's request, it should require some minimum number of homes or premises to be

connected each year so that ratepayers would at least see some return on their investment.

NCPA states that PG&E has not developed the procedures necessary to implement its proposal.

### **11.2.2. Discussion**

PG&E proposes that it be allowed to extend the compliance period up to five years. The length of the compliance period, relative to the POU compliance period, would have a value to the applicant that is relevant to ascertaining whether PG&E's offer matches, but does not exceed the POU's offer. One way to address this is to calculate the dollar value to the applicant of any differences in the compliance period. PG&E has provided no information explaining how its proposed extended compliance period compares to the compliance periods offered by the POU's or how to value any difference between PG&E's and the POU's compliance periods. The fact that PG&E does deficiency billing and the POU's do not also has value. However, PG&E has not addressed how deficiency billing should be valued. Thus, PG&E has not proposed a means of assigning a dollar value to any difference in compliance periods or the absence of deficiency billing by the POU's. In addition, PG&E has proposed no other means of considering differences in the compliance period or the absence of deficiency billing in assessing whether PG&E's offer meets but does not exceed the POU's offer. Thus, we would not be able to ascertain the reasonableness of PG&E's offer.

If the compliance period is extended beyond the present requirements, there will be a longer period of time before any positive CTM is realized. Since the uncertainty of an estimate increases as it goes farther out into the future, the risk that the development will not provide a positive CTM will increase. This

tends to support the need for a threshold CTM and/or a contribution by shareholders to the cost of the incentives to reduce ratepayer risk.

### **11.3. Administrative Discretion**

#### **11.3.1. Positions of Parties**

PG&E requests authority to use its discretion regarding the time period allowed the developer to connect the development to PG&E's system, and whether to make an offer. PG&E represents that it would support establishment of detailed implementation guidelines (through workshops or otherwise) to flesh out any remaining clarifying criteria that may be appropriate. The workshops would take place after this application is approved.

CCSF states that PG&E's intent to offer the incentive selectively, especially since it has not established criteria for doing so, constitutes undue discrimination among developers.

NCPA states that PG&E has not developed the procedures necessary to implement its proposal.

#### **11.3.2. Discussion**

PG&E does not propose to offer the incentive as a standard tariff offering to qualified applicants. Instead it requests authority to use its discretion regarding the time period allowed the developer to connect the development to its system.

PG&E's request for discretion regarding what compliance period to offer the applicant raises the possibility of similarly situated applicants being treated differently. PG&E has not explained in any detail what criteria it would use in determining what compliance period to offer an applicant. Therefore, we cannot determine whether offering different compliance periods to similarly situated applicants would constitute unreasonable discrimination.

PG&E also requests authority to use its discretion in determining whether to offer the incentive when PG&E has reason to believe the offer should not be made even though the customer otherwise meets the eligibility criteria.

If an applicant is not qualified for an incentive, the incentive should not be offered. However, when an applicant is qualified for an incentive, then there are at least two likely reasons not to offer it. One reason would be that there is reason to believe the applicant will not accept the offer. In that case, there would be no harm in offering the incentive anyway because there is always the possibility that the applicant will accept it.

Another possibility is that the applicant is likely to take service from PG&E even without the incentive. Logically, if an applicant is eligible to receive an incentive, but will take service with PG&E even without the incentive, the incentive would generate costs without benefits thus reducing the overall CTM provided by the incentive proposal. Therefore, existing customers would be better off if the incentive is not offered. However, this would likely mean that similarly situated applicants would be treated differently.

PG&E has not explained in any detail what criteria it would use in determining not to offer the incentive to an applicant who appears eligible. While we can speculate on possible reasons, we do not know with any specificity what PG&E has in mind. PG&E's request raises the possibility of similarly situated applicants being treated differently. Thus, we cannot determine whether not offering the incentive would constitute unreasonable discrimination.

PG&E has expressed its willingness to hold workshops after its application is approved to flesh out the criteria it would use in exercising its requested discretion. However, this is unreasonable for several reasons. First, without knowing PG&E's criteria in at least some detail, we can not determine whether

its proposal could lead to unreasonable discrimination and we will not authorize a proposal that could do so. In addition, unless such a workshop results in agreement by all the parties, which we believe unlikely, further hearings would be necessary before the proposal could be implemented.

Overall, PG&E has not justified its request for discretion.

The above analysis points out the possibility that there may be some applicants who would qualify for the incentive, but would take service from PG&E without the incentive or should not be offered the incentive or extended compliance period for other reasons. Offering the incentive in such instances would incur costs with diminished or no corresponding benefits thus reducing the overall CTM provided by the proposal. PG&E has not addressed these possibilities in its CTM calculation and it is unclear whether its request for discretion could eliminate the possibility without unreasonable discrimination. This tends to support the need for a threshold CTM or denial of the application.

## **12. Issues Related to After-the-Fact Reasonableness Review**

### **12.1. Proceeding in Which the Review Should Take Place**

#### **12.1.1. Positions of Parties**

PG&E recommends conducting the review as part of the annual ERRA proceeding because it would be more efficient than establishing a separate proceeding, and would ensure that the review will take place.

DRA recommends that the review take place in a successor proceeding to the annual Revenue Adjustment Proceeding (RAP), and not in the ERRA proceeding because that proceeding already has a significant number of issues to address in a short period of time.

MID states that the review should not take place during the ERRA proceeding because that proceeding already has a significant number of issues to address in a short period of time. MID recommends a separate proceeding for reasonableness reviews.

### **12.1.2. Discussion**

The ERRA proceeding has a significant number of issues and a limited time frame. An annual reasonableness review would entail a separate review of the incentive for each development and the dollar value of the incentives would likely be far less than the value to ratepayers of the issues addressed in the ERRA proceeding. Thus, inclusion of the reasonableness review in the ERRA proceeding would either reduce the parties' ability to address the issues already in the ERRA proceeding, or result in the parties paying little attention to the reasonableness review. Since neither of these outcomes is desirable, the reasonableness review should not be conducted in the ERRA proceeding. Since there is no other available proceeding, the reasonableness review would have to be conducted in a separate proceeding.

As discussed previously, a reasonableness review proceeding would likely be controversial and complex even though it would address relatively small amounts of money. Thus, the reasonableness review could be costly to the Commission, PG&E and the other parties and a drain on their resources. The record does not demonstrate that initiation of such proceedings would be the best use of the parties or the Commission's resources. These facts tend to support denial of the application.

## **12.2. Consequences of a Finding of Unreasonableness**

### **12.2.1. Positions of Parties**

PG&E states that, if the Commission were to find that an incentive was warranted but PG&E had paid too large an incentive, its shareholders will be responsible for any portions of the incentive the Commission finds unreasonable. PG&E proposes that any disallowed amount would be subject to interest at an appropriate rate.

PG&E states that shareholders would be responsible for the entire amount of the incentive if the Commission were to find that no incentive should have been offered. In addition, if the development has not been connected to PG&E by the end of the compliance period, the applicant would be entitled to reconsider whether it wants to connect with PG&E under PG&E's standard tariffs or with the POU.

DRA states that the shareholders should fund any negative CTM.

TURN agrees with PG&E that PG&E should pay the excessive incentive amount. TURN also agrees that PG&E should pay the entire amount of the incentive if no incentive should have been offered.

CCSF says PG&E's proposal, that the unreasonable incentive amount would be disallowed, is insufficient and would merely be viewed by PG&E as a cost of gaining new customers and would not discourage PG&E from acting unreasonably.

Hercules states that if the excessive incentive is due to a misrepresentation by the developer in the affidavit, PG&E should be required to pursue collection against the developer.

Hercules recommends that, if an excessive amount of incentive was negligently or willfully offered by PG&E, or the incentive should not have been offered at all, the incentive should be recovered from the developer in the same manner as a billing error by PG&E. Hercules also recommends that the applicant have the option of rescinding the line extension agreement, taking service from the POU, and receiving a full refund of the amounts paid to PG&E for the line extension. Hercules recommends shareholders pay for any refunds. Additionally, Hercules represents that PG&E should be barred from earning a return on the facilities installed because of the improper incentive.

MID states that any disallowance should include interest at 10% per year.

MID states that, if PG&E or the developer is at fault, they should be penalized and any issue regarding perjury would be addressed by the courts. MID also recommends that the developer should not be allowed more than the tariffed compliance period.

MID recommends, in the event the incentive should not have been offered at all, the customer or developer should have the ability to take POU service immediately as opposed to at the end of the contract term. If a resulting customer is already connected to PG&E, that customer should have the option of taking service from the POU as if the customer was never connected to PG&E.

NCPA states that PG&E has made no showing as to how customers would be made whole if the incentive was improperly offered.

### **12.2.2. Discussion**

If the incentive should have been offered, but in a lower amount, PG&E proposes that the excess incentive be paid by its shareholders. Under this proposal, if the development provides a positive contribution to margin, the

ratepayers would be made whole by PG&E's shareholders paying the excess incentive.

If the incentive should not have been offered at all, PG&E's shareholders should pay for it as recommended by PG&E. However, because the incentive was offered, PG&E may be serving new customers who provide a negative CTM and who otherwise would have taken service from the POU rather than PG&E. Therefore, existing ratepayers could be worse off. However, PG&E has not addressed this possibility or proposed a way to do so.

Under PG&E's proposal, if the incentive should not have been offered and the development has not been connected to PG&E by the end of the compliance period, the applicant would be entitled to reconsider whether it wants to connect with PG&E under PG&E's standard tariffs or with the POU. The reasonableness review would take place in the year following contract signing, but the compliance period could be as long as five years after signing. As a result, the applicant could be bound by the contract for as many as four years after it has been found unreasonable. PG&E has not justified this proposal and we find it unreasonable.

In either of the above instances of PG&E offering an inappropriate incentive, if PG&E's error was intentional or part of a pattern indicating negligence, the Commission would have to consider a penalty to deter further transgressions. Consideration of a penalty would make the reasonableness review more complex, controversial and costly.

If the error is due to a misrepresentation by the applicant and PG&E was not at fault, there is no reason ratepayers should indemnify shareholders for such costs. As a result, PG&E shareholders should still be responsible for any

resulting costs as if PG&E were at fault. PG&E could seek cost recovery from the applicant through the courts, at shareholder expense, if it chooses to do so.

Overall, PG&E has not demonstrated that its proposal regarding the consequences of a finding of unreasonableness appropriately addresses the range of possible outcomes. In addition, the record is insufficient to remedy the shortcomings of PG&E's proposal. Thus its proposal regarding findings of unreasonableness is not practical to implement.

### **13. Backbone-Only Electric Main Line Extensions**

PG&E describes its proposal for backbone-only electric main line extensions as follows:

For backbone-only electric main line extension jobs, where no services are added by the developer, PG&E would not apply any allowance but rather, calculate a project-specific new load incentive. Under this situation, the developer would be required to sign an agreement ensuring that new services in the development would be connected to PG&E's distribution system for the period of years required to justify the new load incentive. In no case would the period of years to justify the new load incentive exceed five years. The project-specific backbone new load incentive would be adjusted, as necessary, to ensure that the revenue to be gained from the development exceeds the marginal cost of providing service to the development.<sup>19</sup>

#### **13.1. Discussion**

The backbone-only services would have no specific new load associated with them. Instead, the developer would have to sign an agreement that new services would have to be connected within five years and would have to justify the incentive within the same five years. Since the developer in this instance

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<sup>19</sup> Exhibit PG&E-1, pages 1-16 and 1-17.

would not be adding new services, it is unclear how PG&E could determine whether the developer would be able to meet its commitment or how the reasonableness of the incentive could be evaluated. It is also unclear whether the applicant's commitment means that the new load would have to be sufficient to pay for the incentives within the first five years or that sufficient new load would be connected within five years to provide a positive CTM over a 30-year period. Overall, PG&E has not explained how this incentive would work in sufficient detail for us to evaluate. Therefore, PG&E has not demonstrated that provision of incentives for backbone-only services is reasonable.

#### **14. Public Utilities Code Section 783**

Section 783 addresses Commission consideration of a decision amending rules governing the extension of services provided by an electric or gas corporation to new customers. It requires the Commission, with the assistance of various other state agencies, to make written findings on seven issues specified therein. The issues address the effect of the rule change on various types of customers, employment, residential and non-residential development and redevelopment, and energy consumption and conservation. Section 783 also provides that the decision shall take effect on July 1 of the year following its adoption.

##### **14.1. Positions of Parties**

PG&E states that, since it does not seek to amend its existing Rules 15 and 16, but seeks authority under the exceptional case provisions of those rules, § 783 does not apply.

TURN states that § 783 applies because PG&E's proposal is a change to Rules 15 and 16 that could result in ratepayers paying for non-refundable line

extension costs that were previously paid by the applicant for the line extension under the current Rules 15 and 16.

CCSF states that § 783 applies to this application because PG&E's proposal is a change to Rules 15 and 16 that are intended to apply on a case-by-case basis.

MID says the exceptional cases provisions of Rules 15 and 16 are normally meant to apply to single special circumstance transactions and not to a general set of circumstances. MID argues that this application is not merely designed to give effect to periodic review of provisions of existing rules. MID also points out that this application is unprecedented. MID (referring to TURN's brief) states that PG&E's proposal is a change to Rules 15 and 16 because it could result in ratepayers paying for non-refundable line extension costs that were previously paid by the applicant. For these reasons MID states that § 783 applies to this application.

NCPA states that by amending the agreements that underlie Rules 15 and 16, PG&E is requesting a major change to those rules.

#### **14.2. Discussion**

PG&E's Electric Rule 15.I.3 states:

"When the application of this rule appears impractical or unjust to either party, or ratepayers, PG&E or Applicant may refer the matter to the Commission for a special ruling or for approval of special condition(s) which may be mutually agreed upon."<sup>20</sup>

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<sup>20</sup> Electric Rule 16.G has the same language except for a difference in punctuation that has no effect on the meaning.

The above language refers to a single "Applicant." Rule 15.J and Rule 16.H define "Applicant" as follows:

APPLICANT: A person or agency requesting PG&E to supply electric service.

Thus the term "Applicant" is singular.

From the above language, we conclude that the exceptional case provisions of Rules 15 and 16 apply to a single contract between PG&E and a single person or agency. Thus, each such contract involving an exceptional case would be viewed separately. PG&E's proposal would involve an unspecified number of future contracts each of which is likely to have a different incentive and may have a different compliance period. Thus, we find PG&E's proposal does not fall within the exceptional case provisions of Rules 15 and 16. If we were to grant PG&E's application, it would require a change to PG&E's rules, triggering § 783.

#### **15. Comments on Proposed Decision**

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed by PG&E on November 26, 2007, and reply comments were filed on December 3, 2007, by DRA, TURN, MID, CCSF, and NCPA. All comments were considered.

#### **16. Assignment of Proceeding**

Dian M. Grueneich is the assigned Commissioner and Jeffrey P. O'Donnell is the assigned ALJ in this proceeding.

### **Findings of Fact**

1. Since there is no significant need for the incentive proposal and the incentives would likely disadvantage some new customers, it would not be good public policy to grant PG&E's application.

2. PG&E's proposal is not practical to implement.

3. PG&E's Rules 15.I.3 and 16.G (exceptional case) provide that when application of the rule appears impractical or unjust to either party (PG&E or the applicant) or the ratepayers, PG&E or the applicant may refer the matter to the Commission for a special ruling or for special conditions which may be mutually agreed upon that allow PG&E to deviate from its standard line extension requirements.

4. PG&E has provided no estimate of the amount of revenues it will fail to obtain in future years due to developers choosing a POU over PG&E or the revenues it will gain if this application is approved.

5. The amount of revenues from customers PG&E claims to have failed to obtain over the last few years amounts to 0.17% of its total annual revenues.

6. The record does not indicate the exact number of years over which the 0.17% loss of revenues occurred but it appears to be between 2001 and 2005, or about 0.034% per year.

7. If the potential for developers to choose a POU over PG&E remains at 0.034% of revenues per year, and the incentive proposal would allow PG&E to attract all new developments that could choose a POU, it would take approximately 29 years for the incentives to have a 1% effect on PG&E's annual revenues.

8. If the potential for developers to choose a POU over PG&E is 0.05% of revenues per year, and the incentive proposal would allow PG&E to attract all

new developments that could choose a POU, it would take approximately 20 years for the incentives to have a 1% effect on PG&E's annual revenues.

9. PG&E does not claim that the incentives would capture all new developments.

10. If the potential for developers to choose a POU over PG&E is 0.034%-0.05% of revenues per year, and the incentive proposal would allow PG&E to attract half of the new developments that could choose a POU, it would take approximately 40-58 years to have a 1% effect on PG&E's revenues.

11. If the potential for developers to choose a POU over PG&E is 0.034%-0.05% of revenues per year, the incentive proposal would allow PG&E to attract half of the new developments that could choose a POU, the CTM per customer from the customers the incentive is intended to attract is the same as from existing customers and a change in revenues would result in the same percentage change in CTM, it would take approximately 40-58 years to have a 1% effect on PG&E's CTM.

12. The record does not indicate that the lack of the incentives would have a significant adverse effect on revenues or CTM, or that the incentives would have a significant positive effect.

13. PG&E has not addressed whether improvements to the 50% nonrefundable discount option or its promotion could reduce or eliminate the alleged need for its incentive proposal.

14. PG&E has not addressed whether improvements to third party installation or its promotion could reduce or eliminate the alleged need for its incentive proposal.

15. The record demonstrates that service to developers is an important factor in competing with the POUs.

16. The record contains some anecdotal evidence indicating that at least some developers have been dissatisfied with PG&E's service and that PG&E intends to improve such service.

17. PG&E has not addressed the degree to which service to developers can be improved, and to what degree such improvement could reduce or eliminate the alleged need for PG&E's incentive proposal.

18. The record demonstrates that PG&E and the POUs have different advantages and disadvantages over each other but PG&E has not provided evidence that quantifies or otherwise demonstrates that POUs have a significant overall net advantage over PG&E.

19. The record does not support PG&E's claim that incentives are necessary to overcome any significant advantage held by the POUs.

20. PG&E has not provided evidence that demonstrates that the delay it may encounter in obtaining the Commission's approval of a tariff deviation is significantly greater than the delay the POU may encounter.

21. PG&E has not demonstrated that any difference in the delay it or a POU may encounter in obtaining approval of a deviation from its tariffs has been a significant factor in developers choosing the POU rather than PG&E.

22. In D.92-11-052, the Commission stated "Bypass is uneconomic when a customer leaves the utility system even though its cost to bypass is more than the marginal cost of utility service."

23. The term uneconomic bypass applies to the loss of an existing customer.

24. D.92-11-052 pertained to rate discounts for the transportation of natural gas.

25. D.92-11-052 stated "Discounts to prevent uneconomic bypass can attract or retain incremental load which would otherwise be lost, and thus help to keep

other rates down.” This means that discounts intended to deter uneconomic bypass could also have the effect of attracting incremental load.

26. In this case, the developer makes the decision about whether to take service from PG&E, but the developer is not ultimately the customer.

27. PG&E’s application does not address the costs to the new customer to bypass.

28. PG&E has not done the necessary analysis to demonstrate that new customers being served by a POU rather than PG&E constitute uneconomic bypass.

29. The Commission’s statement in D.92-11-052 that “Bypass should only be prevented if it is uneconomic” means that rate discounts should not be offered in the case of economic bypass, which occurs when the customer’s cost to bypass is less than the utility’s marginal cost to provide service.

30. If we were to accept PG&E’s claim that developers choosing a POU over PG&E could fit within the definition of uneconomic bypass, there could be economic bypass in such circumstances.

31. If we were to accept PG&E’s claim that developers choosing a POU over PG&E could fit within the definition of uneconomic bypass, PG&E has not done the necessary analysis to demonstrate that new customers being served by a POU rather than PG&E would not constitute economic bypass.

32. PG&E has not demonstrated that this application addresses uneconomic bypass.

33. Since PG&E has not demonstrated that its proposal will have a significant positive effect on CTM or rates, that it is effectively using other tools available to it to compete with POUs, that POUs have significant advantages over PG&E, or

that its proposal will reduce uneconomic bypass, it has not demonstrated a need for its proposed incentives.

34. New customers would not usually be the recipients of the incentives, but would be the ratepayers that provide the CTM necessary to justify the proposed incentives.

35. The incentives would be given primarily to developers.

36. The RIM test is generally used for evaluating load building programs.

37. Since most load building programs offer an incentive to the customer and the customer can choose whether to participate in the program, a customer who chooses to participate can be assumed to benefit from the program.

38. The RIM test calculates the effect of the program on ratepayers who pay for the program through rates, but do not participate in the program.

39. Since PG&E's proposed incentive would usually be paid to the developer and not the new customer, the new customer can not be assumed to benefit from PG&E's proposal.

40. While the RIM test is appropriate for determining the effect on the existing ratepayers, it does not address the effect on the new customers.

41. The TRC test determines the effect on existing and new customers in the aggregate and could indicate that the program is beneficial to customers as a whole, even though new customers could be worse off.

42. D.82-04-069 stated that "any request or proposal which ostensibly promotes the benefit of the majority at the expense of a minority interest requires substantial justification."

43. The TRC test, since it aggregates new and existing customers, does not justify promoting the benefit of the majority at the expense of a minority interest.

44. PG&E has presented no analysis or quantification of the effect of the incentives on new customers or existing customers.

45. PG&E has not shown how modest the effect of its proposal on new customers would be or how substantial the effect on existing customers would be.

46. The record shows that in many cases the POU's rates are lower than PG&E's rates and, in some cases quite a bit lower.

47. The adverse effect of PG&E's proposal on some new customers may not be minimal and could be substantial.

48. PG&E has not demonstrated that it would be good policy to disadvantage some new customers to achieve a minimal advantage to existing customers.

49. If we were to grant the application, additional issues regarding the CTM calculation would have to be addressed.

50. The fact that we do not address additional issues regarding the CTM calculation in this decision does not mean that we would make no changes to the incentive calculation or the inputs thereto if we were to grant the application, or that further analysis would not reveal additional reasons to deny it.

51. In PG&E's 2007 GRC (D.07-09-004), the Commission adopted a settlement.

52. Settlements are not generally intended to constitute a precedent regarding any principal or issue for use in any other proceeding.

53. One of the agreed-upon purposes of the marginal costs adopted in the settlement is for establishing "customer-specific contract rate floors for customer retention and attraction."

54. In this proceeding we are not dealing with rates, much less rate floors, and the incentive would primarily be offered to developers who are not customers.

55. The record does not indicate that the marginal costs adopted in the 2007 GRC settlement were intended by the parties to the settlement or the Commission for use in this proceeding or in calculating incentives.

56. Marginal costs would be a potential issue in the reasonableness review that could add significantly more controversy and complexity to the reasonableness review.

57. The PPP revenue requirement is determined in GRC's, and does not change until the next GRC.

58. PPP costs may not be reflected in rates until the first GRC after the incentive is awarded.

59. In subsequent GRCs, PPP costs would be included in the historical costs on which the GRC forecasts would be based and would be recognized in the rates resulting from the subsequent GRC.

60. PPP costs should be included in the CTM calculation and PG&E has not done so.

61. The record does not indicate how to include PPP costs in the CTM calculation.

62. PG&E's assumption that costs and revenues will remain static over the 30-year period would tend to understate the CTM if both escalate at the same rate.

63. The record does not demonstrate how revenues and marginal costs have escalated historically or how they will do so in the future.

64. PG&E's assumption that costs and revenues will remain static over the 30-year period has not been shown to be reasonable or to understate the CTM.

65. At least some single family homes and multi-family homes will likely be rented over the 30-year CTM analysis period to customers who qualify for the CARE program.

66. PG&E's CTM calculation does not address the possibility that there will be CARE customers later in the 30-year analysis period.

67. The record does not reflect how sizable CARE participation will be.

68. Since the incentive calculations would be specific to each development, CARE participation would have to be addressed in the reasonableness review adding to the complexity of such proceedings.

69. Since PG&E's proposal will have to be administered, there will be administrative costs and reasonableness review costs.

70. Costs related to determining whether the applicant qualifies for the incentive and whether PG&E will offer the incentive have been charged to Account 912, which has not been funded by the Commission in a number of GRCs.

71. PG&E's exhibits do not address administrative costs.

72. The record does not indicate whether the revenue requirement adopted in PG&E's 2007 GRC excluded Account 912 costs or whether all costs related to administration of the proposal would be charged to Account 912.

73. PG&E has not proposed in this proceeding that administration costs related to this proposal, whether charged to Account 912 or not, be born exclusively by shareholders in the future.

74. PG&E has not demonstrated that there would be no administrative costs that should be included in the CTM calculation.

75. Since the Commission's reasonableness review costs, at least part of PG&E's costs and costs incurred by intervenors eligible for intervenor

compensation are recovered from ratepayers, reasonableness review costs would be paid, at least in part, by PG&E's ratepayers.

76. Reasonableness review costs will reduce any CTM generated by the incentives.

77. PG&E has provided no estimate of reasonableness review costs and does not include them in its CTM calculation or otherwise in its proposal.

78. Without a reasonable CTM calculation, the proposed incentive program can not be implemented.

79. PG&E's proposal could provide an incentive for a development that would be estimated to produce a CTM as low as \$1 over a 30-year period.

80. With a CTM as low as \$1, existing ratepayers would essentially break even over a 30-year period and there would be no reason to offer the incentive and assume the attendant risk that a negative CTM will result.

81. In any forecast of costs and revenues going 30 years into the future, there is a significant margin of error.

82. If a CTM estimate falls within the margin of error it essentially means that there is no real certainty that a positive CTM will be realized.

83. If the estimated CTM is significantly above the margin of error it is more likely that the CTM will be positive.

84. PG&E has provided no forecast of the CTM it believes the incentives are likely to produce or the likely margin of error in its estimates.

85. The existence of administrative and reasonableness review costs will reduce any CTM generated by PG&E's proposal and supports the need for a threshold CTM.

86. PG&E has not proposed a threshold CTM and the record is insufficient to determine what it should be.

87. Since there is a risk, particularly when forecasting costs and benefits 30 years into the future, that PG&E's forecast CTM could be wrong, and PG&E's forecast NPV of the CTM could be as low as \$1 for any individual project, the proposed incentives impose a risk on ratepayers.

88. Shareholders will benefit from the incentives because they will have the opportunity to earn a return on their capital investment made to serve the resulting new customers.

89. There is some risk to shareholders regarding the return on investment, but their risk is not directly associated with whether the incentives generate a positive CTM.

90. The record does not indicate that the risk faced by shareholders due to the incentives is as great as the risk faced by ratepayers.

91. One way to reduce the risk to ratepayers, in addition to or instead of a threshold CTM, would be to have shareholders bear some of the incentive program costs.

92. Although having shareholders bear some of the costs associated with the incentives merits consideration as a reasonable way to lessen the risk on ratepayers, the record is not sufficient for us to do so.

93. Key elements of the reasonableness review are determining whether a bona fide POU offer was made and whether PG&E's offer matched, but did not exceed, the POU offer.

94. A copy of the POU's written offer is the best evidence that an offer is bona fide and is also the best evidence of the details of the offer.

95. If a bona fide POU offer is verbal, there would be no written document to include in the affidavit.

96. The record does not indicate how many POU offers are verbal.

97. Without a written offer from the POU, the applicant's representation of the POU offer could not be verified by PG&E in administering the program or by the Commission and parties in the reasonableness review.

98. PG&E's representation that requiring a copy of a written offer would adversely affect the utility of the program means that the incentive program would attract fewer developers and provide less CTM, which tends to support denial of the application.

99. If the written offer requirement is not imposed, the reasonableness review would likely be more controversial, complex and expensive to implement because of the increased difficulty of verifying the POU's offer, especially if it is not in writing.

100. PG&E's proposal not to require a written offer would make the proposal less practical to implement, decrease the resulting CTM, and tends to support denial of the application.

101. The length of PG&E's compliance period, relative to the POU compliance period, would have a value to the applicant that is relevant to ascertaining whether PG&E's offer matches, but does not exceed the POU's offer.

102. PG&E has provided no information explaining how its proposed extended compliance period compares to the compliance periods offered by the POU's or how to value any difference between PG&E's and the POU's compliance periods.

103. The fact that PG&E does deficiency billing, and the POU's do not, has value.

104. PG&E has not addressed how deficiency billing should be valued.

105. PG&E has not proposed a means of assigning a dollar value to any difference in compliance periods or the absence of deficiency billing by the POU's or any other means of considering differences in the compliance period or the

absence of deficiency billing by POU's in assessing whether PG&E's offer meets but does not exceed the POU's offer.

106. Without a means of valuing any difference in compliance periods or the absence of deficiency billing by the POU's, we would not be able to ascertain the reasonableness of PG&E's offer.

107. If the compliance period is extended beyond the present requirements, there will be a longer period of time before any positive CTM is realized.

108. The uncertainty of PG&E's CTM estimate increases as the compliance period goes farther out into the future.

109. The risk that the development will not provide a positive CTM will increase as the compliance period is increased, which tends to support the need for a threshold CTM and/or a contribution by shareholders to the cost of the incentives to reduce ratepayer risk.

110. PG&E does not propose to offer the incentive as a standard tariff offering to qualified applicants.

111. PG&E's request for discretion regarding what compliance period to offer the applicant raises the possibility of similarly situated applicants being treated differently.

112. Since PG&E has not explained in any detail what criteria it would use in determining what compliance period to offer an applicant, we can not determine whether offering different compliance periods to similarly situated applicants would constitute unreasonable discrimination.

113. PG&E's request for discretion regarding whether to offer the incentive to an applicant who appears eligible raises the possibility of similarly situated applicants being treated differently.

114. Since PG&E has not explained in any detail what criteria it would use in determining not to offer the incentive to an applicant who appears eligible, we can not determine whether not offering the incentive would constitute unreasonable discrimination.

115. Offering the incentive to applicants who would qualify for the incentive, but would take service from PG&E without the incentive, or should not be offered the incentive or extended compliance period for other reasons, would incur costs with diminished or no corresponding benefits thus reducing the overall CTM provided by the proposal.

116. PG&E has not addressed the possibility that there may be applicants who would qualify for the incentive, but would take service from PG&E without the incentive, or should not be offered the incentive or extended compliance period for other reasons.

117. The ERRA proceeding has a significant number of issues and a limited time frame.

118. An annual reasonableness review would entail a separate review of the incentive for each development and the dollar value of the incentives would likely be far less than the value to ratepayers of the issues addressed in the ERRA proceeding.

119. Since inclusion of the reasonableness review in the ERRA proceeding would either reduce the parties' ability to address the issues already in the ERRA proceeding, or result in the parties paying little attention to the reasonableness review, the reasonableness review should not be conducted in the ERRA proceeding.

120. Since there is no other available proceeding to include the reasonableness review in, the reasonableness review would have to be conducted in a separate proceeding.

121. A reasonableness review proceeding would likely be controversial and complex even though it would address relatively small amounts of money.

122. A reasonableness review proceeding could be costly to the Commission, PG&E and the other parties and a drain on their resources.

123. The record does not demonstrate that initiation of reasonableness review proceedings would be the best use of the parties' or the Commission's resources.

124. The facts that the reasonableness review would have to be a separate proceeding, would be a drain on parties resources and may not be the best use of the parties' resources tend to support denial of the application.

125. If the incentive should have been offered, but in a lower amount and the development does not provide a negative contribution to margin, the ratepayers would be no worse off if PG&E pays the cost of the excess incentive.

126. PG&E has not proposed a way to make ratepayers whole when the incentive should not have been offered and PG&E ends up serving new customers who provide a negative CTM and who otherwise would likely have taken service from the POU rather than PG&E.

127. Under PG&E's proposal, if the incentive should not have been offered and the development has not been connected to PG&E by the end of the compliance period, the applicant would be entitled to reconsider whether it wants to connect with PG&E under PG&E's standard tariffs or with the POU.

128. Under PG&E's proposal, since the reasonableness review would take place in the year following contract signing, but the compliance period could be as

long as five years after signing, the applicant could be bound by the contract for as many as four years after it has been found unreasonable.

129. PG&E has not justified its proposal that if the incentive should not have been offered and the development has not been connected to PG&E by the end of the compliance period, the applicant would be entitled to reconsider whether it wants to connect with PG&E under PG&E's standard tariffs or with the POU.

130. If PG&E's error in offering an excessive incentive, or offering one when none should have been offered, was intentional or part of a pattern indicating negligence, the Commission would have to consider in the reasonableness review a penalty to deter further transgressions.

131. Consideration of a penalty in a reasonableness review would make the review more complex, controversial and costly.

132. If the error in offering an excessive incentive, or offering one when none should have been offered, is due to a misrepresentation by the applicant and PG&E was not at fault, PG&E could seek cost recovery from the applicant through the courts, at shareholder expense, if it chooses to do so.

133. PG&E has not demonstrated that its proposal regarding the consequences of a finding of unreasonableness appropriately addresses the range of possible outcomes and the record is insufficient to remedy the shortcomings of PG&E's proposal.

134. Since the developer in the case of backbone-only services would not be adding new services, it is unclear how PG&E could determine whether the developer would be able to meet its commitment or how the reasonableness of the incentive could be evaluated.

135. PG&E's proposal for backbone-only services is unclear regarding whether the applicant's commitment means that the new load would have to be sufficient

to pay for the incentives within the first five years or that sufficient new load would be connected within the first five years to provide a positive CTM over a 30-year period.

136. PG&E has not explained how its proposed backbone-only incentive would work in sufficient detail for us to evaluate.

137. Section 783(b) addresses Commission consideration of a decision amending rules governing the extension of services provided by an electric or gas corporation to new customers.

138. Section 783(b) requires the Commission to make written findings on seven issues that address the effect of the rule change on various types of customers, employment, residential and non-residential development and redevelopment, and energy consumption and conservation.

139. Section 783(c) requires the Commission to seek the assistance of various other state agencies, to make the written findings.

140. Section 783(d) provides that a decision amending rules governing the extension of services provided by an electric or gas corporation to new customers shall take effect on July 1 of the year following its adoption.

141. PG&E's Electric Rule 15.I.3 states: "When the application of this rule appears impractical or unjust to either party, or ratepayers, PG&E or Applicant may refer the matter to the Commission for a special ruling or for approval of special condition(s) which may be mutually agreed upon."

142. PG&E's Electric Rule 16.G has the same language as Rule 15.I.3 except for a difference in punctuation that has no effect on its meaning.

143. The Rule 15.I.3 language refers to a single "Applicant."

144. Rule 15.J and Rule 16.H define "Applicant" as: "APPLICANT: A person or agency requesting PG&E to supply electric service."

145. The term "Applicant," as used in Rules 15 and 16, is singular.

146. Each such contract involving an exceptional case would be viewed separately.

147. PG&E's proposal would involve an unspecified number of future contracts each of which is likely to have a different incentive and may have a different compliance period.

### **Conclusions of Law**

1. Because PG&E's proposal would not be good public policy and would not be practical to implement, the application should be denied.

2. Since a significant positive effect on CTM is necessary to have a significant positive effect on rates, we have no reason to believe the incentives would have a significant positive effect on rates.

3. We do not interpret D.92-11-052 to define uneconomic bypass as necessarily including service of new customers by a POU rather than PG&E.

4. The reasonableness of using the marginal costs adopted in the 2007 GRC settlement in calculating CTM is not proven.

5. PG&E's CTM calculation has not been shown to be reasonable.

6. If the ratepayers are to fund the proposed incentives, they should have a reasonable assurance that there will be a positive CTM.

7. It is reasonable to set a threshold CTM at or above the margin of error so that ratepayers will have a reasonable assurance that there will be a positive CTM.

8. PG&E's proposal that the applicant should not be required to obtain a written offer from the POU and include a copy of it with the affidavit is unreasonable.

9. Holding workshops after this application is approved to flesh out the criteria PG&E would use in exercising its requested discretion is unreasonable because we can not determine whether its proposal could lead to unreasonable discrimination and, unless such a workshop results in agreement by all the parties which we believe unlikely, further hearings would be necessary before the proposal could be implemented.

10. PG&E has not justified its request for discretion.

11. If PG&E paid an excessive incentive, PG&E's shareholders should pay for the excess as recommended by PG&E.

12. If the incentive should not have been offered at all, PG&E's shareholders should pay for it as recommended by PG&E.

13. PG&E's proposal that, if the incentive should not have been offered and the development has not been connected to PG&E by the end of the compliance period, the applicant would be entitled to reconsider whether it wants to connect with PG&E under PG&E's standard tariffs or with the POU, is unreasonable.

14. If PG&E's error in offering an excessive incentive, or offering one when none should have been offered, was intentional or part of a pattern indicating negligence, the Commission should consider in the reasonableness review a penalty to deter further transgressions.

15. If the error in offering an excessive incentive, or offering one when none should have been offered, is due to a misrepresentation by the applicant and PG&E was not at fault, there is no reason ratepayers should indemnify shareholders for such costs and PG&E shareholders should still be responsible for any resulting costs as if PG&E were at fault.

16. PG&E's proposal regarding findings of unreasonableness is not practical to implement.

17. PG&E has not demonstrated that provision of incentives for backbone-only services is reasonable.

18. The exceptional case provisions of Rules 15 and 16 apply to a single contract between PG&E and a single person or agency.

19. PG&E's proposal does not fall within the exceptional case provisions of Rules 15 and 16.

20. If we were to grant PG&E's application, it would require a change to PG&E's rules, triggering § 783.

21. This decision should be effective immediately.

## **O R D E R**

**IT IS ORDERED** that:

1. Application 06-07-027 is denied.
2. Application 06-07-027 is closed.
3. This order is effective today.

Dated December 6, 2007, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
DIAN M. GRUENEICH  
JOHN A. BOHN  
RACHELLE B. CHONG  
TIMOTHY ALAN SIMON  
Commissioners

**ATTACHMENT A**  
**LIST OF ACRONYMS**

Acronym	Name
A&G	administrative and general
CARE	California Alternative Rates for Energy
CCSF	City and County of San Francisco
COO charge	cost of ownership charge
COS factor	cost of service factor
CTM	contribution to margin
D.	Decision
DRA	Division of Ratepayer Advocates
ERRA	Energy Resource Recovery Account
FF&U	franchise fees and uncollectibles
GRC	general rate case
ITCC	Income Tax Component of Contributions
kWh	kilowatt-hours
MID	Collectively the Modesto Irrigation District and the Merced Irrigation District
NCPA	Northern California Power Agency
NPV	net present value
O&M	operations and maintenance
PG&E	Pacific Gas and Electric Company
POUs	publicly-owned energy utilities

**ATTACHMENT A**  
**LIST OF ACRONYMS (cont.)**

PPP	public purpose program
RAP	Revenue Adjustment Proceeding
RIM test	Ratepayer Impact Measure test
Rule(s)	PG&E tariff rules
§ 783	Public Utilities Code Section 783
TRC test	Total Resource Cost test
TURN	The Utility Reform Network

**(END OF ATTACHMENT A)**