

**Brundage. Peter**

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**From:** Kazama, Joyce K  
**Sent:** Wednesday, April 12, 2006 5:38 PM  
**To:** Brundage. Peter  
**Cc:** McFadden, Nancy; Bedwell, Ed  
**Subject:** PG&E's Position Summary for LAFCo  
**Importance:** High  
**Attachments:** PGEPosition41206.doc

<<PGEPosition41206.doc>>

Mr. Brundage - Attached is PG&E's position summary. If you have any questions, please let us know. Thanks!

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## PG&E Position

Pacific Gas and Electric Company ("PG&E") is strongly opposed to the application by the Sacramento Municipal Utility District ("SMUD") to annex territory in Yolo County and acquire, via eminent domain condemnation, PG&E's facilities for purposes of providing electric service in this area.

PG&E requests that the Sacramento Local Agency Formation Commission ("LAFCo") reject SMUD's application as not in the public interest, because SMUD has failed to demonstrate that it will reduce rates and improve services to the customers PG&E is currently serving in the annexation territory.

If LAFCo decides to place this matter before the public for a vote, PG&E requests that LAFCo include a full and complete assessment of the range of outcomes, and the potential for financial and reliability risk to both Yolo and Sacramento residents, should the 20-year projections upon which the proposal is based turn out not to be true. PG&E recommends this because the impact of this proposal will be determined by factors that truly cannot be anticipated with certainty. These include, most prominently:

1. The final cost of the PG&E assets to be acquired will be determined by the courts in an eminent domain proceeding that will be complex, lengthy and adversarial. Under certain scenarios, more than one court trial could be required, and the California Public Utilities Commission could be involved as well.
2. Energy markets are highly volatile. No one knows what natural gas prices will be 10 or more years from now, but the SMUD application relies on natural gas forecasts that are the basis of its optimistic projections of "net economic benefit."

In addition to the assessment and explanation of these risks, we request LAFCo fully inform the public of the possible outcomes should SMUD's projections fail to come to pass, such as the potential for higher rates to customers in both the area to be annexed and in SMUD's current service territory.

The Application, including the supporting material and additional information provided by SMUD, relies upon a number of assertions regarding the costs of SMUD service to Yolo relative to the status quo (PG&E). Many of these assertions are erroneous. The Application thus reaches an unsupportable conclusion by predicting that Yolo customers would receive a discount relative to PG&E's rates, at the same time that SMUD's Sacramento customers would not bear any of the costs of serving Yolo. PG&E's analysis shows that overall costs would go up, and that there is no way for SMUD to keep its pledge to both sets of customers. Furthermore, SMUD's surcharge principle #3c (adopted by the SMUD Board in Resolution 05-07-01 on July 14, 2005), shifts significant costs to SMUD's existing customers by requiring them to absorb power costs to serve Yolo up to a particular cost level that is well above the cost of SMUD's existing resources.

The March 29, 2005 report prepared by LAFCo's consultant GES Engineers and Appraisers ("GES Report") similarly contains erroneous conclusions and fails to analyze several key issues fully. As a result, policymakers and Yolo and Sacramento County voters are given a false sense of security about the proposed takeover, while serious risks are glossed over or ignored.

The key findings of PG&E's analysis are as follows:

- SMUD's estimate of the cost of acquiring PG&E's Yolo facilities is hundreds of millions of dollars in any case and up to \$430million too low if our assessment of system value is sustained SMUD missed equipment and undervalued the equipment it found. The largest value differences are associated with:
  - Count of Poles, Wires, Equipment and Land
  - Rights of Way
  - Trenching and Paving
  - Valuation Basis
  - Depreciation and Salvage
  - Going concern value
  - New Facilities
- SMUD underestimated, by \$50 million, the cost of severing the annexation area from PG&E's system and restoring PG&E's remaining system to its preannexation capacity, serviceability and reliability.
- SMUD's estimates of the cost of providing power to Yolo remain \$105 million too low, even after SMUD increased its estimates by a staggering \$428 million in January 2006, six short weeks after telling LAFCo that its prior estimates were reliable. SMUD assumes it can obtain power from newly constructed gas-fired facilities while paying only half their construction cost, and not covering the associated transmission costs.
- SMUD has made no plans for acquiring the additional electricity resources it will need to serve customers in Yolo, and therefore Yolo customers face significant risks that SMUD will not be able to procure sufficient resources to serve Yolo reliably and at reasonable cost.
- SMUD has unrealistically escalated its estimate of PG&E's rates in order to present the illusion of annexation savings to Yolo. Specifically, SMUD's Feb 15, 2006 update to its LAFCo filing makes unsubstantiated and unwarranted adjustments to PG&E rates to present the false conclusion that the \$428 million increase to SMUD's costs actually translates into a net increase in annexation benefits by \$140 million. These claims are simply not credible.

- SMUD assumes it will realize operating economies by serving Yolo customers without Yolo service yards, but does not account for the impact that the additional driving distances will have on service calls and outage restoration times.
- SMUD assumes it can use cash contributed by Sacramento customers to buy the Yolo facilities and replace the cash with new debt without violating its pledge to protect Sacramento customers – and further assumes the new debt may be tax-exempt although federal law prohibits funding acquisitions with tax-exempt debt.
- SMUD assumes that it can replace franchise fees and property taxes contributed by PG&E with an agreement to negotiate with the cities and County to implement various energy efficiency and demand response programs already provided by PG&E, and/or rate discounts that will simply be paid by other customers, and therefore represents a tax-in-disguise.

In short, SMUD’s plan would increase rates for Yolo customers by 14%, assuming that SMUD fulfills its pledge to its Sacramento customers. SMUD’s plan would result in the following adverse impacts to customers on both sides of the river:

**Impacts of the Proposed Annexation on:**

Sacramento Customers	Yolo Customers
It trades their cash for debt	It will raise their electric rates, because it contains no enforceable rate guarantee.
It forces them to absorb a significant amount of Yolo’s power costs, in direct contravention to SMUD’s claims that it would preserve SMUD’s low-cost power resources for its Sacramento customers.	It strips Yolo residential customers of the AB1X rate protection they enjoy as PG&E customers.
It forces them to absorb some or all of the extra costs that SMUD will incur, as it tries to fulfill a “promised” 2 percent rate break for Yolo customers.	It denies them beneficial State energy policies, including mandatory resource adequacy, mandatory renewables and a mandatory conservation-based loading order, and automated metering.
It forces them to spend money to fund SMUD’s pursuit of Yolo, including costs to hedge gas prices for Yolo, yet lacks an enforceable mechanism to recover the money from the Yolo jurisdictions. If SMUD abandons the	It contains no enforceable mechanism to replace PG&E’s local franchise fees and property taxes, so it may force reductions in local public services.

annexation, or Yolo votes it down, or the court denies SMUD's right-to-take, SMUD's present Sacramento customers will be liable for the costs incurred.	
It lacks an enforceable mechanism to ensure the SMUD Board imposes rates on Yolo sufficient to recover the full costs of annexation.	It subjects them to longer outage response times, because SMUD will not have local service yards.
It weakens their control of SMUD by diluting their representation on the SMUD Board.	It subjects them to minority status in an agency not subject to independent or State regulation.
It may weaken SMUD's credit rating.	It denies them access to PG&E's below-market and non-gas dependent power resources, and makes their power wholly-dependent on new gas-fired generation and renewables.
	It imposes duplicate and unnecessary facilities, including a transmission line and substation PG&E would not have to build.

In its numerous submissions to LAFCo on SMUD's proposal, PG&E has identified significant risks and costs associated with SMUD's proposal, in addition to the above.

We have identified significant environmental impacts associated with the proposal that LAFCo's EIR has neither evaluated nor mitigated, including increased air pollution from SMUD's Cosumnes Powerplant that LAFCo's EIR fails to mitigate.

We also note the SMUD has not responded with any enforceable commitment of funds to mitigate the significant reductions in public services that will occur due to lost PG&E property tax revenues and franchise fees in the jurisdictions affected by SMUD's takeover. The recently announced "Memoranda of Understanding" with Yolo county jurisdictions contain no enforceable funding provisions and therefore cannot be used as a "mitigation" measure for the loss of funding for essential public services.

There are serious issues, both factual and legal, regarding the enforceability and scope of SMUD's purported commitment that existing customers will not pay for any of SMUD's costs of acquiring and serving Yolo customers.

Finally, neither LAFCo nor its consultants have provided any analyses of different scenarios and probabilities for "success" and "failure" by SMUD in delivering on its promise that annexation will result in lower rates to Yolo customers and better service. SMUD's own consultants R. W. Beck performed just such an analysis of different cost and benefit scenarios -LAFCo so far has failed to do its own, independent analyses of the risks of success and failure by SMUD.

SMUD can provide no guarantee to LAFCo, voters or customers that the ultimate cost of acquiring and operating PG&E's facilities will be less than the cost of PG&E's current service to Yolo.

For these reasons, LAFCo must reject SMUD's application as not in the public interest.