

ORIGINAL

Decision 84 11 015

NOV 7 1984

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND)
 ELECTRIC COMPANY and the CITY OF)
 UKIAH for an order authorizing)
 the former to sell and convey to)
 the latter certain electric)
 distribution facilities, in)
 accordance with the terms of an)
 agreement dated March 19, 1982.)
 (Electric))

Application 83-03-12
(Filed March 3, 1983)

INTERIM OPINION

Statement of Facts

Pacific Gas and Electric Company (PG&E) since October 10, 1905 has been an operating public utility corporation organized under the laws of the State of California. PG&E is engaged principally in the business of furnishing electric and gas services in California, although it also distributes and sells water in some cities, towns, and rural areas, and produces and sells steam in certain parts of the City of San Francisco.

The City of Ukiah (the city), located in Mendocino County, is a municipal corporation existing under the laws of the State of California. For some time the city has owned and operated an electric distribution system located within its corporate limits. From this system the city furnishes electric service to its residents and inhabitants.

In accordance with its obligation as a public utility, PG&E has been supplying electric services to two residential and six commercial customers in a formerly unincorporated area outside the

city's boundaries known as Lewis Lane. By Resolution No. 80-66 the city annexed this unincorporated area, and on March 3, 1980 the annexation was certified by the Executive Officer of the Mendocino County Local Agency Formation Commission.

The city has now determined that it desires to acquire the PG&E electric distribution facilities which serve this area, to incorporate them into its municipal distribution system. Accordingly, the city and PG&E on March 19, 1982 executed an agreement whereby the city would purchase the poles, conductors, meters, transformers, fixtures, etc. involved within the annexed area.

By this application PG&E and the city seek an ex parte order of the Commission authorizing the sale and transfer of PG&E's electric facilities, including any additions and betterments, within the annexed area to the city. Upon acquiring these properties, the city intends to continue to furnish the electric service presently supplied by means of these facilities, charging and collecting rates and charges not in excess of those presently paid to PG&E by the customers involved. Concurrent with the connection of the customers in the annexed area to the city's facilities, PG&E also seeks to be relieved of its public utility obligation within the annexed area.

The purchase price for the facilities reflects replacement cost less depreciation, and is in the amount of \$4,870,¹ plus severance costs of \$1,578 and "going concern" charges of \$731, adjusted to reflect:

- a. The net value of the facilities (as determined under the practice set forth in the Uniform System of Accounts), together with the net value of the additions

^{1/} The historical book cost of the electric facilities, as listed in the sales agreement, is \$2,890. Depreciation, as of January 1, 1983, was \$1,392 resulting in a net book value of \$1,498.

to and retirements from the facilities by PG&E subsequent to February 20, 1981, and prior to conveyance,

- b. 15% of such net value, and
- c. Any additional applicable severance costs.

The current ad valorem taxes for the tax year in which the facilities and any additions are conveyed will be prorated as of the conveyance date.

The city has been advised that certain of the facilities involved may contain polychlorinated biphenyls (PCBs), and the city has agreed to hold PG&E harmless for any and all liability arising from such substances or from any failure of the city to perform its utility obligations to customers in the area.

PG&E has derived a gross annual revenue of approximately \$600 from the domestic customers and \$15,000 from the commercial customers. PG&E holds no credit or line extension deposits for customers involved in this application. Notice of the application appeared in the Commission's Daily Calendar of March 8, 1983. No protest has been received.

Discussion

While most communities in California obtain their electric services from privately owned public utility corporations such as PG&E, some cities prefer and are able to invest in the acquisition of their own electric distribution facilities to take advantage of the low wholesale power rates available under preferential allocations from federally owned hydroelectric projects. Having lower financing costs than do the privately owned public utility corporations, and not having to pay income taxes, cities are sometimes able to deliver electricity to the residents and businesses within their boundaries at rates lower than those that the public utility must charge. But to become entitled to a preferential allocation from federal power.

projects a municipality must own its own distribution facilities and must accept utility responsibility for present and future customers in the area it will serve. Lacking its own transmission lines, a city usually pays the area public utility to wheel the federal power from the federal project source to the city's distribution lines. Then, to meet its utility responsibility fully, the city contracts with the area public utility for a wholesale purchase to make up any supplemental power supply it requires over and above its federal allocation. In many instances this places upon the area public utility the requirement that it have available peaking period capability.

In California, a municipal corporation is empowered to acquire, construct, own, operate, or lease any public utility (West's Ann. Pub. Util. Code § 10002). Thus, the city has the power of eminent domain to acquire, by court action, the electric distribution and streetlighting facilities within any area annexed to the city, and each annexation and acquisition of electrical facilities entitles the city to a larger share or allocation of any federal power becoming available the next contract period. Under such circumstances, in order to avoid a condemnation suit and to compromise possible litigation, the public utility corporation involved in an annexation area similar to the present situation is often willing to sell its facilities to the city by direct negotiation and contract.

While Public Utilities Code § 851 provides that no public utility other than a common carrier by railroad may sell the whole or any part of its system or property useful in the performance of its public duty without first obtaining authorization to do so from this Commission, under present operation of law, where a municipal corporation is the purchaser, the approval of this Commission is substantially a routine act if there is fair and just compensation to the public utility for the voluntary sale. In this

instance, reflecting as it does the replacement cost of the facilities less depreciation, the purchase price meets the test of fair and just compensation for the facilities to be sold. The city has also agreed to assume the utility obligation to provide electric service in the annexed area, and the city will hold PG&E harmless from any and all liability arising from any failure of the city to perform its utility obligations to customers in the area. The city also accepts responsibility for any liability arising out of the latent PCB potential. The parties to the agreement assert that their agreement is fair, just, and reasonable both as to the parties and to the customers directly affected. There is no opposition to the application, and no need to set the matter for public hearing. The application will be approved.

Incidental to the sale and transfer transaction is the fact that the purchase price agreed upon between the parties includes an increment of \$3,372 over the recorded net book or depreciated rate base valuation of the facilities to be sold and transferred.² This fact raises the issue whether this appreciation in value belongs to the PG&E shareholders or whether some or all of PG&E's ratepayers have a right to some or all of it. This issue is being considered in ongoing proceedings in Application (A.) 83-04-37. Rather than further delay approval of this sale and transfer transaction between Ukiah and PG&E, by this interim decision we will authorize its consummation, while reserving disposition and accounting of the \$3,372 gain over depreciated original cost until further order after resolution of the same issue in the A.83-04-37 proceeding.

In the application going concern charges of \$731 are included, and are shown as having a separate independent value apart

² Sale price of \$4,870 less net book value of \$1,498 equals gain of \$3,372.

from that value ascribed to the physical facilities. But going concern value has reality only in the context that the physical facilities are being put to use in an actual operation, one with established customers, management, employees, records, and business operational experience, and with assumed potentials of service expansion.³ Without some actual and successful ongoing business, the physical property would either be worthless or have only a commodity or demolition scrap value. In the present situation the city will merely have to cut over an ongoing operation into its own existing and operating distribution system. Obviously the purchase price obtained under these circumstances was premised upon and embodied not only the existence of physical facilities, but also the reality of an ongoing electrical distribution operation with customers and consumption requirements. However, the actual costs incurred in developing this existing operation and business were currently included in past operating expenses of the utility. These were paid during prior years by the ratepayers. There is a question whether, upon sale at this time of the facilities and the business, these going concern values realized from the sale should inure to the ratepayers or the shareholders.

In conclusion, while we approve this application we still feel the concerns we expressed in D.83-02-044 dated February 16, 1983 in a similar application involving sale and conveyance by PG&E of electric distribution facilities to a municipality. How many such annexations and facility transfers will it take before serious

³ Going concern value is not to be confused with good will. Good will is that element of value which inheres in the fixed and favorable consideration of customers arising from an established, well-known, and well-conducted business. While in the private sector good will may be a valuable asset, in the regulated or monopoly field of service it has less relevance; the disposition of the customer is not controlling. In a monopoly situation, service can be had only from the monopoly. The city did not purchase good will.

detriment will be done to the ability of area public utilities to serve their remaining customers and territories? Inevitably higher costs must result to PG&E in serving its remaining territory; higher costs spread over ever fewer public utility customers. As municipalities with electric distribution systems continue to annex, and present power supply allocation contracts to PG&E from federal hydroelectric projects run their term, PG&E will have to replace the cheaper federal power lost to the municipalities under preferential bidding where the cities have priority, involving replacements at today's higher costs with fully taxed facilities.

Findings of Fact

1. PG&E provides public utility electric service in many areas of California, including areas in and about the city.

2. The city, a California municipal corporation, for some time has owned and operated an electric distribution system in areas within the municipal limits.

3. In 1980 the city annexed an unincorporated area which is the subject of this application, wherein the electric service was provided by PG&E.

4. In the interim since annexation, PG&E has continued to provide this area with electric service.

5. The city itself now plans to provide the electric service in this area, and has contracted with PG&E to purchase the existing distribution facilities from PG&E and will incorporate these facilities into the city's existing electric distribution system.

6. The purchase agreement negotiated between the city and PG&E, embracing the proposed purchase price for the facilities (and reflecting replacement value less depreciation), the proposed payment of net value plus 15% of any additions and retirements made after February 20, 1981 and prior to conveyance, the proposed payment of applicable severance costs, the proposed payment of "going concern" charges, and the proposed proration of current ad valorem taxes constitute a just and reasonable compensation to PG&E for the transfer.

7. The furnishing of electric service in the annexed area by the city will not result in rates and charges to the customers of the area in excess of those paid to PG&E.

8. There is no known opposition to the proposed sale and transfer.

9. It can be seen with reasonable certainty that there is no possibility that the sale and transfer of these particular facilities alone may have a significant effect on the environment.

10. The proposed sale and transfer of these particular facilities alone, under all the conditions applicable, would not be adverse to the public interest.

11. The sooner the sale and transfer can be consummated, the sooner the customers in the annexed area may be able to obtain the lesser rates and charges the city plans to offer them. Accordingly, this order should be effective when it is signed.

12. PG&E has no credit or line extension deposits for customers involved in this sale and transfer.

13. Upon completion of the sale and transfer PG&E should be relieved of its public utility obligations in the annexed area.

14. The gain in the sale price of \$3,372 over net book value when realized by PG&E and the going concern charges of \$731 should be held in a suspense account pending further order of the Commission in ongoing proceedings in A.83-04-37.

Conclusions of Law

1. A public hearing is not necessary.
2. The application should be granted as provided in the following order.

INTERIM ORDER

IT IS ORDERED that:

1. Within six months after the effective date of this order Pacific Gas and Electric Company (PG&E) may sell and transfer to the City of Ukiah the electrical distribution facilities set forth in their March 19, 1982 agreement annexed to and made a part of their application as Exhibit B.
2. Within 10 days of the actual transfer PG&E shall notify the Commission in writing of the date on which the transfer was consummated. A true copy of the instrument of transfer shall be attached to the written notification.
3. Within 90 days after the date of actual transfer, PG&E shall advise the Commission's Evaluation and Compliance Division, in writing, of the adjustments for additions and betterments made in accordance with Exhibits B and C annexed to and made part of the application.
4. Within 10 days of the actual transfer, PG&E shall record the gains accruing over net book value from this sale and transfer, as well as the going concern charges discussed previously, in an appropriate suspense account and retain them in that account until further Commission order.

5. Upon compliance with this order, PG&E shall stand relieved of its public utility obligations in connection with electric service in the area served by the transferred facilities.

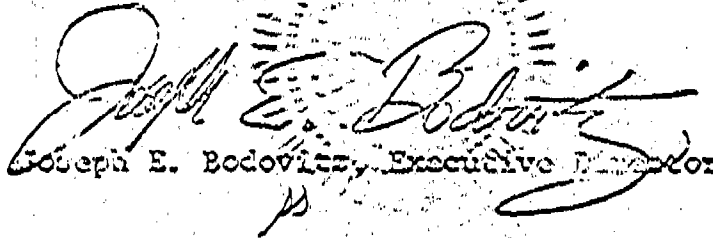
6. The application is granted as set forth above. ✓

This order is effective today.

Dated November 7, 1984, at San Francisco, California.

VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY.


Joseph E. Bodovitz, Executive Director

instance, reflecting as it does the replacement cost of the facilities less depreciation, the purchase price meets the test of fair and just compensation for the facilities to be sold. The city has also agreed to assume the utility obligation to provide electric service in the annexed area, and the city will hold PG&E harmless from any and all liability arising from any failure of the city to perform its utility obligations to customers in the area. The city also accepts responsibility for any liability arising out of the latent PCB potential. The parties to the agreement assert that their agreement is fair, just, and reasonable both as to the parties and to the customers directly affected. There is no opposition to the application, and no need to set the matter for public hearing. The application will be approved.

Incidental to the sale and transfer transaction is the fact that the purchase price agreed upon between the parties includes an increment of \$3,372 over the recorded net book or depreciated rate base valuation of the facilities to be sold and transferred.² This fact raises the issue whether this appreciation in value belongs to the PG&E shareholders or whether some or all of PG&E's ratepayers have a right to some or all of it. This issue is being considered in ongoing proceedings in Application (A.) 83-04-37. Rather than further delay approval of this sale and transfer transaction between Ukiah and PG&E, by this interim decision we will authorize its consummation, while reserving disposition and accounting of the \$3,372 gain over depreciated original cost until further order after resolution of the same issue in the A.83-04-37 proceeding.

But the gain issue arising out of the appreciation from net book differs from that portion of the consideration denoted in the application as "going concern" charges. In the application going concern charges of \$731 are included, and are shown as having a

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separate independent value apart from that value ascribed to the physical facilities. But going concern value has reality only in the context that the physical facilities are being put to use in an actual operation, one with established customers, management, employees, records, and business operational experience, and with assumed potentials of service expansion.³ Without some actual and successful ongoing business, the physical property would either be worthless or have only a commodity or demolition scrap value. In the present situation the city will merely have to cut over an ongoing operation into its own existing and operating distribution system. Obviously the purchase price obtained under these circumstances was premised upon and embodied not only the existence of physical facilities, but also the reality of an ongoing electrical distribution operation with customers and consumption requirements. However, the actual costs incurred in developing this existing operation and business were currently included in past operating expenses of the utility. These were paid during prior years by the ratepayers. Upon sale at this time of the facilities and the business, these going concern values realized from the sale should be returned to the ratepayers. The going concern values realized do not belong to the shareholders.

In conclusion, while we approve this application we still feel the concerns we expressed in D.83-02-044 dated February 16, 1983 in a similar application involving sale and conveyance by PG&E of electric distribution facilities to a municipality. How many such annexations and facility transfers will it take before serious

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15. The "going concern" charges included in the compensation should be treated as operating income by PG&E.

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4. Within 10 days of the actual transfer, PG&E shall record the gains accruing over net book value from this sale and transfer in an appropriate suspense account and retain them in that account until further Commission order.
5. Within 10 days of the actual transfer, PG&E shall record the "going concern" charges accruing from this sale and transfer in an appropriate operating income account.

A.83-03-12 ALJ/bg

6. Upon compliance with this order, PG&E shall stand relieved of its public utility obligations in connection with electric service in the area served by the transferred facilities.

This order is effective today.

Dated _____, at San Francisco, California.

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