

Decision 97-04-024 April 9, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company, a California Corporation, and Royal Gorge Lands, a California General Partnership, for an Order Authorizing the Former to Sell and Convey to the Latter a Certain Parcel of Land in Nevada and Placer Counties.

Application 96-06-009
(Filed June 7, 1996, Amended
December 10, 1996)



O P I N I O N

Statement of Facts

Since October of 1905, Pacific Gas and Electric Company (PG&E) has been a California public utility corporation engaged principally in the business of furnishing gas and electric service in California.

On December 31, 1910, by general transfer from the South Yuba Water Company, a predecessor entity, PG&E acquired an approximate 960-acre property lying south of the Southern Pacific Railroad Company tracks and Highway 80, between Soda Springs and Donner Lake at Norden, California. The property is the former site of a reservoir known as Lake Van Norden. The dam creating the lake was constructed in 1900, and PG&E operated the lake-reservoir as part of its hydroelectric system until 1976, when the State Department of Water Resources found it seismically unsafe because of foundation conditions. Not economically feasible to repair, the dam was decommissioned and breached. The property lies in both Nevada and Placer Counties; 190 acres in the former and the remaining 770 acres in the latter.

PG&E continues today to maintain and operate three overhead electric transmission lines, an overhead electric distribution line, and two underground electric distribution lines across the property, but foresees no further public utility use, other than for these electric facilities, for the rest of the property. Since the dam was breached in 1976 and the reservoir drained, PG&E has permitted various uses (sheep grazing,

dog trial events, hiking, and skiing) which have generated annual income approximating \$11,500.

The property is characterized as 523 acres of meadow/grasslands including the former lake bed area, and surrounding higher levels of 361 acres with stands of lodge pole pine and true fir. The timber areas contain merchantable timber. Past logging operations have created an excellent road system throughout the property with all areas accessible for logging. Twice in the past 20 years the property has been harvested, most recently in 1980 when 3.0 million board feet were removed. Elevations range from 6,700 to 7,200 feet.

By identifying and reserving easements which will reserve for itself the rights for its existing facilities as well as for additional facilities in the future, thus anticipating all foreseeable future needs,¹ PG&E believes it need not maintain fee interest in the property, and that by exchanging unused fee interests for easements and by removing the book value of the fee interests from rate base, it will be able to maintain customer service at a reduced cost.

Accordingly, pursuant to a Standard Purchase and Sale Agreement dated October 25, 1995, PG&E proposed to convey the 960 acres of unimproved land by a grant deed to Royal Gorge Lands, a California general partnership² while retaining public utility easements, as well as certain water rights (both riparian and appropriative rights) thus preventing successors in interest to the basic property from interfering with

¹ There are two easements being reserved for the electric lines; the first of 78.8 acres will contain all but a portion of the overhead distribution line, the three overhead electric lines, and the underground line; the second of one acre includes that portion of the overhead distribution line that branches away from the first easement.

² Royal Gorge Lands currently operates a cross-country ski recreation area adjacent to the PG&E property and is purchasing the property for recreational purposes consistent with its current operations.

the beneficial use of water needed for power generation at PG&E's downstream powerhouses.

The original cost of the property was \$25,697. However, PG&E is retaining 1.3 acres for possible expansion of its existing substation located adjacent to the property. Accordingly, PG&E adjusted the original cost to \$25,662.

The sale price under the Agreement is \$2,530,875, with \$1 million payable at or before the close of escrow and the balance in the form of a promissory note, secured by the property, which is due and payable with a fixed compound interest rate of 9% per annum for 18 months following close of escrow or October 31, 1997, whichever shall be later.³

This sale price is well above the estimated market value today of \$2,290,000 for both the land (\$1,340,000) and the excess marketable timber (\$950,000). To obtain the land value, PG&E employed the services of Clark-Wolcott Company, Inc., a Sacramento real estate analyst and consultant firm which considered the legally permitted uses governed by Nevada and Placer Counties, and concluded that the highest and best use was estimated to be and include a personal use and recreation component, a conservation component, and a development component with near- to mid-term subdivision potential in the low-intensity, residential recreation categories. The appraisal of the excess marketable timber was done by PG&E's Leland D. Bolger, a registered professional forester currently PG&E's supervisor of natural resource management. The appraisal comprehensively reviewed and updated the existing lumber inventory for the property conducted in 1984 by PG&E foresters with consideration of current timber market conditions, and in the absence of recent representative sales, used the California State Board of Equalization Harvest Value Schedules for the area to determine values. It was concluded that there was an existing

³ PG&E marketed the property by contacting the adjacent property owners. Three showed interest and entered discussions, but only Royal Gorge Lands made an offer.

total inventory of 8.9 million board feet, and with the timber age and size class distribution, that the total excess volume was approximately 3.0 million board feet valued as stated.

While PG&E has no plans to pursue a timber harvest at this time, Royal Gorge Lands does. Accordingly, prior to the close of escrow PG&E allowed Royal Gorge Lands to submit a timber harvest plan for approval to the California Division of Forestry and Fire Protection. This plan received the Division's approval on November 17, 1995.

Because the three overhead electric transmission lines traversing the property are included in Federal Energy Regulatory Commission (FERC) Project 2310 (the Drum-Spaulding Hydroelectric Project), FERC approval of the sale was required and obtained November 17, 1995.

Treatment of the Gain on Sale

By its original proposal as contained in the June 7, 1996 application, PG&E proposed that the gain on sale from sale of this property, like that of other non-depreciable assets, would go to the utility shareholders, the owners of the property.

On July 12, 1996 the Division of Ratepayer Advocates, predecessor to the present Office of Ratepayer Advocates (ORA), filed its protest to this treatment of the capital gain, contending that the gain on sale of real property which has been in rate base should flow to ratepayers to offset ongoing costs of service; also recommending that with regard to electric industry restructuring, the gain should be applied to reduce transition costs.

Thereafter, on September 20, 1996, the Commission issued Decision (D.) 96-09-044 approving PG&E's sale of its Grizzly Substation to the Regents of the University of California with the net of tax proceeds to be booked initially to a balancing account, and after a Competition Transition Charge (CTC) balancing account is established as part of electric restructuring, the proceeds including interest in this initial balancing account will be booked as an offset to the CTC balancing account. Substations generally are considered to be transmission or distribution assets. The CTC

balancing account is designed to recover uneconomic costs related to generation assets. While admonishing utilities not to seek to recover "stranded" transmission or distribution costs through CTC, in D.96-09-044 the Commission followed ORA's recommendation and allowed use of the CTC account to ensure that ratepayers would receive the gain on sale associated with the substation.

While adhering to its belief that it is the shareholder, not the ratepayer who bears the risk associated with non-depreciable property, PG&E recognized that to persist in this stance would delay this and other sales, and the utility's ability to remove underutilized assets from rate base. It recognized its need to expedite the sale of underutilized real property, and that under performance based ratemaking, rate base may no longer help determine revenue requirements. Accordingly, on December 10, 1996, PG&E filed an amendment to its Application (A.) 96-06-009 to replace and supersede the ratemaking treatment initially proposed.

Under its amendment proposal, the net-of-tax proceeds from the Lake Van Norden property would be booked to a new memorandum account named Real Property Sales (RPS) Memorandum Account and would accrue interest at the three-month commercial paper rate. Following establishment of the CTC balancing account, PG&E would transfer the entire balance including interest to the CTC balancing account and net it against the balance there.⁴ To reflect these changes, it furnished edited revisions to pages 9-15 and Exhibit K of the original application.

On January 10, 1997, ORA responded to the PG&E amendment proposal. ORA agrees that the Lake Van Norden property is not a stranded transmission or distribution asset, and that the ratepayers' interests are served by the early retirement of transition costs as proposed here following discussions between ORA and PG&E. ORA also

⁴ PG&E plans to sell numerous other underutilized properties which are incidentally encumbered with utility facilities. It plans to follow this same procedure with regard to the proceeds from the sale of its fee interest in each of these sales.

agrees to PG&E's proposal to use the same treatment for subsequent sales of additional rate based properties.

Notice of A.96-06-009 appeared on the Commission's Daily Calendar of June 13, 1996. Notice of the amendment pursuant to the ratemaking changes appeared on the Daily Calendar of December 12, 1996. No protests were received. However, by date of October 12, 1996, R. Wade Freedle, president of Serene Lakes Property Owners Association (SLPOA) wrote Administrative Law Judge John B. Weiss to make comment regarding future disposition of the historic and archeological resources of the property, wildlife habitat values, the watershed of the South Yuba River, and possible toxic wastes on the property.

Discussion

In its amended form PG&E's application for authorization to sell and transfer the Lake Van Norden property in Nevada and Placer Counties to Royal Gorge Lands should be approved together with the amended capital gains treatment proposed. As amended, the application represents a reasonable disposition of present and similar future underutilized real properties, where the public utility requirements of the utility can be met without continued retention of a fee interest in the properties.

The present day \$2,530,875 sale price of the Lake Van Norden property being sold and transferred far exceeds the \$25,662 adjusted book value. Each year under the existing fee interest ownership ratepayers pay a rate of return on the whole fee interest, and as the value of the fee interest does not depreciate, the amount the ratepayers must pay never diminishes. In addition, at present the ratepayers also pay the operating costs. This sale represents an example of the potential of PG&E's program to convert underutilized fee parcels into easements, thereby eliminating those parcels from its rate base and reducing the costs associated with fee ownership. At the same time PG&E will retain full ownership and use of the public utility facilities currently existing on the property, and retain all rights by the easements reserved sufficient for all present and foreseeable additional future public utility uses. PG&E will also retain water rights which will prevent the buyer or any successor in interest from interfering with the

beneficial use of water needed for power generation at PG&E's downstream power houses.

Here, as was the case with the Grizzly Substation,⁵ the use (as amended) proposed of the CTC balancing account will insure that the proceeds of assets flow to all ratepayers of PG&E. By allocating all after-tax proceeds to the CTC balancing account, the total amount of the transition costs will be recovered sooner, and the CTC charge will be eliminated more quickly, thereby reducing the overall CTC burden on the PG&E ratepayers. In addition, allocation of the after-tax gain to the CTC account in effect will withhold taxes on the sale until they ultimately must be remitted to the Internal Revenue Service. This ensures that the PG&E shareholders are not obligated to pay taxes on a transaction from which they receive little or no benefit.

The ORA position accepted by PG&E expedites the sale of underutilized fee interests and more quickly positions PG&E for the restructured electric industry. At the same time by allocation of the proceeds from the sale of all underutilized fee interests to reduce the CTC account, the charge will more quickly be eliminated from ratepayers' bills.

One final matter requires comment. While its stated intent is not to protest the proposed sale, SLPOA by its letter expresses concerns of the association, and inferentially at least, would have the Commission impose land use restrictions with regard to construction activities or future subdivision. This we decline to do. Royal Gorge Lands states it will maintain the same recreational uses after the purchase is completed as it presently employs on its adjacent cross-country ski recreation area. We note that both Nevada and Placer Counties either have or are formulating general plans, and are open to input from affected property owners and the public concerning land use with attendant governmental processes required for development of

⁵ D.96-09-044 (1996) Application of PG&E for authorization to sell Grizzly Substation to the Regents of the University of California.

alternatives inconsistent with their general plans. While at some prior time during its ownership of the property PG&E may have handled, treated, stored, and/or otherwise disposed of hazardous substance, in the absence of any evidence of any such substances currently on the property, or of any notice from any governmental agency as to the existence of any such hazardous substance currently on the property, we see no basis to require a survey or testing as a condition to the sale.

Today, the Z'berg-Nejedly Forest Protection Act (Cal. Public. Res. Code §§ 4511 et seq.) requires license authorization from the State Water Resources Control Board and a Department of Forestry Harvesting Plan approval for timber harvesting. The process ensures controls necessary to preserve downstream beneficial uses including fish habitat, recreation, etc. If future joint venture partners contemplate a change in land use contrary to that planned by Royal Gorge Lands, the public and interested parties will have adequate opportunity pursuant to local permit authority requirements to obtain consideration of their concerns.

Findings of Fact

1. PG&E provides public utility electric service in many areas of California, and in meeting its service obligations over the years has acquired numerous parcels of land which have been used and useful in its provision of service.
2. With the passage of time PG&E's requirement of full use of some of these parcels has diminished, and PG&E is determining that its present and future requirements on some of these parcels can now and for the future be met by retention of easement rights while disposing of the basic fee interests in these parcels.
3. By exchanging unused fee interests in such properties for retained easements, the book value of these fee interests can be removed from rate base, enabling PG&E to maintain customer service at reduced costs.
4. A PG&E reservoir, acquired from a predecessor utility, and part of its hydroelectric system, for seismic safety and cost reasons, was decommissioned and breached in 1976, leaving a 960-acre property (known as the Lake Van Norden

property) traversed by certain overhead and underground transmission and distribution lines.

5. The Lake Van Norden property is one such parcel of real estate where PG&E has determined that its present and future public utility requirements are capable of being met through use of reserved easements without the necessity of continued retention of the fee interest in the property or its retention in rate base.

6. By use of outside professional appraisers and its in-house timber management personnel, PG&E has obtained an estimated present day market value for both the real estate and the excess marketable timber on the property; concluding the total market value to be \$2,290,000, divided \$1,340,000 for the land less the reserved easements, and \$950,000 for the timber that can be harvested.

7. Offered for sale, the only bid received was for \$2,530,875 from Royal Gorge Lands, a neighboring property owner operating a ski and recreational area.

8. The bid exceeds the estimated present day market value.

9. PG&E has negotiated and on October 25, 1995 signed a standard purchase and sale agreement whereby PG&E for \$2,530,875 would sell and transfer the approximate 960-acre property to Royal Gorge Lands, except for 1.3 acres being retained for probable expansion of an adjoining PG&E substation, and reserving easements over 79.8 acres as well as water rights.

10. The negotiated price for sale and transfer of the Lake Van Norden property to Royal Gorge Lands includes a substantial gain over original cost less depreciation.

11. It can be seen with reasonable certainty that the sale and transfer to Royal Gorge Lands presents no significant impact on the environment.

12. Today, because of the Z'berg-Nejedly Forest Practices Act, it is no longer necessary for PG&E to retain full fee ownership in order to protect unchecked erosion from rapacious logging practices which might endanger PG&E's electric lines on the property and produce excessive siltation creating problems for PG&E's downstream hydroelectric facilities.

13. ORA agrees that the proposed easements will protect ratepayers' interests in the electric lines.

14. By its December 10, 1996 amendment to this application, PG&E replaced and superseded the ratemaking treatment to be accorded the net-of-tax proceeds initially proposed, and with ORA agreed to apply this after-tax gain to a new RPS Memorandum Account accruing interest until implementation of the CTC balancing account being established as part of electric industry restructuring, at which time the entire balance including interest would be transferred by PG&E to the CTC balancing account and netted against the balance there.

15. By allocating all after-tax proceeds to the CTC balancing account, the total amount of the electric industry restructuring transition costs will be recovered sooner, and the CTC charge will be eliminated more quickly, thereby reducing the overall CTC burden on ratepayers.

16. As the real property assets which are the subject of this application are not "stranded transmission or distribution assets," use of the CTC balancing account is appropriate.

17. As Royal Gorge Lands intends to harvest 361 acres of merchantable timber on the property after acquisition, PG&E allowed the former to submit a timber harvest plan to the California Department of Forestry and Fire Protection for approval prior to close of escrow; this timber harvest plan was approved by the Forestry Department on November 17, 1995.

18. Any alternative use of the Lake Van Norden property to which Royal Gorge Lands or its successors in interest might seek to adopt will be subject to the zoning requirements and general plans of the local county jurisdictions.

19. The easements will adequately protect PG&E's existing and future electric facilities requirements, and removal of fee ownership costs will result in lower costs to both PG&E and its ratepayers; accordingly, the proposed sale and transfer as well as the amendment proposed ratemaking treatment of the after-tax gain on sale is in the public interest.

20. Because the public interest would best be served by having the sale and transfer take place expeditiously, the ensuing order should be made effective on the date of issuance.

Conclusions of Law

1. A public hearing is not necessary.
2. The proposed sale and transfer as set forth in the application, and the ratemaking treatment of the gain on sale after tax as set forth in the amendment to the application, should be approved.

O R D E R

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 Royal Gorge Lands, the Lake Van Norden property as set forth in Application 96-06-009, subject to the easements and reservations therein described.
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 effecting the sale and transfer shall be attached to the written notification.
3. Upon completion of the sale and transfer authorized by this Commission order, PG&E shall stand relieved of public utility responsibilities for the property except as to the reserved easements.
4. The ratemaking treatment shall be as set forth in PG&E's December 10, 1996 amendment to Application 96-06-009; specifically that PG&E shall remove the \$25,662 cost of the property from rate base; allocate the \$1,476,948 after-tax proceeds of the sale to a new Real Property Sales (RPS) Memorandum Account to accrue interest at the three-month commercial paper rate; and following establishment under part of Electric Industry Restructuring of the Competition Transition Charge (CTC) balancing account,

A.96-06-009 ALJ/JBW/bwg

PG&E shall transfer the entire balance, including interest accrued, in the RPS Memorandum Account to the CTC balancing account to be netted against that balance.

5. Application 96-06-009 is closed.

This order is effective today.

Dated April 9, 1997, at San Francisco, California.

P. GREGORY CONLON

President

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

RICHARD A. BILAS

Commissioners