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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

**RESOLUTION E-3528
APRIL 23, 1998**

RESOLUTION

RESOLUTION E-3528. STANISLAUS COUNTY LOCAL AGENCY FORMATION COMMISSION. REQUEST FOR A COMMISSION OPINION ON THE EFFECT OF THE PROPOSED REORGANIZATION OF PATTERSON WATER DISTRICT (PWD) WITHIN PACIFIC GAS AND ELECTRIC COMPANY'S (PG&E) SERVICE TERRITORY. THIS RESOLUTION FINDS THAT THE PROPOSED PWD WILL NOT SUBSTANTIALLY IMPAIR PG&E'S ABILITY TO PROVIDE ADEQUATE SERVICE AT REASONABLE RATES IN THE REMAINDER OF PG&E'S SERVICE TERRITORY

BY LETTER FEBRUARY 2, 1998 RECEIVED FEBRUARY 5, 1998.

SUMMARY

1. Pursuant to Government Code Section 56131, the Stanislaus County Local Agency Formation Commission (LAFCO) has requested the opinion of the Commission whether the reorganization of the Patterson Water District (PWD) will substantially impair the ability of Pacific Gas and Electric Company (PG&E) to provide adequate service at reasonable rates in the remainder of PG&E's service territory. PWD proposes to provide electrical service to new and existing industries within the existing boundaries of the PWD in Stanislaus.
2. This resolution finds that the proposed PWD will not substantially impair PG&E's ability to provide adequate service at reasonable rates in the remainder of PG&E's service territory.

BACKGROUND

1. The PWD has applied to the Stanislaus County LAFCO to reorganize into an Irrigation District for numerous purposes including electrical service to existing and new industries within a defined geographic region. The Irrigation District will be the same as the Water District.
2. Patterson Water District has a 3.3 mile main canal with 11 main laterals drawing water off the main canal and distributing water to 13,606 acres of farmland. There are five (5) pumping stations which lift the water from the San Joaquin River a total of approximately seventy-five (75) feet to the last pool on the main canal. The pump

stations house a total of twenty-six (26) pumps powered by motors ranging from 250 Hp to 15 Hp. The Water District also owns and operates three (3) wells for agricultural use.

3. Funding of additional water system infrastructure will come from water revenue associated with water and electrical sales. Operations costs are charged to the users on a yearly basis. Water system operations and maintenance will be the responsibility of the Irrigation District.
4. The Water District currently owns three (3) miles of 12 kV transmission lines along its main canal and also five (5) 12 kV to 480 volt transformers. Costs for electrical facilities will be funded through bond financing throughout the course of establishing electrical service. Within the first ten years there will be two bond financing instruments worth an estimated \$4.2 million. The first phase will be financed in 1998-99 for a total of \$2,885,000, and will include ten miles of 69 kV double circuit transmission line and Patterson substation. Total construction time for this phase from start to finish will be 12 months. The second phase will be financed between 6 months and one year after the completion of phase I for a total of \$537,000. The next planned phase will be financed 2-3 years after completion of phase 2 and will cost approximately \$1,823,000.
5. It is anticipated that the revenue generated from electrical service and water sales will be sufficient to fund the ongoing operations of the Irrigation District and the repayment of bonds.
6. The Irrigation District intends to provide the following services:
 - a) Non-Potable Water Service: The Irrigation District will provide non-potable water service for irrigating the entire District. Operation costs for service will be paid for by users on yearly basis. The District bills water costs during the irrigation season as the customer uses the water supplied.
 - b) Electrical Service: The Irrigation District will provide electrical service to new and existing customers within the Irrigation District Electric Service Boundary. Upon completion of required electrical service infrastructure, including substations and transmission and distribution lines, the Irrigation District could provide electrical service to many of its customers. Operation costs for electric service will be funded entirely by those customers in the district receiving power from the Irrigation District or using the Electric Facilities of the Irrigation District. Electric service costs will be billed on a monthly basis.
7. The following is a summary of the Irrigation Districts facilities:

- a) Non-Potable Water System: The San Joaquin River, Delta Mendota Canal and wells will provide the non-potable water supply for the Irrigation District, the same as that of the existing Water District. The main sources of water for the Water District are pre 1914 and riparian rights on the San Joaquin River and a supplemental water contract with the Bureau of Reclamation from its Central Valley Project. In times of need the Water District's three (3) groundwater wells are also used to provide supplemental water. These water supply sources will continue to provide the Irrigation District with water. The district's pre-1914 rights are freely transferable, and the Water District's contract with the United States Bureau of Reclamation can also be assigned.
 - b) Electrical Service: Under State law, the Irrigation District would have the power to provide electrical service to itself as well as to new and existing customers.
8. Government Code Section 56131 requires the LAFCO to file a copy of the proposal by an irrigation district to furnish electrical service with the Commission. The Commission must then report to the LAFCO within 90 days its opinion whether the proposed service by the district "will substantially impair the ability of the public to provide adequate service at reasonable rates within the remainder of the service area of the public utility."
 9. Public Utilities Code Section 369, adopted pursuant to Assembly Bill 1890 (Stats. 1996, Ch. 854), provides that "the obligation to pay the competition transition charges cannot be avoided by the formation of a local publicly owned electrical corporation on or after December 20, 1995."
 10. Public Utilities Code Section 374 (a)(1), adopted pursuant to Assembly Bill 1890 (Stats. 1996, Ch. 854), provides that 110 megawatts (MWs) of load served by irrigation districts shall be exempt from the obligation to pay uneconomic costs. An irrigation district requesting an allocation of these 110 MWs must submit a detailed plan to the California Energy Commission (CEC).
 11. Public Utilities Code Section 374 (a)(1)(F), adopted pursuant to Assembly Bill 1890 (Stats. 1996, Ch. 854), provides that any load within San Joaquin County, served by any irrigation district that is currently serving or will be serving retail customers, must submit a plan to the CEC if it requests an allocation or exempt load.
 12. Government Code Section 56131 does not define the factors in evaluating whether a proposed service would "substantially impair the ability of the public utility to provide adequate service at reasonable rates within the remainder of the service area of the public utility."

NOTICE

1. The request of the Stanislaus LAFCO, dated February 2, 1998, was received in the Commission on February 5, 1998.
2. The Energy Division noticed this letter on the Commission Calendar on March 2, 1998.

PROTESTS

1. By letter dated March 2, 1998, PG&E provided comments on the proposed reorganization of PWD into an irrigation district.
2. PG&E believes that PWD's proposed reorganization would substantially impair its ability to provide adequate service at reasonable rates in the remainder of its service territory.
3. PG&E bases its position on the discussion in Commission Resolution E-3472 (November 26, 1996) regarding the proposed formation of the Crossroads Irrigation District (CID). In E-3472, the Commission used three criteria for evaluating whether or not the proposed reorganization of CID would impair the ability of PG&E to provide adequate service at reasonable rates in the remainder of PG&E's service territory.
4. The first criteria is whether PWD will be able to bypass payment of generation related transition costs. PG&E asserts that PWD would not be eligible for an exemption to bypass payment of generation related costs because the Competition Transition Charge (CTC) exemptions have been fully allocated by the California Energy Commission.
5. The second criteria is whether PWD will install duplicative distribution facilities. PG&E contends that PWD's intention to embark on construction of new facilities will have an adverse affect on PG&E and its ratepayers.

6. The third criteria is the rate impact. PG&E states that it cannot provide detailed information on the rate impact because PG&E does know the scope of PWD's activities. "PG&E is concerned that the potentially stranded facilities, and the continuant rate impact, would not be limited to facilities and revenues with (sic) PWD's boundaries."
7. On March 27, 1998, Stephen L. Garber of PG&E sent a letter to Kevin Coughlan of the Energy Division and Fran Sutton-Berardi of the Stanislaus LAFCO raising concerns about PWD's compliance with the California Environmental Quality Act (CEQA) process. PG&E points out that PWD has renoticed its intent to adopt a negative declaration and reopened its comments period regard its plan to reorganize as an irrigation district. PG&E contends that PWD's decision to reopen the comment period and to reconsider its action now moots its January 27, 1998 adoption of a negative declaration and decision to apply to Stanislaus LAFCO for reorganization of the PWD and makes the prior action a nullity. PG&E further contends that there is no reason for Stanislaus LAFCO to ask the Commission to respond to its February 7, 1998 request, since their request is now moot.
8. In response to PG&E's letter of March 24, 1998, Jeanne M. Zolezzi, Esq., representing PWD, informed Energy Division by letter dated April 1, 1998 that PWD's actions do not moot its request of a Commission opinion. PWD's position is that its negative declaration and application are still valid. Moreover, PWD contends that only the Stanislaus LAFCO can terminate its request of the Commission.

DISCUSSION

1. As Government Code Section 56131 does not define the factors on how to evaluate whether proposed service would "substantially impair the ability of the public utility to provide adequate service at reasonable rates within the remainder of the service area of the public utility," the Commission must establish criteria in making this determination. In Resolution E-3472 (re San Joaquin County LAFCO, November 24, 1996) the Commission adopted the three criteria raised in PG&E's comments.
2. The first factor the Commission should review is whether the customers of the proposed irrigation district will be able to bypass payment of generation-related transition costs, which would require the remaining PG&E customers to cover those costs.

3. The second factor the Commission should review is whether the proposed irrigation district will install duplicate distribution infrastructure, potentially idling PG&E distribution facilities and requiring remaining PG&E customers to cover the costs of these idled facilities.
4. The third factor the Commission should review is whether the amount of generation related transition costs or idle distribution facilities shifted to remaining PG&E customers, if any, would have a significant rate impact on remaining PG&E customers.
5. With respect to the first factor, formation of a local publicly owned utility does not exempt the customer served by the new utility from the obligation to pay the CTC (PU Code Section 369); however, irrigation districts may apply to the CEC for an allocation of load that is exempt from the obligation to pay CTC (PU Code Section 374). In response to PG&E's claim that PWD is ineligible for CTC exemption, PWD has informed the Energy Division that it will not seek such exemption. Thus, PG&E would be entitled to collect CTC from the departing customers as reimbursement for generation-related transition costs and collection of generation-related transition costs would not be shifted to remaining PG&E customers.
6. With respect to the second factor, PWD's "Plan of Operation" does not specify firm plans regarding the purchase or lease of distribution facilities. If PWD were to purchase or lease existing distribution infrastructure from PG&E, then the costs associated with those facilities would not be shifted to remaining customers. If PWD chooses to build duplicative distribution infrastructure then the costs associated with existing facilities will need to be recovered from remaining PG&E ratepayers, but in this case these costs are very small, less than \$50,000.
7. The discipline of the marketplace mitigates the impact of the construction of duplicative facilities on PG&E and its customers. Allowing for the construction of duplicative facilities provides a competitive check on the ability of the utility to pass through unreasonable costs through to ratepayers in distribution rates and provides discipline to both the utility and the Commission in determining the rate design for distribution services. Uneconomic bypass of existing utility facilities shows areas where our ratedesign is economically inefficient and highlights areas where reform of our rate design may make sense. In addition, the provision of duplicative systems in this area will increase the level of competition available to the customers in this area, even those that remain with PG&E.
8. Regarding the final factor, PG&E currently collects annual revenues of approximately \$50 thousand from its customers within the proposed PWD boundaries. Some

portion, but not all, of that revenue goes to pay for generation-related costs, both the energy related costs and the cost of stranded asset recovery that are currently included in rates. Recovery of stranded costs will still be recovered from the customers in question via the CTC and the cost of procuring electricity will be avoided. Thus the actual revenue impact of this loss will be substantially less than \$50,000¹.

9. In Resolution E-3516 (January 21, 1998), the Commission determined that Base Revenues for PG&E for 1998 should be \$2.4 billion. Using the assumption that PG&E's remaining customers must cover the full revenue shortfall caused by the formation of PWD, the rate impact would be minimal, resulting in less than a 0.0021% change in revenues²This shortfall may change depending on the rise or decline in load growth. In this specific instance, the Commission finds that the potential rate impact associated with PWD formation does not substantially impair PG&E's ability to provide adequate service at reasonable rates in the remainder of its service territory.
10. Since customers of the proposed irrigation district will be not able to bypass payment of generation-related transition costs, and the rate impact of irrigation districts decision to install duplicative distribution infrastructure will have only a very small impact on remaining PG&E customers, the Commission concludes that formation of the PWD would not substantially impair the provision of reliable service to remaining customers at reasonable rates. This resolution should be forwarded to the Stanislaus Local Agency Formation Council.
11. The Commission takes no position nor should it on PG&E's letter of March 24, 1998 regarding the adequacy of PWD's CEQA process. This issue is left to other jurisdictions.

FINDINGS

1. The Stanislaus LAFCO request for an opinion under Government Code Section 56131 was dated February 2, 1998 and was received by the Commission on February 5, 1998.

¹ In Resolution E-3472 (Crossroads), the revenue impact of PG&E's other customers was nearly 20 times greater than is the case here.

² $\$50,000 / \$2,400,000,000 = 0.000021$

2. Government Code Section 56131 does not define how to evaluate whether proposed service would “substantially impair the ability of the public utility to provide adequate service at reasonable rates within the remainder of the service area of the public utility.”
3. Whether the customers of the proposed irrigation district will be able to bypass payment of generation-related transition costs, whether the proposed irrigation district will install duplicative distribution infrastructure, and the rate impact of these actions on remaining PG&E customers are reasonable criteria for evaluating Government Code Section 56131.
4. PWD will not be able to bypass generation since it does not have an exemption from the California Energy Commission.
5. There is a possibility that costs associated with existing distribution infrastructure may be shifted to remaining PG&E customers but the amount of this cost shifting is not substantial and will not impair the ability of PG&E to reliably serve its remaining customers at reasonable rates.
6. The potential rate impact associated with the formation of the PWD does not substantially impair PG&E’s ability to provide adequate service at reasonable rates to its remaining customers.
7. The adequacy of PWD’s CEQA process is not an issue for this Commission to decide.
8. The formation of PWD would not substantially impair PG&E’s ability to provide adequate service at reasonable rates in the remainder of PG&E’s service

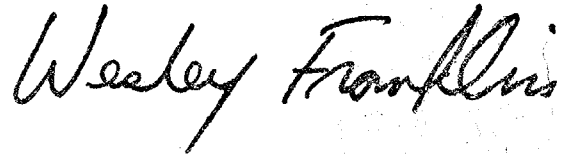
THEREFORE, IT IS ORDERED THAT:

1. A certified copy of this Resolution shall be mailed to the Executive Director of the Stanislaus County Local Agency Formation Commission, Pacific Gas and Electric Company, and Patterson Water District.

April 23, 1998

2. This resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on April 23, 1998. The following Commissioners approved it:



WESLEY M. FRANKLIN
Richard A. Bilas, President
Henry M. Duque
Josiah L. Neeper
Commissioners

I will file a dissent.
/s/ P. Gregory Conlon
Commissioner

I will file a concurrence.
/s/ Jessie J. Knight, Jr.
Commissioner

Commissioner Jessie J. Knight, Jr., Concurring:

Item E-2a recommends to Stanislaus County that Patterson Water District be allowed to offer electric service and be allowed to construct facilities for the transmission and distribution of electricity. I support this item because I do not believe that Patterson Water District's provision of such service would substantially impair the ability of Pacific Gas & Electric (PG&E) to provide adequate service at reasonable rates to the remainder of the service area of the public utility.

First, customers served by the proposed irrigation district will not be able to bypass payment of generation-related transition costs. Hence, the proposed irrigation district will not shift stranded costs onto PG&E's remaining ratepayers.

Second, the standard raised by Government Code section 56131 is substantial harm. While it is true that if the irrigation district would purchase or lease PG&E's distribution facilities, there would not be any impact on PG&E's remaining customers. However, this test sets the bar too high. The intentions of the code section was clearly to ensure that PG&E's other customers were not harmed, but just as clearly said that such harm had to be substantial to justify the Commission's opposition of a proposed irrigation district. The water district already has transmission and distribution facilities. The construction of these said facilities was at the irrigation district's own economic risk, which further shields ratepayers from the impact of these facilities.

Third, should the irrigation district propose to construct its own facilities, only a infinitesimally small portion of PG&E revenues would be affected. PG&E's total revenue in the affected area is approximately \$50,000. Of this \$50,000, a substantial portion of these revenues will be unaffected because of the ongoing competition transition charge (CTC) obligation of customers, who will be unable to shift the obligation to PG&E's remaining customers. In addition, the energy portion of these revenues is avoidable by PG&E, as the utility will not have to procure this power from the Power Exchange. Hence, these costs will not be shifted to PG&E's remaining customers. In short, only a portion of the \$50,000 in revenue responsibility would be shifted from customers served by the irrigation district to those customers of PG&E. This minute cost shift would result in increased revenue requirement per customer of less than two thousandths of a percent. In my mind, this is a *prima facie de minimis* change. Such an infinitesimal change will not substantially impair the ability of PG&E to provide adequate service at reasonable rates. The magnitude of this impact is smaller than the normal rounding error in most of the Commission's other rate cases and is about 20 times smaller than the impacts cited in the Crossroads case. Moreover,

revenue fluctuations in the range of significantly less than \$50,000 do not substantially harm PG&E's ability to provide reliable service at reasonable rates.

Finally, it is not this Commission's obligation, nor its duty to protect PG&E, its ratepayers and its customers from every slight variation in revenue requirement caused by dynamic market conditions. Also, it is not the Commission's obligation to raise barriers to entry for new entrants when PG&E faces the prospect of competition at what can only be considered the edge of the fringes of competition. Lest we forget the mantra I have espoused many times: **competition brings with it certain benefits over time; it leads to innovation, a focus on customer service, and lower costs.** Even this small degree of competition will provide incremental discipline to the utility **and** regulators over time, to ensure prudence of judgment in approving costs that are loaded into utility distribution rates. Limited competition will provide important price signals for efficiency and long-term sustainability of any distribution rate design. As I see it, the irrigation project will bring significant benefits to those California citizens and taxpayers who are their customers, and impose a barely measurable potential burden on the remainder of PG&E's customers, even in a worse case scenario.

For these reasons, I support this very important ground-breaking decision to further the goal of unharnessing the benefits of competition.

Dated this 23rd day of April, 1998 at Sacramento, California.



Jessie J. Knight, Jr.
Commissioner