

***EXECUTIVE OFFICER'S REPORT***

**SACRAMENTO MUNICIPAL UTILITY DISTRICT**

**SPHERE OF INFLUENCE AMENDMENT**

**And**

**ANNEXATION OF TERRITORY IN YOLO COUNTY**

***(05-05)***

***April 20, 2006***

***Peter Brundage, Executive Officer  
Sacramento Local Agency Formation Commission  
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**SACRAMENTO LOCAL AGENCY FORMATION COMMISSION**  
**1112 I Street, Suite #100**  
**Sacramento, California 95814**  
**(916) 874-6458**

April 20, 2006

TO: Sacramento Local Agency Formation Commission  
Affected Agencies and Interested Persons

FROM: Peter Brundage, Executive Officer

RE: **SMUD SPHERE OF INFLUENCE AMENDMENT**  
**AND ANNEXATION OF TERRITORY IN YOLO COUNTY**  
**(05-05) [CEQA: Environmental Impact Report]**

**RECOMMENDATIONS**

1. Adopt Resolution No. LAFC 1312 Certifying the Final Environmental Impact Report for Sacramento Municipal Utility District (SMUD) Sphere of Influence Amendment and Annexation of Territory in Yolo County (05-05)
2. Adopt Resolution No. LAFC 1313 Making Determinations and Findings on the SMUD Municipal Service Review (MSR) and Amending the Sphere of Influence of the Sacramento Municipal Utility District to include the proposal territory and approving the Annexation of the Cities of Woodland, Davis and West Sacramento and unincorporated territory in Yolo County into the Sacramento Municipal Utility District. (05-05)
3. Adopt Resolution No. 1314 Adopting Findings including a Mitigation Monitoring Reporting Program (05-05).
4. Order the Election proposing the annexation of the proposal territory to SMUD to be held in the affected territory. The vote in Yolo County shall be territory wide, i.e., the majority of total registered voters in the proposal territory must approve the ballot measure(s).
5. Order the election in the proposal territory to ask the question: "Should Sacramento Municipal Utility District replace Pacific Gas & Electric Company as the electric service provider within the affected territory?"

## **SUMMARY OF EXECUTIVE OFFICER'S REPORT**

As Executive Officer of the Sacramento Local Agency Formation Commission, I have reviewed the proposed **Municipal Service Review, the Sphere of Influence Amendment and proposed Annexation of Territory in Yolo County to the Sacramento Municipal Utility District (05-05)**. The cities of Woodland, Davis, West Sacramento and Yolo County have requested that the Sacramento Municipal Utility District provide electric service to approximately 212 square miles in Yolo County that is currently served by the Pacific Gas & Electric Company.

I have reviewed the Sacramento Municipal Utility District application, Pacific Gas & Electric Company's responses and analyses as well as supplemental information provided by both entities. I have also reviewed the GES Economic Evaluation; Davis, Wright, Tremaine Legal Opinion; the Draft and Final Environmental Impact Reports prepared by URS, Inc., all public comment and public agency comments on the proposal. My recommendation is set forth in the following report, Addendum and Appendix.

In summary, it is my informed opinion that SMUD can provide reliable and cost-effective service to the territory proposed for annexation without negatively impacting current SMUD ratepayers, ratepayers in the annexation territory, or the remaining Pacific Gas & Electric ratepayers. Moreover, it is likely that the proposal will create positive economic benefits to both current SMUD ratepayers and ratepayers within the Yolo County proposal territory.

Commission consultants have conducted an environmental review, a level of service analysis, and an economic valuation analysis of the proposal. The Final Environmental Impact Report (EIR) sets forth the probable environmental impacts associated with this project. This document incorporates a Mitigation Monitoring and Reporting Program (MMRP) and Best Management Practices. ***I recommend that your Commission certify the Final EIR, adopt Findings including a Mitigation Monitoring Program to mitigate the identified negative impacts as discussed in the Final Environmental Impact Report.***

The economic and valuation analysis is intended to estimate the most probable range of economic benefits of the proposal. The intent of the economic analysis is to determine the reasonableness of data given SMUD's assumptions, i.e., will SMUD be able to provide cost-effective and reliable service to the proposal territory and not negatively impact current ratepayers or prospective ratepayers?

Also, the GES valuation estimate is not intended to verify either SMUD or PG&E value estimates of PG&E's distribution system. Rather, it is to provide LAFCo with a likely range of fair market value of PG&E facilities so that the Commission will have adequate information, based on its policies, to render a decision.

Ultimately, based on admissible evidence, the court will determine the value of Pacific Gas & Electric Company's distribution system through eminent domain proceedings.

GES estimates the value of PG&E's distribution system to be \$110.0 Million, including stranded facilities, good will and rights-of-way.

GES has reconciled the estimated value of \$110.0 Million using accepted appraisal practice and methods. This value estimate falls within the likely range between original cost less depreciation and replacement cost less depreciation. This range is typically used for just compensation for condemnation proceedings. This range is supported in the legal opinion provided to your Commission by Davis, Wright and Tremaine. To the extent that the court renders a different value, the net economic benefits would change. Moreover, as outlined in the GES report, the net economic benefits are impacted by a number of different variables.

Based on the analysis performed by GES Engineers and Appraisers, the proposed annexation should generate positive net economic benefits of approximately \$165.0 to \$380.0 Million during the twenty-year study period. The net economic benefit is based on the fair market value of PG&E's distribution system, estimated by GES to be \$110.0 Million. Other SMUD acquisition and start-up costs are estimated to be approximately \$53.0 Million. The net economic benefits also factor in higher power supply costs to serve the proposal territory.

**The Commission is charged with the responsibility of ensuring that ratepayers will have at least the same level of service and same level of rates after the annexation as before the annexation.** My recommendation is based upon my determination that there will be at least minimum improvement in rates and service level that is sustainable over the long run versus attempting to establish the maximum benefit regarding this proposal. Based on the information provided, I conclude that sustainable improvement is realistic and there is a high probability that the proposal will be beneficial as set forth in this report.

Based on my analysis, it appears that this proposal poses no risk to current SMUD ratepayers. Based on the conservative assumptions stated above, it appears that this proposal poses no risk to ratepayers in the proposal territory. Moreover, SMUD has held harmless its existing ratepayers. All costs to acquire and serve the proposal territory will be borne through a surcharge to proposal territory ratepayers.

SMUD has entered into agreements with Yolo County and the Cities of Woodland, Davis and West Sacramento to offset revenue losses to these local jurisdictions from both property taxes and franchise fees. SMUD's goal is revenue neutrality. Further, a Revenue and Tax Exchange Agreement has been executed with Yolo County. In addition, the parties have executed Memorandums of Understanding which contemplate compensating the jurisdictions for lost revenues through discounted rates, energy efficiency programs, economic development rates, and beneficial electrification programs.

Finally, registered voters in the proposal territory as well as registered voters within SMUD's current service boundary must approve the annexation. This procedure is not typical. Usually, when elections are called, they are called exclusively within the

proposal territory. The SMUD Board of Directors intends to call a binding election among the voters within its current district boundary. The Commission is asked to call an election only in the territory proposed for annexation.

In conclusion, I have conducted a thorough and careful analysis and review of all documentation related to the proposed project. **I recommend approval of the Sacramento Municipal Utility District's Sphere of Influence Amendment and Annexation of territory within Yolo County subject to the terms and conditions set forth in this report and the Resolutions.**

Peter Brundage  
Executive Officer  
Sacramento Local Agency Formation Commission  
April 20, 2006

## **PROJECT PROPONENTS**

Board of Directors, Sacramento Municipal Utility District  
City Council, City of Woodland  
City Council, City of Davis  
City Council, City of West Sacramento  
Board of Supervisors, Yolo County

## **PROJECT DESCRIPTION**

The proposal consists of three parts:

1. Municipal Service Review;
2. Sphere of Influence Amendment for SMUD service to the proposal territory; and
3. Annexation of the proposal territory to provide electric service within the territory.

The Sacramento Local Agency Formation Commission (LAFCo), as principal county, <sup>1</sup> must determine whether or not SMUD has the ability, capacity and expertise to serve electricity within the proposal territory. In addition, LAFCo must evaluate the impacts of the proposal to potential Yolo customers and to the current SMUD customers within Sacramento County. The California Public Utilities Commission is required to evaluate the impact to remaining PG&E ratepayers and advise LAFCo of its findings.

From staff, and its consultants', evaluation, your Commission must determine whether or not SMUD can provide electric service to the proposal territory at reasonable rates, at adequate service levels; without negatively impacting current SMUD ratepayers or the ratepayers in the affected territory. The California Public Utilities Commission determines if there will be negative impact on remaining PG&E customers.

Your Commission must evaluate:

1. Rates to Yolo County PG&E customers, before and after annexation;
2. Rates to Sacramento County SMUD customers, before and after annexation;
3. Service levels to Yolo County PG&E customers, before and after annexation;
4. Service levels to Sacramento County SMUD customers, before and after annexation;
5. SMUD's capacity to serve Yolo County customers, before and after annexation;

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<sup>1</sup> Sacramento County is the principal county due to the rule that the majority of assessed valuation of SMUD is within Sacramento County. Government Code Section 56066.

6. SMUD's capacity to serve Sacramento County customers, before and after annexation;
7. Loss of PG&E revenue impacts to Yolo jurisdictions.

PG&E has a franchise, or exclusive right, approved by the California Public Utilities Commission, to serve the proposal territory. The citizens in the affected territory may seek to exercise their lawful choice to replace their current service provider. Your Commission must evaluate the proposed change in service providers and may, at the conclusion of public hearings, approve the annexation subject to approval of the electorate.

**PROJECT LOCATION**

The proposal territory consists of approximately 212 square miles in Yolo County. It includes the Cities of Woodland, Davis and West Sacramento as well as unincorporated territory in Yolo County near and surrounding these cities. Please see map in Appendix IV.

**PROJECT CHARACTERISTICS<sup>2</sup>**

	<b><u>SMUD Service Area</u></b>	<b><u>Proposal Territory</u></b>
<b>Area</b>	900 sq. miles	212 sq. miles
<b>Population</b>	1.3 Million	150,000
<b>Customers</b>	575,000	70,000
<b>Registered Voters</b>	642,242	77,316
<b>Megawatts</b>	2,959 MW	250 MW
<b>Land Use</b>	Commercial Industrial Residential Agricultural	Commercial Industrial Residential Agricultural
<b>Transmission Line Miles</b>	500 miles	76 miles
<b>Distribution (Overhead/ Underground)</b>	9,885 miles	1,312 miles
<b>Sub Stations</b>	236	5
<b>Average Growth/ per year</b>	12,700 customers	1,400 customers

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<sup>2</sup> Data is approximate.

	<u><i>SMUD Service Area</i></u>	<u><i>Proposal Territory</i></u>
<b>Percent Projected Growth</b>	3%	2%
<b>Employees</b>	2,400	79

**PROPOSAL TERRITORY**

The area proposed to be annexed represents approximately a twelve percent increase in customers (70,000), or about five - six years of growth for SMUD. The proposal territory represents an increase of approximately 23.5 percent (212 square miles) for SMUD's service area. The proposal territory contains approximately 1.4 percent of PG&E's total customers. The percentage of PG&E customers in the proposal territory generate approximately 1.5 percent of PG&E's 2004 electric operating revenue, approximately \$150 Million.

**PROPOSAL HISTORY/ BACKGROUND**

In February, 2003, the City Councils of the Cities of Woodland, Davis and West Sacramento, together with the Board of Supervisors of Yolo County, requested the Sacramento Municipal Utility District (SMUD) Board of Directors conduct a study to examine whether or not it would be beneficial (lower rates and better reliability of service) if SMUD were to annex the proposal territory and provide electric service within Yolo County.

In July, 2003, the Cities of Woodland, Davis, West Sacramento, Yolo County and SMUD agreed to fund an independent feasibility study conducted by R. W. Beck to determine whether or not annexation would be technically as well as financially feasible. In January, 2005, R.W. Beck issued the findings of its feasibility study. The Beck report concludes that annexation of the proposal territory [Cities of Woodland, Davis, West Sacramento and unincorporated territory within Yolo County] would be beneficial to both Yolo customers and SMUD ratepayers.

On April 5, 2005, the City Councils of the Cities of Woodland, Davis, West Sacramento and the Yolo County Board of Supervisors adopted a Joint Resolution requesting SMUD to proceed with annexation of the proposal territory.

SMUD reviewed the Beck study as well as conducted its own analysis of the proposal. The SMUD analysis, for the most part, validated the Beck study. SMUD also retained Sanjay Varshney, Ph.D., CFA,<sup>3</sup> to review SMUD's findings and methodology of the proposal. Dr. Varshney concluded that the methodology and assumptions used by R.W. Beck and SMUD are reasonable and the benefits are achievable.

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<sup>3</sup> Dr. Varshney is Dean of the Business School, California State University, Sacramento.

On August 1, 2005, SMUD submitted its application to amend its Sphere of Influence to include the Cities of Woodland, Davis and West Sacramento, and surrounding portions of unincorporated Yolo County coterminous with the County line, and to annex the proposal territory into the District.

LAFCo has contracted with URS Corporation to conduct the environmental analysis; GES Engineers and Appraisers to evaluate the economic benefits and provide an opinion of value (range) of P.G. & E's distribution system based on customary appraisal practices; and Davis Wright Tremaine, LLP, special legal counsel, to provide a legal analysis of the valuation methodology used to value electric utilities during eminent domain proceedings.

LAFCo hired GES Engineers and Appraisers to conduct an independent review of the Beck Study, SMUD Study and PG&E response to valuation, economic benefits and service reliability impacts related to the proposed annexation. The contract scope for the GES contract was to estimate the probable value and economic benefits based on information provided by the parties and determine the reasonableness of data used to reach their conclusions.

### **COMMISSION AUTHORITY**

Your Commission may approve, deny, or modify the Sphere of Influence Amendment and Annexation of the proposed territory to the Sacramento Municipal Utility District, subject to election by the registered voters.

### **APPLICABLE COMMISSION POLICY**

#### **General Policies**

The fundamental question to be evaluated by your Commission will be the comparison of the cost-effectiveness and service delivery capability between service providers. LAFCo procedure provides that the following policies be applied to all proposals:<sup>4</sup>

The Commission is charged with encouraging orderly growth and development.

The Commission is responsible for encouraging the logical formation and determination of boundaries.

The Commission must exercise its authority to ensure that affected populations receive efficient services.

The Commission can impose terms and conditions to mitigate environmental impacts, fiscal impacts or other impacts.

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<sup>4</sup> Sacramento Local Agency Formation Commission Policies, Standards and Procedures for LAFCo, adopted September 5, 1990, Amended May 4, 1993.

The Commission may deny the project.

The Commission will favorably consider those applications that do not shift the cost for services and infrastructure benefits/ costs to other service areas.

Commission policy encourages the use of service providers that are governed by officials elected by the citizens.

### **Boundaries**

Boundaries must be definite and certain.

Boundaries cannot create islands, corridors or peninsulas.

Boundaries cannot split neighborhoods or parcels.

Boundaries must not create areas that may be difficult to serve.

### **Revenue Neutrality**

The Commission will approve a proposal for a change of organization only if it finds the proposal is revenue neutral.

Where revenue neutrality is not possible because of the requirements of state law or those standards, the Commission shall impose all feasible conditions available to reduce any revenue imbalance or it may deny the proposal. In the event the expense to the current service provider exceeds the amount of revenue transferred (lost), the current service provider and new service provider may agree to a revenue transfer provision to compensate for the imbalance. Such provision may include, but is not limited to, tax-sharing, lump sum payment, and payments over a fixed period of time.

### **Efficiency**

The Commission should evaluate efficient services and orderly development described as follows:

An annexation proposal must provide the lowest cost and highest quality of urban services for the affected population. The Commission will approve an annexation only if it determines that the annexing agency possesses the capability to provide the most efficient delivery of applicable urban services.

For the purpose of this standard, the most efficient services are those which are provided at the most optimum combination of service cost and service level. **In the case of providers with similar service costs, the provider with higher service levels shall be deemed more efficient.<sup>5</sup> In the case of providers of**

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<sup>5</sup> Ibid., page IV-11.

**similar service levels, the provider with the lowest cost shall be deemed more efficient.**

***In comparing the providers of adequate but low cost services, with providers of high quality, high cost services; the Commission shall retain discretion to determine this optimum efficiency based on compliance with the other provisions of the Standards.***

Identification and measurement of service costs for purpose of determining revenue impacts as well as for assessing financial feasibility should be based on the actual cost of service provided. If actual costs cannot be reasonably identified and measured, costs should be allocated based upon the measure which most accurately reflects the level of service received. The Commission will rely upon current service providers to estimate service costs, so long as costs are estimated in compliance with these Standards.

**ECONOMIC EVALUATION**  
**PURPOSE OF LAFCO VALUATION**

GES Engineers and Appraisers conducted an independent objective review of the Beck Study, SMUD Study, and PG&E response to valuation, economic benefits and service reliability impacts related to the proposed annexation. The GES findings and analysis is included in the Appendix.

**Role of LAFCo**

Your Commission is not responsible for the estimation of fair market value of the PG&E electrical facilities to be acquired by SMUD. Obviously, SMUD's estimate is significantly different from PG&E's estimate of value. Ultimately, the parties will either negotiate a value or the court will determine the fair market value.

However, LAFCo must evaluate what it believes to be a reasonable range of value as well as evaluate the assumptions that have been used to create that reasonable range of value and economic benefits. The economic feasibility of the proposed annexation is dependent on two significant assumptions: (1) The price, or value of the electrical facilities to be acquired; and (2) the power supply cost, or cost of energy to serve the proposal territory. LAFCo retained GES to review these issues. The summary of GES findings are contained in this report.

**SMUD ANNEXATION POLICY**  
**GOALS AND OBJECTIVES**

**Criteria for Annexation**

On April 3, 2003, by Resolution No. 03-04-06, the Board of Directors of the Sacramento Municipal Utility District adopted criteria related to annexation proposals. Those criteria are, generally, as follows:

1. The area proposed for annexation is a relatively dense, urban area.
2. The area proposed for annexation is growing.
3. The area proposed for annexation falls within approximately 30 driving miles from SMUD's current service facilities.
4. The proposal for annexation is initiated by local jurisdictions in the territory proposed for annexation.
5. The jurisdictions within the territory proposed for annexation will share in the cost of the feasibility study for the annexation proposal.

The SMUD Board of Directors adopted **Resolution No. 05-05-08** that contains the terms and conditions it desires for the proposed Yolo Annexation. Commission Staff has reviewed the proposed terms and conditions and made changes based on public comment received April 5, 2006. These changes address enhanced protection of existing SMUD ratepayers and require monitoring of the terms and conditions for compliance. These revised terms and conditions have been reviewed with SMUD and they concur with these changes.

**LAFCO PROPOSED TERMS AND CONDITIONS**

1. Existing SMUD customers shall be held harmless as a result of the annexation of the Cities of West Sacramento, Davis and Woodland and contiguous unincorporated areas of Yolo County into SMUD's electric service area. **This condition shall be implemented as follows:**
  - a. Annexation shall not adversely affect the quality or level of service and reliability to existing SMUD customers. **During the Surcharge Period (as defined in 1.b.iv), SMUD shall continue to monitor indices of customer satisfaction and reliability and publicly report these findings on an annual basis. A copy of the annual customer satisfaction and reliability report(s) will be provided to LAFCo.**
  - b. SMUD ratepayers in the annexed territory shall pay through their rates and a surcharge an amount sufficient to recover the costs of annexation, including costs associated with the acquisition of the PG&E facilities,

increased power supply costs and non-bypassable charges assessed to departing load by the California Public Utilities Commission or California law. The recovery of annexation costs shall be consistent with the following principles:

- (i) SMUD shall recover the first \$90 Million of acquisition costs of PG&E's facilities over the long-term through SMUD rates charged to SMUD customers in the annexed territory (Yolo Customers). This amount constitutes the Base Amount.
- (ii) Acquisition costs in excess of the Base Amount shall be included in the Surcharge Amount. Payment of this portion of the Surcharge Amount shall represent the Yolo Customers' equity contribution to the SMUD system.
- (iii) Following the Yolo territory election addressing annexation, SMUD will acquire energy resources to serve the Yolo Customers and to the extent reasonable and prudent will fix the cost of all or a portion of the energy resources. In fixing the cost of the energy resources, if the forward price of natural gas is more than \$1 per MMBtu above the natural gas price assumed in the April 2005 SMUD Staff Assessment and Recommendation (SMUD Staff Assessment), the Surcharge Amount shall be increased to include the impact of natural gas prices (in excess of the assumed price plus \$1 per MMBtu) on the estimated economic benefits of the annexation.
- (iv) The Surcharge Amount described in paragraphs 1.b.ii and 1.b.iii above shall be collected from the Yolo Customers during the Surcharge Period. The Surcharge Period shall continue until the Surcharge Amount is fully paid. While the term of the Surcharge Period is not fixed, it is expected last between 5 and 10 years (based upon the assumptions in the SMUD Assessment).
- (v) During the Surcharge Period, the Surcharge Amount shall be reduced each year by the revenue collected from the Yolo Customers which is in excess of the revenue that would have been generated by SMUD tariffs plus any non-bypassable charges and amounts necessary to defray the reasonably calculated costs or impacts to the Cities of West Sacramento, Davis and Woodland and Yolo County (Yolo Jurisdictions) associated with the provision of electric service by SMUD.
- (vi) **SMUD shall separately track and account for the costs included in the Surcharge Amount. When the Surcharge Amount has been recovered from the Yolo Customers, the SMUD Board of Directors shall certify at a publicly noticed**

**meeting that the Surcharge Amount has been fully recovered and shall transmit a copy of the certification to LAFCo.**

- (vii) During the Surcharge Period, the initial tariff rates for the Yolo Customers shall be 2 percent or more below the then effective PG&E tariff rates. The initial tariff rates shall be set to contribute to coverage of SMUD's fixed costs to recover the Surcharge Amount (over the Surcharge Period) **and non-bypassable charges until fully satisfied.**
  - (viii) At the end of the Surcharge Period, the Yolo Customers shall be placed on the then applicable SMUD tariff rates for similarly situated customers. In addition to the SMUD tariff rates, the Yolo Customers shall continue to pay any ongoing non-bypassable charges **until fully satisfied.**
2. A mechanism to defray the reasonably calculated costs and impacts to the Cities of West Sacramento, Davis and Woodland, and the County of Yolo, associated with the provision of electric service by SMUD, shall be implemented pursuant to agreements between SMUD and the local jurisdictions **and in a manner consistent with LAFCo policies regarding revenue neutrality. SMUD and the local jurisdictions have executed Memorandums of Understanding (MOUs) which contemplate the subsequent execution of Customer Tailored Electric Service Agreements that shall provide the benefits of annexation and satisfy revenue neutrality through mechanisms contemplated in the MOUs. Within 90 days of the date LAFCo records a certified copy of the certificate of completion of the annexation with the Yolo County Recorder, SMUD and the local jurisdictions shall negotiate, consistent with the MOU principles, Customer Tailored Electric Service Agreements that definitively identify the benefits of annexation for, and obligations of, the Parties and in the opinion of the Parties achieves the goal of revenue neutrality. SMUD shall provide executed copies of the Customer Tailored Electric Service Agreements to LAFCo.**

To the extent any such mechanism is subject to the approval of voters in the territory to be annexed, and the voters do not approve the mechanism, SMUD shall not be obligated to proceed with the annexation unless each of the Cities of West Sacramento, Davis and Woodland, and the County of Yolo, confirm that they still desire to be annexed into SMUD's electric service territory.

- 3. Protests and votes cast in any elections that may be required under Government Code Sections 56129 and 57075 shall be counted throughout the territory to be annexed, rather than on a jurisdiction-by-jurisdiction basis.
- 4. SMUD shall offer to hire qualified PG&E employees displaced as a direct result of the annexation to fill the SMUD positions created to effect the annexation.

5. **The SMUD Board of Directors intends to place a measure ordinance on the November 7, 2006, election ballot for the purpose of allowing voters within SMUD's existing territory to decide whether or not SMUD should provide electric service to the affected territory.** The annexation effective date shall occur nine months after the date of election under Government Code Sections 56129 and 57075 **and the SMUD Ordinance** in which a majority voted **on each ballot measure** in favor of SMUD's annexation **of and provision of electric service to the affected territories.**
6. At the time the annexation becomes effective, or as soon as possible thereafter, SMUD shall modify its ward boundaries, consistent with Public Utilities Code Section 11857.1.

### **OVERVIEW OF SMUD HISTORY AND OPERATIONS**

The following provides a very brief summary of District operational highlights. Formation of the Sacramento Municipal Utility District was approved by the Sacramento County electorate on July 23, 1923. However, between 1923 and 1946, SMUD was engaged in litigation with PG&E. The District did not provide electric service until 1946. Today, SMUD provides electric service and street lighting to a significant portion of Sacramento County and a very small portion of Placer County and Yolo County.

SMUD was formed under the Municipal Utility District (MUD) Act. SMUD has seven directors, elected by wards, or districts. The Board is responsible for setting District policies, programs and rates within the District.

SMUD is not regulated by the California Public Utilities Commission. However, the District meets or exceeds CPUC General Orders 95, 128, and 165, which regulate investor-owned utilities. These General Orders establish standards for construction and operation of overhead and underground facilities.

SMUD has provided electric service for sixty years. Today, the District serves approximately 900 square miles to approximately 1.3 Million residents. SMUD has a total customer base of 575,000 customers with a peak demand of 2,959 megawatts.<sup>6</sup> *The Sacramento Municipal Utility District is the sixth largest customer-owned utility in the nation.*

SMUD owns and operates generation facilities including hydroelectric facilities, a gas generation facility, and wind and co-generation facilities. In addition, the District must purchase power to meet its total demand. SMUD operates approximately 500 miles of transmission lines and approximately 9,885 miles of overhead and underground distribution lines. SMUD also provides Energy Conservation programs to reduce peak demand. The District also participates in green energy and renewable energy programs (i.e., solar, wind and bio-mass programs).

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<sup>6</sup> In 2005.

SMUD has total assets and liabilities of \$3.9 billion. The earnings, or "profits," are reinvested into the electrical system, rate stabilization fund, and other programs to benefit the ratepayers and the community. The District does not pay dividends. The District does not pay property tax or income tax. Over the last several years, SMUD has added about 12,700 new customers per year, or approximately a three percent increase in megawatt demand per year.

### **SMUD Vision and Mission**

As a community-owned utility, the District's vision is to be a leader in customer service satisfaction and a positive force in promoting community benefits.

### **SMUD Goals and Strategic Directives**

Maintain Competitive Rates

Maintain Access to Credit Markets

Provide Reliable Service

Maintain High Level of Customer Relations

Provide a safe working environment for both employees and customers.

Promote environmental protection through resource conservation, pollution prevention, waste minimization and recycling programs.

Maintain employee relations in order to provide a diverse and respectful employment environment.

Provide resource planning that improves local air quality and conserves fossil fuels by developing conservation programs, renewable energy programs, and distributes clean energy.

Investment in research and development that support core values based on an analysis of the risks of the project versus potential benefits to SMUD customers.

### **Comparison of SMUD Rate With Those of Other California Electricity Providers**

Monthly rates to customers based on residential usage of 750 kilowatt hours as of rate structure on March 30, 2005. The following illustrates rate differentials between various California utilities.

**Table 1**

Roseville Electric Company	\$ 66.50
<b>Sacramento Municipal Utility District</b>	<b>\$ 73.01</b>
Los Angeles Power & Water Company	\$ 78.11
Pacific Gas & Electric Company	\$ 99.53
Southern California Edison	\$100.63
San Diego Gas & Electric Company	\$108.12

**Comparison of SMUD Service Reliability  
With That of Other California Providers**

A comparison of customer experienced frequency and duration of outages for the year 2003.

**Table 2<sup>7</sup>**

	<b><u>Duration</u></b>	<b><u>Frequency</u></b> (Per Year)
Roseville Electric Company	13 minutes	.25
<b>Sacramento Municipal Utility District</b>	<b>50 minutes</b>	<b>0.769</b>
Pacific Gas & Electric Company	193 minutes	1.308
Southern California Edison	57 minutes	1.148
San Diego Gas & Electric Company	76 minutes	.72

This table illustrates SMUD's service reliability compared to other California electric utilities. This analysis is discussed in greater detail in the Service Reliability section. SMUD data has been adjusted to conform with California PUC Reliability Data so that a direct comparison can be made between SMUD and PG&E.

**SMUD Control Area**

SMUD operates its own control area which is larger than its District boundary. Within its control area, SMUD is responsible for balancing resources and energy loads, while managing the transmission grid on a real time basis in accordance with WECC<sup>8</sup>, NERC<sup>9</sup> and prudent utility practices. SMUD does not participate in membership of the California Independent System Operator (CAISO). The CAISO is responsible for the distribution of wholesale power to its control area, which represents approximately seventy-five percent of California. CAISO functions as a traffic controller of the transmission of wholesale energy within its control area. Customers in SMUD's control area are not subject to CAISO charges.

<sup>7</sup> The data in Table 2 has been adjusted to conform to the CPUC methodology.

<sup>8</sup> WECC = Western Electricity Coordinating Council.

<sup>9</sup> NERC = North American Electric Reliability Council.

In the event that total demand for power exceeds total supply, CAISO prorates the available power supply within its control area. As a result, utilities under CAISO can be required to black-out areas. Because SMUD operates its own control area, it is not required to participate in mandatory CAISO-ordered black-outs and brown-outs in the event the demand for electricity exceeds supply due to economic conditions. SMUD assumes the risk for black-outs and brown-outs in its control area. However, SMUD would participate in black-outs that are required to protect the integrity of SMUD's facilities and the surrounding electrical facilities.

SMUD's control area is adjacent to the CAISO control area. SMUD and CAISO exchange real time information and coordinate operations to provide for reliable operation of the transmission grid. As part of the transition to SMUD service in the proposal territory, certain PG&E transmission facilities will be transferred from the CAISO control area to SMUD's control area.

**SMUD Overall Financial Condition**  
**(Credit Rating)**

The credit rating of the Sacramento Municipal Utility District is A1/ A2 as reported by Moody's Investor Service as of June 24, 2005. There are a number of factors that are considered by rating agencies in the evaluation and assignment of their listings. The following discussion summarizes SMUD's key strengths and weaknesses that influence its credit rating. The following "strengths/ weaknesses" discussion is a compilation from credit reports issued by Moody's, Standard & Poors and Fitch.

**Strengths**

- a. SMUD has a history of strong financial stability.
- b. SMUD has rebuilt its rate stabilization reserve to \$75 Million.
- c. SMUD has established a plan to build customer equity to 20% of its capitalization structure by 2007.
- d. SMUD has improved its debt ratios.
- e. Since the energy crisis, SMUD has placed even greater emphasis on risk management practices.
- f. SMUD has the ability and willingness to raise rates to maintain a sound financial position without regulatory approval, e.g., CPUC.
- g. SMUD has a large residential base and large governmental sector. This allows fixed costs to be spread over a large rate base.

- h. SMUD's retail rates are expected to remain substantially below PG&E's average rates for the next several years.
- i. SMUD has established fuel supply hedging strategies up to 30% of its gas needs through long term agreements, another 50% with one to five year commodity or hedging contracts, and the balance with spot market contracts.
- j. SMUD's relatively competitive cost structure, improved debt ratios and the utility's strong management have resulted in continued strengthening of the District's finances and factor in the stable credit outlook.
- k. SMUD has re-established its control center operation, somewhat limiting financial exposure to disruptions in the California statewide transmission grid.
- l. Operation of the Cosumnes Power Plant will minimize SMUD's reliance on wholesale markets. This project is also expected to enhance local transmission reliability.

**Weaknesses (Challenges)**

- a. Volatility related to the hydro-electric production. Hydro-facilities are subject to nature's rainfall and snow melt. SMUD purchases insurance to minimize this risk.
- b. About 60% of the capacity of the District is natural gas fired generation. Thus, SMUD is subject to price increases from its suppliers. SMUD minimizes this financial exposure by hedging contracts.
- c. From an investor's point of view, bond covenants are weaker than typical for a public power system.
- d. SMUD is still decommissioning Rancho Seco Nuclear Power Plant. Decommission is expected to be completed by 2012. SMUD has established a trust fund to cover the anticipated costs.
- e. SMUD has a large capital expenditure plan to spend approximately \$810 Million over the next five years. SMUD intends to fund a majority of its capital outlay program through operating cash flows.

The most important concern of credit rating agencies is that the borrower has the financial ability and where-with-all to repay its debt. The credit agencies evaluate not only the financial, but management and operational components of an agency as well.

Over the last several years, SMUD has improved in many areas. Rating agencies have pointed out that SMUD has a strong management team and there is a good relationship between the SMUD Board of Directors and management. SMUD has reported to rating

agencies that the Board's strategic plan is to achieve customer equity of twenty percent, i.e., reduce its outstanding debt by paying down debt or using cash to fund capital improvements.

SMUD, like most utilities, is subject to price volatility of energy markets. SMUD rates do not provide for automatic escalators or adjustments, however, the SMUD Board of Directors has the ability to adjust rates at any time to minimize its financial exposure.<sup>10</sup> That is, rate increases are not subject to approval of any regulatory agency, i.e., CPUC. Moreover, rate increases are not subject to Proposition 218.

### **SMUD History**

SMUD's proposed annexation of territory in Yolo County is not unique. In the past, SMUD has annexed several areas, as summarized below.

<b><u>Year</u></b>	<b><u>Action</u></b>
1923	District Formation
1946	Service Delivery
1967	Detachment of Roseville Area
1975	Annexation of Alex Brown Electric Company (Delta) [Four square miles]
1977	Annexation of Area near Rancho Seco [104.0 square miles]
1982	Annexation of Kelsey property and City of Folsom [110 square miles]
2004	Sacramento County Regional Sanitation District Yolo Pump Station [15 acres]
2006	Proposed annexation of portions of Yolo County [212 square miles]

### **CITY OF FOLSOM**

#### **SPHERE OF INFLUENCE/ ANNEXATION**

##### **A Case Study**

In 1984, your Commission approved the Folsom Service Area<sup>11</sup> Annexation to the Sacramento Municipal Utility District. SMUD paid \$13 Million to Pacific Gas & Electric Company for its transmission and distribution system plus \$3.4 Million in interest that accrued over a five year court proceeding. SMUD spent an additional \$3.4 Million to upgrade the PG&E system, for a total investment of \$19.8 Million.

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<sup>10</sup> Information provided from various public records of Moody's Investor Service, Standard & Poors and Fitch Credit Rating Agencies.

<sup>11</sup> An area consisting of approximately 110 square miles.

SMUD collected \$18.4 Million in surcharges and earned \$2.9 Million in interest. In essence, the Folsom residents paid SMUD the total cost of assets acquired from Pacific Gas & Electric Company.

Based on SMUD estimates, SMUD customers saved \$125 Million because SMUD's fixed costs and debt were allocated to the Folsom customer base. Also, Folsom residents saved \$238 Million (measured in 2004 dollars), compared with what they otherwise would have paid Pacific Gas & Electric for electric service. The total economic benefits (cost savings) related to the Folsom Annexation can be seen below.

SMUD Customers	\$125 M
Folsom Customers	<u>\$238 M</u>
Total Economic Benefits	\$363 M

This case study demonstrates that acquisition can produce positive economic benefits to all ratepayers and that the annexed territory, through a surcharge, can fund the acquisition costs and required improvements.

**DESCRIPTION OF PROPOSAL TERRITORY**

**City of West Sacramento**

The City of West Sacramento is located in eastern Yolo County between the Sacramento River on the east and the Yolo Bypass on the west. It lies immediately across the Sacramento River from the City of Sacramento and is approximately 85 miles east of San Francisco. Interstate 80 runs through the northwestern part of the city; Capital City Freeway bisects the City, running east-west through the center of town; and Interstate 5 runs north-south through the City of Sacramento, just across the river. The city limits of West Sacramento encompass what, before the City's incorporation in 1987, were the four separate communities of Broderick, Bryte, West Sacramento and Southport.

West Sacramento has a population of 40,030 and the City limit encompasses 23.3 square miles. The City is a powerful job center for the region. The City General Plan addresses the following types of land uses: Residential, Commercial, Office, Business Park, Industrial, Central Business District, Mixed Use & Riverfront Mixed Use, Public/ Quasi Public, Recreation & Parks, Open Space and Agricultural.

**City of Davis**

The City of Davis is located in the southeast corner of Yolo County, along Interstate 80 and the main Union Pacific railroad line. Davis is positioned in the Central Valley of California, 50 miles northeast of the San Francisco Bay Area and 15 miles west of Sacramento. Davis is separated from surrounding cities in the Counties of Yolo and Solano by ten to fifteen miles of agricultural land. Between Davis and West Sacramento is the two mile wide Yolo Bypass, one of the overflow drainage ways which provide flood protection for the Sacramento River valley.

Davis has a population of 64,259; the City limit encompass 9.8 square miles. The City is a university-oriented town (UC Davis) with a progressive, vigorous community noted for its energy conservation, environmental programs, parks, preservation of trees, bicycles and the quality of its educational institutions. Land uses covered by the City General Plan include: Residential, Neighborhood Retail, Community Retail, Commercial, Office, Business Park, Industrial, University of California, Public/Semi Public, Parks/Recreation, Neighborhood Greenbelt, Agricultural, Natural Habitat Area, and Urban Reserve.

### **City of Woodland**

Woodland is the county seat of Yolo County, located in California's Central Valley. Woodland is located 20 miles northwest of Sacramento at the intersection of Interstate 5 and State Route 113. To the south is the City of Davis, with its University of California campus. The Sacramento International Airport is eight miles to the east. Waterways include the Yolo Bypass and Sacramento River to the east, Willow Slough to the southeast, and Cache Creek to the north.

Woodland has a population of 53,382; the City limit encompass 14.5 square miles. Woodland has a strong historic heritage, reflected in the historic buildings in its downtown area and surrounding neighborhoods. Woodland's agricultural setting is largely responsible for the community's distinct identity and plays an important economic role in Woodland. Due to its proximity to major transportation nodes, Woodland has also become increasingly important as a manufacturing and distribution center. Land uses covered by the City General Plan include: Residential, Neighborhood Preservation, Planned Neighborhood, Commercial, Business Park, Industrial, Public Service, Open Space, Urban Reserve and Agricultural.

### **Yolo County**

Agriculture is the primary industry of Yolo County. The eastern two-thirds of the County consists of nearly level alluvial fans, flat plains, and basins, while the western third is largely composed of rolling terraces and steep uplands used for dry-farmed grain and range. The elevation ranges from slightly below sea level near the Sacramento River around Clarksburg to 3,000 feet along the ridge of the western mountains.

Yolo County has a population of over 184,000 people and has a county territory of 1,034 square miles. Yolo County has a population density of 182 persons per square mile. The 2000 population density, according to the U.S. Census, was 167 persons per square mile. For comparison, California's overall population density is 220 persons per square mile. San Francisco, the most densely populated county in the state, has more than 17,000 persons per square mile. For comparative purposes, Solano County has 476 persons per square mile. Tehama County has 19 persons per square mile. Sacramento County has 217 persons per square mile.

Just four percent of total Yolo County lands are within the jurisdictional boundaries of a city, though the vast majority of population resides in cities. Correspondingly, residential land uses occupy the largest percentage of city lands. Commercial and industrial land uses are also more prevalent in the cities compared to the unincorporated County. Approximately 4,500 acres of land countywide (of which more than 3,300 acres are in the cities) are vacant and designated for some type of urban development.

Nearly 85% of the population lives in the County's four cities (Davis, West Sacramento, Woodland, Winters). Its proximity to Sacramento International Airport, as well as two major interstate highways, places it within a major transportation hub of the state.

As was the case in 1983, during the last comprehensive Yolo County General Plan Update, the majority of County land is used for cultivated agricultural cropland. Livestock grazing is the next most common land use. Public open space is next in terms of total acreage. Orchards and vineyards, which are distinguished from cultivated agricultural lands for the purposes of this study, are another important County land use. Rural residential development is the largest user of residential land in the County. Rural residential land is distinguished from agriculture by the lack of commercial agricultural activity. Such parcels could be re-categorized as "agricultural" if commercial agricultural activity were to occur on these properties. Yolo County's General Plan addresses the following land uses: Agricultural, Residential, Mobile Home Park, Commercial, Industrial, Public & Quasi-Public, Central Business District and Public Open Spaces.

Based on the growth rates assumed in the various SACOG Blueprint scenarios, adjusted for the 2000 Census counts, the population of Yolo County could increase from 168,660 in 2000 to more than 310,000 by 2025 if a new community is developed, or to nearly 267,000 if a new community is not developed. The unincorporated area population could increase from 21,457 in 2000 to between 32,000 and 65,000 in 2025, depending on whether a new community is developed.

### **PACIFIC GAS & ELECTRIC COMPANY** **CURRENT SERVICE PROVIDER**

Pacific Gas & Electric Company incorporated in California in 1905. It is one of the largest combination natural gas and electric utilities in the United States. PG&E is based in San Francisco and is a wholly owned subsidiary of PG&E Corporation, a holding company.

PG&E currently generates, transmits, and distributes electric power to a 70,000 square mile service area. The service area of PG&E encompasses nearly all Northern California (with the exception of a few local publicly-owned utilities). It extends from Eureka in the north to Bakersfield in the south and from the Pacific Ocean in the west to the Sierra Nevada in the east. PG&E's annual electric revenues are about \$10 billion.<sup>12</sup> PG&E serves a population of 15 Million people. PG&E has approximately 5 Million electric customers, and employs approximately 20,200 people.

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<sup>12</sup> Based on PG&E's 2004 FERC Form 1, Electric Operating Revenues, pp. 300-301.

Pacific Gas & Electric Company is a publicly traded, investor-owned utility (IOU), governed by an 11-person Board of Directors elected by PG&E Corporation shareholders. PG&E Corporation has twelve corporate officers and PG&E has 24 company officers. Decisions affecting the operation of the utility are made by the PG&E Corporation Board of Directors. On the state level, PG&E is regulated by the California Public Utilities Commission (CPUC), which is located in San Francisco. The public may participate and provide comment to the CPUC in regulatory proceedings regarding PG&E. However, the CPUC process can be complex and costly when it comes to participation by the general public. **Pacific Gas & Electric Company has the ability to continue to serve the proposal territory. PG&E will continue to serve natural gas to the proposal territory.**

### **ANALYSIS**

Staff and its consultants have evaluated/ analyzed the following issues and factors related to SMUD's proposed annexation.

1. Municipal Service Review Requirements
2. SMUD Service Plan for the proposal territory
3. Sphere of Influence Review Requirements
4. PG&E Comments in Opposition to the Proposed Annexation
5. GES Economic Evaluation
6. Legal Basis to Value Utilities for Condemnation Purposes
7. Comparison of SMUD and PG&E Rate Structures
8. Yolo Surcharge
9. SMUD Pro Forma Income Statement
10. Impact of Natural Gas Prices
11. Analysis of System Valuation of PG&E Assets
12. Net Economic Benefit
13. Economic and Service Delivery Impacts to Affected Ratepayers
14. Service Reliability/ Quality of Service
15. Revenue Neutrality / Memorandums of Understanding
16. Section 99 Property Tax Exchange Agreement
17. Proposed Boundary
18. Election Process
19. Representation on SMUD Board of Directors
20. Environmental Impact Report
21. LAFCo Factors
22. Conclusion

## **MUNICIPAL SERVICE REVIEW REQUIREMENTS**

In order to prepare and to update Spheres of Influence in accordance with Government Code Section 56425, the Commission shall conduct a service review of the municipal service provided in the County or other appropriate area. The SMUD Municipal Service Review (with attachments) is available on LAFCo's website: [www.saclafoo.org](http://www.saclafoo.org). The MSR was presented to the Commission March 1, 2006. Information, as appropriate, from the MSR is included in this Executive Officer's Report.

## **SERVICE PROVISION**

The Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 requires that districts proposing annexation provide LAFCo with a plan for providing service in the annexation territory. Specifically, Government Code Section 56653 provides:

(a) Whenever a local agency or school district submits a resolution of application for a change of organization or reorganization pursuant to this part, the local agency shall submit with the resolution of application a plan for providing services within the affected territory.

(b) The plan for providing services shall include all of the following information and any additional information required by the commission or the executive officer:

- (1) An enumeration and description of the services to be extended to the affected territory.
- (2) The level and range of those services.
- (3) An indication of when those services can feasibly be extended to the affected territory.
- (4) An indication of any improvement or upgrading of structures, roads, sewer or water facilities, or other conditions the local agency would impose or require within the affected territory if the change of organization or reorganization is completed.
- (5) Information with respect to how those services will be financed.<sup>13</sup>

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<sup>13</sup> Amended by Stats. 2000, Ch. 761.

## **SMUD SERVICE PLAN FOR PROPOSAL TERRITORY**

SMUD submitted its separate plan for providing services to the proposal territory with its Resolution of Application and Municipal Service Review. In order for SMUD to serve the proposal territory, it must complete the construction and reconstruction of several electrical facilities. Prior to construction and reconstruction of these electrical facilities, SMUD will be required to complete additional environmental analysis, obtain required permits from regulatory agencies, and acquire rights-of-way and real property. These actions include the following:

### **Electrical Infrastructure Projects**

#### **Power Inn Road to Hedge Transmission Line Reconstruction**

SMUD will need to reconstruct an existing 115 kV<sup>14</sup> transmission line that runs approximately 2.5 miles from Power Inn Road to SMUD's Hedge Substation. The reconstruction consists of the replacement of lattice towers with new steel poles and increase the number of circuits from 2 to 3 or from 6 conductors to 9 conductors. This project is located in an existing right-of-way. SMUD will be required to obtain any required permits and permission prior to construction.

#### **North City Interconnection**

This project involves the interconnection of SMUD lines with existing PG&E 115 Kv power lines near the SMUD North City Substation. The interconnection is within existing easements and will require the construction of one or two poles and overhead conductors. SMUD will be required to obtain permits, permission, and notify appropriate agencies prior to construction.

#### **Proposed Woodland-Elverta 115 kV Transmission Line**

SMUD will need to construct a new 15 to 18 mile 115 kV transmission line from it's Elverta Substation to a point near the City of Woodland. This line will intersect with and connect to PG&E's Rio Oso/Woodland 115 kV transmission line. The Environmental Impact Report examines a study area within which a transmission line will be sited. Additional technical studies and environmental studies will be required prior to selection and approval of a final route.

This transmission line has not been designed, sited, nor have rights-of-way been proposed or acquired. Only if the annexation is approved by LAFCo and the electorate, will SMUD proceed with the necessary environmental review and permit approval process. LAFCo has no authority to site transmission lines or related electrical facilities. SMUD, the final decision-maker for the siting of this transmission line, has indicated that it will work with local jurisdictions, affected agencies, the public, and property owners.

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<sup>14</sup> kV = 1,000 Volts.

The typical easement width for a 115 kV to 230 kV transmission line is 60 to 100 feet wide, depending on the span length between towers. It is likely, the transmission line will consist of 6 conductors supported by steel poles that stand 90 to 110 feet high. The poles for this type of construction are typically spaced 500 to 1200 feet apart.

### **Willow Slough Substation**

This will be a new substation located near County Roads 102 and 27, near an existing P. G. & E. 115 kV transmission line that runs north and south between Woodland and Davis. This substation will be approximately 1-3 acres. The specific site and location have not been determined. However, the program EIR identified a one square mile study area. If the annexation is approved, additional approval and environmental review will be required prior to construction of any electrical facilities.

### **Transmission Line and Substation Siting Criteria and Process**

In the EIR, the study areas within which the Woodland-Elverta Transmission Line and the Willow Slough Substation will be located are analyzed at the program level. SMUD is the agency with authority to approve the ultimate location of the Transmission Line and Substation within the study areas; LAFCo does not have land use authority. (See, for example, Government Code Section 56886.)

If the proposed annexation is approved by LAFCo and the voters, SMUD will complete a detailed analysis of Transmission Line and Substation siting issues. SMUD will undertake project level environmental review of the Transmission Line and Substation. SMUD will use the guidance regarding siting energy facilities and minimizing environmental impacts set forth in the Sacramento County General Plan (Public Facilities Element, Section VII, Energy Facilities) and the Sacramento County Zoning Ordinance (Sections 301-10 - 301-12). Because the siting guidance in the Sacramento County General Plan and Zoning Ordinance is the most thorough, SMUD, will also use it for the portions of the Transmission Line that may be located in Yolo and Sutter Counties, as well as the City of Sacramento.

SMUD will also engage in a cooperative effort with agencies, local jurisdictions, property owners, and the public to develop and analyze alternative Transmission Line alignments within the study area with the goal of avoiding or minimizing effects on the environment and landowners, without making the Transmission Line infeasible or interfering with the authority and responsibility of the SMUD Board of Directors to make the final decision, in the public interest, regarding the location of SMUD facilities.

The cities and counties in which the Transmission Line will be located have approval authority over its location. The SMUD Board of Directors may override a local jurisdiction's disapproval of a siting location with a supermajority vote. (See Government Code Sections 53091, 53096.)

### **Distribution System Upgrades**

This work involves the reconductoring or replacement of existing overhead conductors with slightly larger diameter wires to increase the electrical load-carrying capacity to several areas within the affected territory. The various upgrades and proposed construction has been analyzed by URS at the project and program level in the EIR.

### **Level and Range of Services**

SMUD will provide the same level, or an improved level, of electric service to the proposal territory. The transition to SMUD service will likely be transparent. SMUD plans to commence service in the fourth quarter, 2008. Yolo customers will be informed of the change over date by SMUD during this transition period.

SMUD anticipates that it will be able to provide more reliable service after various system improvements are completed. (Based on SMUD Application and supplemental information that has been submitted to LAFCo.) The next section describes how electric utilities measure and define reliable service. SMUD has made a commitment in its application to reach certain goals and objectives within certain time lines. Recently, Ann L. Trowbridge,<sup>15</sup> stated to Commission Counsel Nancy Miller that PG&E's President and Chief Executive Officer admitted in testimony filed with the CPUC in PG&E's 2007 General Rate Case, that "PG&E's customers have been telling us through surveys that our service can improve, and that we need to work harder to meet their expectations."

### **System Reliability**

Reliability is a measure of the constancy of electric service. The utility industry has agreed on several indices to measure the reliability of an electric system. SMUD uses some of these indices to measure its performance. The definitions of these measurement indices are found in the table below.

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<sup>15</sup> Attorney at Law, Downey, Brand, LLP, in correspondence to Nancy Miller, Commission Counsel, dated March 1, 2006.

**Table 3**  
**Reliability Criteria Definitions**

<b><u>Performance Criteria</u></b>	<b><u>Definition</u></b>
<b>SAIDI</b>	<b>System Average Interruption Duration Index</b>  <u>Total Minutes of Electric Interruption</u> Total # of Customers Served
<b>SAIFI</b>	<b>System Average Interruption Frequency Index</b>  <u>Total # of Customers Affected</u> Total # of Customers Served

The utility industry uses several other indices, in addition to those listed in Table 1 above, to measure reliability. However, the two listed here are the predominant gauges by which utilities measure their reliability.

SMUD's goal for 2005 is to have the SAIDI index in the range of 80.4 to 94 minutes of average outage time per customer. SMUD is well within that range--over the last five years (2000 - 2004), average outage time per SMUD customer was 89 minutes. SMUD's goal for the SAIFI index is 1.16 to 1.33 outages per customer average for 2005. SMUD also meets the SAIFI goal--SMUD's five-year (2000 - 2004) average number of outages per customer was 1.31 outages.

Improving reliability requires a multi-pronged approach that includes a combination of planning, design, maintenance, capital improvements and operations.

Access to and analysis of system data (outage trends, maintenance intervals, root cause, etc.) for the proposal territory will allow SMUD to develop an integrated plan for system maintenance and operations. Improvements in maintenance planning, maintenance backlog reductions, planning through establishing capacity levels, redundancy requirements, and protection practices in SMUD's existing area are enhancing reliability. These changes include installing backup capacity, the modification of protective relaying schemes to allow fuse savings where appropriate, managing repairs and replacement of failed underground cables, and removal of idle or underutilized facilities.

SMUD expects to implement some or all of the above-mentioned actions to bring reliability in the proposal territory in line with SMUD's standards. SMUD's application indicates it will install capital improvements that will:

1. Reduce the number of multiple terminal lines to more reliable two terminal lines;
2. Reduce system overloads under contingency conditions;
3. Resolve local voltage problems; and
4. Replace underrated equipment.

The GES analysis concludes that SMUD has the capacity to provide service reliability within the proposal territory that is at least equal to PG&E service within the proposal territory.

### **Customer Service/ Relations**

SMUD is fully committed to maintaining the highest levels of customer satisfaction for its programs and services. The SMUD Board has adopted customer service as a core value for the organization. To achieve this goal, SMUD continuously obtains information from customers through surveys.

SMUD conducts periodic customer satisfaction surveys that are sent to customers who participate in SMUD's programs and services. These surveys are designed to assess overall customer satisfaction in order to hear the voice of the customer. In addition, SMUD regularly conducts satisfaction surveys after customers have completed a specific transaction with SMUD, (e.g., new service, connect/disconnect, and tree trimming) to measure the level of customer satisfaction with the transaction.

In conjunction with these surveys, SMUD has adopted a minimum customer satisfaction target, which the District continuously strives to exceed. Currently, the target has been set at a minimum of 96% satisfaction. In other words, SMUD's goal is to have 96% of customers report they are satisfied or very satisfied with SMUD. As a result of SMUD's continuous attention to improving customer satisfaction, the District has been able to achieve the established target, with satisfaction results at the 95-96% level over the last three years.

Externally, SMUD subscribes to various customer satisfaction surveys with research firms such as J.D. Power and Associates. The purpose of this subscription is to compare SMUD against other major utilities so the District can improve its services and programs. On an annual basis, J.D. Power and Associates fields an electric utility residential customer satisfaction study, as well as a business customer satisfaction study. These studies are designed to measure multiple aspects of customer satisfaction (i.e., power quality and reliability, customer service, company image, billing and payment, price, and communications). Since these surveys are conducted on an ongoing basis, they allow for tracking performance over time.

Over the years, SMUD has performed extremely well in both the annual residential and business customer satisfaction surveys conducted by J.D. Power and Associates. In 2004, SMUD ranked in the top quartile among all utilities for the western region. In addition to being in the top quartile, SMUD was the highest ranked electric utility in California for both residential and commercial customers for customer satisfaction in the 2004 J.D. Power survey.

In July 2005, the J.D. Power and Associates' survey measuring Residential Customers' satisfaction with the nation's largest electric utilities showed that SMUD was ranked No. 1 in California for five of the previous six years and was ranked third in the western region.

SMUD scored 108 points on the survey, which represented a 6-point improvement in one year and made SMUD one of the top gainers among utilities nationwide. The score of 108 was an all-time high for SMUD, whose customers have been surveyed since 1999. With 78 large utilities in the survey, the District was rated in the top ten.

Among other California utilities participating in the survey, Southern California Edison scored 101 points, the Los Angeles Department of Water and Power scored 94 points, San Diego Gas & Electric scored 93 points, and PG&E scored 91 points, the average score was 97 points in the western region.

Additionally, RKS Research & Consulting conducted a 2004 survey for the California Municipal Utilities Association that analyzed how customers rate SMUD, other municipal electric utilities, and IOUs in California. Based on the results of the survey, RKS Research & Consulting reported, "Customers awarded SMUD customer service representatives high scores for their performance, rating them above statewide municipal utility and IOU averages on all measures." Based on industry surveys, SMUD ranks higher in customer service satisfaction than does PG&E.

### **Stranded Facilities**

SMUD has identified the PG&E transmission and distribution facilities currently serving the annexation territory that will be acquired for the proposed annexation. The selection of the annexation boundary and the list of PG&E facilities to be acquired were chosen to: avoid impact to the remaining PG&E customers, avoid the duplication of facilities, minimize the need for new facilities, and to minimize the cost of annexation. However, minimal facilities may be stranded by the proposed plan. SMUD proposes to compensate PG&E for any transmission and distribution facilities that are stranded.

### **Stranded Transmission**

SMUD estimates that there will be approximately 10.7 miles of existing PG&E 115 kV transmission line and one (1) line termination that may be stranded by the proposed annexation. This represents approximately 18% of the total amount of transmission lines

that will be acquired from PG&E as part of the annexation. These stranded transmission facilities are:

**Table 4**

<b><u>Description of Facility</u></b>	<b><u>Length</u></b>
Davis Substation to Brighton Substation Single Circuit 115 kV Transmission Line from just south of Elder Creek Road to Brighton Substation and associated line termination at Brighton Substation	2.5 miles
Woodland Substation to Woodland Tap Double Circuit 115 kV Transmission Line from County Road 17 to Woodland Tap	<u>8.2 miles</u>
<b>Total Stranded Transmission Line Facilities</b>	<b>10.7 miles</b>

**Stranded Distribution**

In selecting the annexation boundaries, SMUD has made every effort to avoid stranding existing PG&E distribution facilities. Existing distribution system 'open points'<sup>16</sup> as well as natural geographical features were used to select the proposed boundaries. It is SMUD's intent that the severance points between the proposal territory and the remaining PG&E facilities will not impact the service reliability of SMUD and PG&E customers. There is approximately one mile of existing PG&E distribution line, one (1) 115 kV/ 60 kV transformer, and one (1) circuit breaker that may be stranded by the proposed annexation. The estimated distribution line length of one mile represents less than 0.14% of the total amount of distribution lines that will be acquired from PG&E as part of the annexation. The estimated stranded distribution facilities are:

**Table 5**

<b><u>Description of Facility</u></b>	<b><u>Measure</u></b>
Distribution Lines at various locations throughout the annexed territory.	1 mile
115 kV/ 60 kV Transformer Bank at Davis Substation that currently services U.C. Davis Substation.	1 each
60 kV/ 12 kV Plainfield Substation Circuit Breaker <sup>17</sup>	1 each

<sup>16</sup> Power can be switched or disconnected at an open point without disrupting service to either segment or the system.

<sup>17</sup> The existing PG&E 60 kV/ 12 kV Plainfield Substation is located in the annexation territory. The proposed annexation will not include PG&E 60 kV facilities. After approval of the proposed annexation,

The District will compensate PG&E for these facilities. The ownership of these facilities will be determined by mutual agreement of SMUD and PG&E or the court, as previously described. A similar difference existed during the Folsom Annexation. However, the electrical engineers from SMUD and PG&E were able to reach an agreement regarding what facilities were stranded as well as a reasonable value of the stranded facilities.

#### **Additional Upgrades by SMUD of PG&E's Distribution System**

The District anticipates that it will need to spend approximately \$40.0 Million on the PG&E transmission and distribution system upgrades and construction of new SMUD facilities to serve the proposal territory. These upgrades are essential in order that SMUD can improve the system reliability i.e., decrease outage times and reduce the frequency of outages per customer. These upgrades will be constructed over several years and funded through the surcharge entirely by the Yolo ratepayers.

#### **Operations and Maintenance and Administrative Staffing Proposals**

SMUD will need to add approximately 79 employees to serve the proposal territory. The increased staffing is estimated to cost approximately \$11.5 Million (2005 prices). This represents a 6.7% increase in costs, however, the staffing proposal represents only a 3.6% increase in SMUD employees. SMUD proposes that LAFCo include a condition in its resolution of approval that requires SMUD, to the extent practical, to hire qualified PG&E employees displaced as a direct result of the annexation. A breakdown of anticipated positions to serve the proposal territory is set forth below.

#### **Distribution**

The distribution staffing level includes 45 new positions. The cost increase is estimated to be \$5.7 Million. The following position classifications are proposed in SMUD's service plan for the proposal territory.

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the substation will continue to be owned and operated by PG&E and it will continue to serve customers located outside of the annexation territory. However, those customers within the annexed territory currently served by the Plainfield Substation will be served from the proposed Willow Slough Substation. Therefore, one of the existing circuit breakers at Plainfield Substation may be stranded.

**Distribution and Transmission Work Force**

Line Workers	20
Electrician/ Tech	3
Troubleshooters	4
Vegetation Planner	2
Cable Locators	2
Designers	2
System Engineer	2
System Operator	2
Meter Technician	3
GIS Specialist	2
Foreman Network	1
Process Supervisor	1
Other	<u>1</u>
<b>Total</b>	<b>45</b>

Broken down by type of position, field employees are increasing approximately 12 percent, while support positions are increasing only 4 percent. Labor and benefit costs for these incremental positions total \$3.0 Million in O & M and \$1.7 Million in Capital, which is contained in Annual Capital Upgrades. Incremental costs for contract services labor is estimated at \$2.31 Million, with the majority of this amount, \$1.872 Million, designated for tree trimming. Tree trimming labor for the annexed territory will be entirely by contract, so this increase is 30 percent higher than the 2005 budget. Other direct costs, which are primarily materials, are assumed to increase 12 percent. The non-labor portion of indirect costs, which includes small tools, training, and supplies, is assumed to increase \$410,000, or 9 percent, proportionate to the amount of O & M labor growth. The budget for internal service and technology allocations is assumed to increase \$310,000, or 4.6 percent, to accommodate an increase in vehicle charges and additional personal computers.

The Distribution Business Unit estimates an additional \$768,000 will be required for first-year start-up costs. These costs will be required for substation equipment documentation and evaluation, and for tree trimming costs to bring the annexed territory up to SMUD trimming cycle standards.

**Customer Business Unit**

The Customer Business Unit projects incremental operating costs of \$3.62 Million, which is 5.7 percent of its 2005 O & M budget. Included in this estimate are 26 new positions (4.1 percent increase) as follows:

Meter Readers	5
Field Services	6
Remittance Processing	3
Contact Center	5
Key Account Reps	5
Residential Services	<u>2</u>
<b>Total</b>	<b>26</b>

The increase in meter readers is only 6 percent higher than current staffing levels, in spite of a 12 percent increase in customers, because of the assumed installation of Encoder Receiver Transmitter (ERT) meters in the annexed territory as part of startup costs. No staffing increases are assumed in the Strategy and Customer Communication segments. The total labor and benefits cost of these new positions is \$2.5 Million, which is 6.2 percent higher than the 2005 O & M labor budget. This increase is higher than the staffing increase because of positions utilized in Capital and Public Goods. Other direct costs, such as contract services, postage, office supplies and advertising are assumed to increase \$1.02 Million, or 10 percent, over the 2005 budget, slightly less than the 12 percent increase in customers. Business unit indirect costs, such as office supplies, contract services, uniforms and training, are projected to increase \$70,000, or 5 percent, which is in line with the staffing increase. Technology and internal service costs are estimated to increase \$370,000, or 3.1 percent, to provide for additional vehicles, personal computers and SAP licenses. The Customer Business Unit is also anticipating \$320,000 of first-year start-up costs to provide for 4 additional contact center positions to handle additional calls following the cut-over.

**Energy Supply Business Unit**

The only two segments of Energy Supply to be affected by annexation are System Operations and Reliability (including transmission O & M) and Commodity Procurement and Sales. The other two segments, Energy Production and Decommissioning, will not be affected. The cost of incremental power plant staffing is included in the power supply estimates. In the two affected segments, annexation will generate incremental costs of \$1.16 Million, which is 4.3 percent of the 2005 O & M budget. This figure includes a \$330,000, or 15 percent, increase in transmission O & M labor, which is the equivalent of 3 positions included in the Distribution Business Unit's new positions. The only other new positions are two positions in System Operations for system protection and operations engineering. Commodity Procurement and Sales does not anticipate any incremental staffing requirements. The projected labor increase of \$580,000 from annexation is 4.2 percent of the 2005 budget. Other direct costs such as materials and contract services total \$8.16 Million in the District's 2005 budget, and annexation will increase these costs \$480,000, or 5.9 percent. Indirect non-labor costs will increase 30,000, or 4.7 percent, and technology and internal service will increase \$70,000, or 2.9 percent. Energy Supply has not estimated any one-time start-up costs in O & M.

### **Corporate and Business Services**

Corporate and Business Services are projecting increases of \$460,000, or 3.5 percent, and \$1.01 Million, or 7.1 percent, respectively, from annexation. The only additional staffing requirement is one new position in Government Affairs. Business Services non-labor costs, which are mostly property and liability insurance, are projected to increase \$1.01 Million, or 10 percent. Corporate Services non-labor costs, such as outside legal and contract services, are projected to increase \$310,000 (or 10 percent).

### **Technology and Internal Services**

Projected increases in these Business Units is included in the increases discussed previously. The Technology Business Unit is projecting an increase of \$350,000, or 1.3 percent, from annexation, primarily in the Customer Business Unit for non-labor costs related to SAP. No new staffing is anticipated. Internal Services is projecting an increase of \$410,000, or 1.4 percent, primarily due to additional vehicles and substation security. One new position is anticipated in Transportation and one in Asset Protection.

### **Financing Plan**

#### **SMUD Proposed Financing of Acquisition and Construction Costs**

The District will use debt and/or available cash to cover the acquisition costs and capital improvements. SMUD will develop a financing plan that minimizes costs, complies with bond requirements as well as financial market expectations to protect its credit rating. The following information outlines the most likely financial strategy that SMUD will execute.

In summary, the District will use full debt financing of initial annexation capital expenditures. New long-term, fixed rate, tax-exempt system revenue bonds, with a level debt service structure, will be issued to the extent possible. The portion of initial capital outlays that require taxable debt will be financed with commercial paper supported by a letter of credit. Taxable commercial paper is typically less expensive than fixed rate taxable debt, has more lenient debt coverage requirements, and provides much greater flexibility for repayment. The District will apply cash generated by annexed Yolo customers to repay taxable commercial paper as quickly as possible. For the first five years, the total revenue requirement for debt service will consist of tax-exempt debt principal and interest, tax-exempt debt coverage payments and interest costs for taxable commercial paper. SMUD's debt service coverage will be in accordance with both current senior bond indenture coverage requirements and the District Board of Directors' goal for building equity. After the first five years, principle payments will be made on the taxable commercial paper to retire the balance of taxable debt over time. Taxable debt will actually be retired relatively quickly because coverage charged on tax-exempt debt will be used to help retire taxable commercial paper. Subsequent capital

expenditures will be financed with tax-exempt debt until taxable debt is fully repaid, at which point cash from debt coverage will be applied to annual capital expenditures.

### **SMUD CUSTOMER PROGRAMS**

As a community-owned utility, SMUD is committed to providing programs and services to its customer owners tailored to their specific needs; these services are available across all customer segments. Such programs include energy efficiency, photovoltaic (solar) energy, low-income assistance, load management programs and value-added retail products and services. Many of SMUD's programs are unique and innovative and are continually shaped and improved based on customer demand and customer feedback. A few of these programs and services are highlighted in this section.

#### **Programs**

Energy efficiency programs are a significant part of SMUD's identity and a core value of the utility. SMUD is a recognized leader in energy efficiency programs with nearly 30 years of experience in the development and implementation of award-winning, customer-driven programs. In 2004, SMUD invested over \$15 Million in energy efficiency programs for its customers. The District's 2004 energy efficiency expenditures represent 2.4 percent of SMUD's 1994 electricity revenues.

One of the more popular programs offered by SMUD is the Shade Tree Program, which provides free shade trees to customers to plant in locations that directly shade homes and reduce summer air conditioning loads. Since 1990, the District, in collaboration with the Sacramento Tree Foundation, has planted more than 350,000 trees in the Sacramento area. These trees create an urban forest that helps mitigate the summer heat-island effect and provide air quality benefits. This program received the U.S. Department of Forestry's Tree Line USA award in 2004 for the fourth consecutive year. Other recent awards for energy efficiency programs include:

1. The ENERGY STAR® Partner of the Year award for SMUD's 2004 Residential Lighting program, given by the U.S. Environmental Protection Agency.
2. The Community Service and Resource Efficiency awards for SMUD's Refrigerator Recycling and Cool Roof programs in 2003 and the Aeroseal Duct Sealing program in 2002, given by the California Municipal Utility Association.
3. The Champion of Energy Efficiency award in 2004, given by the American Council for an Energy Efficient Economy.

The District's commitment to Photovoltaic (PV), or solar energy, began in the 1980s. Over the past two decades, SMUD has compiled one of the highest annual installation goals for solar energy of any utility in the country in relation to its size. Nearly 10 MW of grid-connected solar systems have been installed, representing approximately 10% of all grid-connected PV systems in California. SMUD offers solar programs to residential

and commercial customers and works with both the retrofit and new construction markets to continue to promote and improve this technology.

The District also operates several load management programs designed to help it manage the summer air conditioning peak load. SMUD's various programs can reduce energy usage by residential and commercial customers to provide load relief in case of local or regional system emergencies. One of the oldest and most reliable of these programs is SMUD's Peak Corps Program. Customers on this program agree to have cycling devices installed on their air conditioners that allow SMUD to cycle their compressor for a customer-selected amount of time per hour during the summer months. Customers receive a nominal fixed bill discount per month, as well as a per-cycling event bill credit depending on the level of cycling selected by the customer. This program includes approximately 100,000 customers, which is a significant percentage of the total number of customers with central air conditioners in the service territory.

For more than twenty-five years, the District has also offered a broad range of programs and assistance to customers with special financial needs. Programs are available for low-income households, senior citizens, customers with special medical needs, and families and individuals in crisis. One of the more recent and innovative programs in this area is the Energy Help program, which is an emergency intervention program that uses charitable contributions from customers who donate a monthly amount through their electric bill to help low-income customers avoid interruption of electricity service.

SMUD's commitment to providing help to households in need of financial assistance has also been recognized at the national, state, and local levels. Some of the recent awards in this area include:

1. The 2003 Corporate Award for Excellence in Support of Low-Income Customers, given by the National Fuel Funds Network.
2. The California Municipal Utilities Association award for Innovative and Comprehensive Approaches to Community Service in 2002.
3. The 2001 People Helping People Business Awards for SMUD's Community Housing Coalition effort, given by the Community Services Planning Council.

In addition, the District offers a suite of value-added retail products and services to its customers. Many of these programs were developed in response to customer demand and tailored to the unique requirements of the local community. An example of one of these products is the Greenergy® program. This "green energy" program allows customers to pay an additional monthly charge for SMUD to buy energy that is produced from clean, renewable, energy resources. This gives SMUD customers the opportunity to take an active role in helping SMUD be environmentally friendly, diversify its resource mix, and contribute to a better environment. The program is offered to both residential and commercial customers with options tailored to the needs of either individual households

or businesses. SMUD then matches 40% of all Greenergy® premiums to build new SMUD-owned renewable generation assets.

Greenergy® electricity is generated from a mix of local renewable energy resources including the Keifer Landfill Plant (landfill gas), the Solano Wind Farm, and the Slab Creek reservoir (small hydroelectric plant), to complement certified green power purchased on the open market. Almost 30,000 residential customers and over 1,200 businesses have signed up for this program, making this program the fourth largest green pricing program in the United States, based on enrollment.

SMUD also provides a number of on-line programs and services to help customers interact with the District, manage their accounts and bills, and conduct other business with the District.

### **Non-Utility Private Generators**

SMUD will honor agreements for both residential and commercial customers that generate power. For example, customers that generate electricity have the ability to reduce their electric charges and even sell excess power which they produce.

SMUD will honor current solar sites and current Qualifying Facility (QF) contracts within the annexation territory. In addition, SMUD will facilitate delivery to the California Independent System Operator (CAISO) grid. Upon expiration of these contracts, SMUD will enter into negotiations with QF's to establish new power purchase contracts or develop transmission and interconnection agreements to enable delivery of energy to the CAISO grid.

Energy delivered by QF's such as Woodland Biomass, will be wheeled without fee to SMUD inter-tie points enabling delivery to the CAISO grid for the term of the agreement to avoid transmission rate impacts.

Interconnection requirements in place for generator connections with the PG&E electrical grid will be honored to the extent the interconnection and the non-utility generator complies with prudent utility practices and WECC requirements. SMUD interconnection requirements are set forth in Rules and Regulations 21.

### **Municipal Service Review Determinations**

Under the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, the Commission must prepare written determinations<sup>18</sup> with respect to each of the following:

1. Infrastructure needs or deficiencies.
2. Growth and population projections.
3. Financing constraints and opportunities.
4. Cost avoidance opportunities.

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<sup>18</sup> Government Code Section 56430.

5. Opportunities for rate restructuring.
6. Opportunities for shared facilities.
7. Government structure options, including advantages and disadvantages of consolidation or reorganization of service providers.
8. Evaluation of management efficiencies.
9. Local accountability and governance.

SMUD submitted its Municipal Service Review to LAFCo on January 13, 2006. LAFCo presented the MSR to the Commission on March 1, 2006. (The MSR is available @ [www.saclafco.org](http://www.saclafco.org).) Resolution No. LAFC 1317 Making Determinations for the SMUD Municipal Review is included as an Appendix of this report.

### **SPHERE OF INFLUENCE REQUIREMENTS**

In order to carry out its purposes and responsibilities for planning and shaping the logical and orderly development and coordination of local governmental agencies so as to most advantageously provide for the present and future needs of the County or counties and local communities, the Commission shall develop and determine the Sphere of Influence of each local governmental agency within the County.

The Commission shall consider and prepare a written statement of its determinations with respect to each of the following:

1. The present and planned land uses in the area including agricultural and open space lands.
2. The present and probable need for public facilities and services in the area.
3. The present capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide.
4. The existence of any social or economic communities of interest in the area if the Commission determines that they are relevant to the agency.

### **SMUD SPHERE OF INFLUENCE**

LAFCo policy indicates that Spheres of Influence should be approved prior to undertaking an annexation proposal. However, amending SMUD's Sphere of Influence prior to a proposal for annexation would have created unrealistic expectations. Therefore, I recommended the concurrent processing of SMUD's Sphere of Influence and the proposed annexation in order that staff could perform a single comprehensive analysis.

At the present time, the Sphere of Influence of the Sacramento Municipal Utility District is coterminous with the District boundary. SMUD has adopted annexation policies that indicate that it does not desire to have a Sphere of Influence which extends beyond its District boundary, as amended.

The SMUD service area is completely surrounded by other utilities that provide electric service. For example, the surrounding areas are either in the franchise area of Pacific Gas & Electric Company or the City of Roseville.

### **SPHERE OF INFLUENCE ANALYSIS**

1. ***The present and planned land uses in the area including agriculture and open space lands.***

SMUD is not a jurisdiction that has land use authority. SMUD cannot make local zoning and land use decisions. Whether or not the agricultural and open space lands within the proposal territory will urbanize is a decision beyond the purview of the Sacramento Municipal Utility District. SMUD proposes to amend its Sphere of Influence into an area that is regulated by four local jurisdictions: Yolo County and the Cities of West Sacramento, Davis and Woodland. The Board of Supervisors and City Councils of these jurisdictions regulate land use decisions. Typically, these elected officials provide for residential, industrial, commercial, open space and agricultural uses based on local preference and market demand.

Each of these jurisdictions has a General Plan that provides for the accommodation of future growth. The composition of each of these communities is very similar to the composition of the communities that SMUD currently serves. Yolo County does not promote development in the unincorporated area. Yolo County attempts to protect open space and agricultural uses. The City of Davis is very cautious regarding annexation and new growth. The City of Woodland limits growth to approximately two percent per year by referendum. The City of West Sacramento potential growth areas are restricted by the Yolo Bypass and other environmentally sensitive sites. SMUD proposes to provide service in accordance with local planning and zoning requirements of the jurisdictions in the proposal territory.

2. ***The present and probable need for public facilities and services in the area.***

The proposal territory is currently served by Pacific Gas & Electric Company which has the ability to continue to serve the territory as well as its probable future growth. The local jurisdictions that petitioned SMUD for the provision of electric service did so according to the following justifications:

1. SMUD has lower rates than PG&E.
2. SMUD has a better service record than PG&E.
3. SMUD is operated by a locally elected Board of Directors.

SMUD has provided documentation that supports its ability to serve the affected territory. SMUD has over sixty years of experience in providing electric

service. SMUD can operate and maintain both the current and expanded transmission and distribution system. SMUD has the expertise to purchase and generate electricity to serve the affected territory. SMUD has demonstrated that it can provide electricity in an efficient and cost-effective manner to its current ratepayers.

For SMUD to be able to provide cost-effective service to the proposal territory depends on three major variables:

1. The acquisition price.
2. The power supply cost to serve the proposal territory.
3. The rate differential between SMUD and PG&E.

GES analysis indicates that SMUD can provide cost-effective service at rates that are lower than the rates of Pacific Gas & Electric Company.

3. ***The present capacity of public facilities and adequacy of public services that the agency provides, or is authorized to provide.***

In order for SMUD to serve the proposal territory, it will need to construct facilities to connect the proposal territory with SMUD's current service territory. These construction projects have been described under the Plan for Service. Basically, SMUD will need to construct a transmission line, electrical substation and interconnect with the PG&E distribution system in the territory it proposes to serve. SMUD will also need to reconstruct some of its facilities as described in their application.

The cost to construct these facilities will be recovered from a surcharge imposed on Yolo ratepayers. Depending upon the total acquisition costs and other variables, SMUD estimates these capital costs will be repaid within a five to ten year period. After all construction and acquisition costs have been repaid, rates will be reduced in the proposal territory. The power supply costs will also be included in the surcharge. This part of the surcharge could continue until rates between the proposal territory and SMUD's current boundaries are equalized. That is, over time, SMUD rates will likely increase and will equal or exceed the surcharge rate in the proposal territory.

4. ***The existence of any social or economic communities of interest in the area if the Commission determines that they are relevant to the agency.***

The boundary of the proposal territory includes a service area that is electrically interconnected and integrated. The boundary of the proposal territory attempts to minimize stranded facilities and the need to construct duplicate facilities to serve the area. Therefore, there appears to be an economic community of interest and service delivery reasons that support the boundary as currently proposed. There

are social communities of interest. However, they do not appear to have significant impact on the boundary as currently proposed.

**IMPACT OF CHANGING ELECTRICAL SERVICE PROVIDERS**

In terms of electrical energy, there is no way to differentiate between SMUD and PG&E. The voltage provided to the consumer is the same. That is, no difference between SMUD electricity and PG&E electricity exists for the consumer's electrical devices.

**Major Factors That Differentiate Electrical Service Providers**

The customer generally does not have a choice when it comes to purchasing municipal type services other than moving to a different neighborhood. Sewer districts, phone companies, electric service providers, etc., provide service to specific geographical territory. Potentially, there are several factors that will differentiate service provided between SMUD and PG&E. The major differences discussed in this report focus on rates and quality of service, or reliability. These issues are the most tangible to customers. The generation mix could also be a factor that would differentiate service provision from an environmental perspective.

Generally, construction and environmental impacts related to electrical distribution systems is very similar between electric utilities. However, design of electric systems can be significantly different. This, in turn, can impact system reliability. Moreover, types of generation facilities may impact environmental resources, depending on the type of fuel used. Generation sources may be local but many times, the power source is not local. Therefore, the generation mix of a utility may influence the preference of the customer.

The following table compares the generation portfolio of SMUD and Pacific Gas & Electric Company.

**Table 6**  
**2004 Generation Energy Resources Portfolio**  
**By Resource Type**

<b><u>Generation Source</u></b>	<b><u>SMUD</u></b>	<b><u>PG&amp;E</u></b>
Hydroelectric	21%	13%
Nuclear <sup>19</sup>	-0-	19%
Renewable <sup>20</sup>	10%	10%
Co-Generation <sup>21</sup>	23%	13%
Purchased (Contracts)	<u>46%</u>	<u>45%</u>
Total	100%	100%

<sup>19</sup> SMUD share includes 900 GWh of hydroelectricity from WAPA (Approximately 9%.)

<sup>20</sup> SMUD renewables includes energy produced by SMUD's Greenergy Program.

<sup>21</sup> Cogeneration for PG&E includes all QF contracts that are not renewable only.

Both SMUD and PG&E are committed to providing renewable and green energy generation as part of their generation sources. Both utilities are also committed to demand side energy conservation programs. SMUD's plan for serving the proposal territory is discussed below.

### **Impacts on the State Energy Market Place**

The proposal territory represents an existing load of approximately 250 MW during peak load period. This is the base load that will be transferred if the annexation is approved by your Commission. The total statewide energy consumption will not change as a result of the annexation. However, if the annexation is approved, SMUD will have to purchase, or generate, additional supply to serve the existing load. Likewise, PG&E should be able to reduce what it needs to buy or generate by a corresponding amount. Nevertheless, the overall net effect statewide should be the same or no change. That is, a similar mix of resources will be consumed. Increased supply will be required as the area grows or develops. This increase will occur whether SMUD or PG&E serves the proposal territory because growth is not dependent on which particular entity provides electric service.

### **SMUD's Capacity to Serve the Annexation Territory**

Capacity to serve represents the capability of the transmission system to deliver power, assuming contingency conditions. Contingency conditions generally assume the possible failure of the longest single component of the system.

SMUD's existing total capacity to serve throughout its 230 kV and 115 kV service area is approximately 3,100 MW. SMUD expects its capacity to serve will increase to 3,400 MW by early 2006 with completion of the Cosumnes Power Plant. With the completion of the Roseville Energy Park in approximately 2007, SMUD's capacity to serve will increase to approximately 3,650 MW. SMUD does not own or operate the Roseville Energy Park. However, its presence within the Sacramento region will improve the grid's capacity to serve, including SMUD's capacity to serve its customers.

In 2008, SMUD expects its capacity to serve will likely increase to 3,900 MW with the completion of the proposed WAPA O'Banion Substation to Elverta Substation 230 kV transmission line.

### **SMUD's Power Supply to Serve the Proposal Territory**

***The SMUD Board of Directors has reserved its current low cost energy supply resources for current SMUD customers.*** If the annexation proposal is approved, SMUD will complete an energy supply plan for the proposal territory. In addition to extending its energy efficiency and demand response programs to the proposal territory, SMUD expects to serve the territory through a combination of new short- and long-term power contracts, spot market purchases, customer-owned generation and new renewable power supply.

SMUD may also use power produced from CPP<sup>22</sup> when it is technically and economically feasible. There are many variables that SMUD must consider when determining whether it will generate or purchase power for the needs of its customers or sell surplus power to the energy marketplace. Until SMUD concludes the energy plan for the proposal territory, it is premature to finalize the details of an energy supply plan for the proposal territory. Given the relatively small amount of power required by the territory proposed to be annexed compared to the size of the energy marketplace, and the fact that SMUD is an active participant in WECC<sup>23</sup> energy markets with a history of success developing new energy resources, SMUD anticipates being able to secure appropriate power resources for the proposal territory. SMUD's development of a power supply for the proposal territory will be likely offset by corresponding reductions in the provision of power by PG&E.

### **PG&E COMMENTS IN OPPOSITION TO THE PROPOSED ANNEXATION**

PG&E has submitted voluminous documents and letters that oppose the proposed annexation and refute the benefits to both SMUD and Yolo residents. PG&E has summarized its position; the document is included in the Addendum to this report. Briefly, PG&E believes that there is "potential for financial and reliability risk to both Yolo and Sacramento residents, should the twenty year projections upon which the proposal is based turn out not to be true." PG&E's bases its position of uncertainty on the following two variables:

1. The final cost of PG&E assets to be acquired will be determined by the court in an eminent domain proceeding.
2. Energy markets are highly volatile. The SMUD application relies on natural gas forecasts that result in optimistic projections of the net economic benefits. PG&E asserts that assumptions used by SMUD and GES are erroneous.

Key issues identified by PG&E are summarized as follows:

1. SMUD has underestimated the quantity of PG&E equipment to be acquired.
2. SMUD has underestimated the unit value of PG&E equipment to be acquired.
3. SMUD has applied the wrong depreciation method on PG&E equipment to be acquired.
4. SMUD has not included a going concern value on PG&E assets to be acquired.
5. SMUD has not included the fair market value of PG&E rights-of-way to be acquired.

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<sup>22</sup> Cosumnes Power Plant (500 MW natural gas turbine)

<sup>23</sup> Western Electricity Coordinating Council

6. SMUD has understated the cost of new facilities in its assumptions.
7. SMUD has understated the cost of trenching and paving in its assumptions.

### **GES ENGINEERS AND APPRAISERS ECONOMIC EVALUATION**

LAFCo's consultant, GES, Engineers and Appraisers', independent evaluation of the information provided by both SMUD and PG&E addresses the following questions as well as each of the PG&E issues identified above.

1. If approved by LAFCo, what is the difference in the expected cost of service to current SMUD customers and what is the difference in the expected cost of service to customers in the proposal territory?
2. If approved by LAFCo, what is the difference in the expected level of service to current SMUD customers and what is the difference in expected level of service to customers in the proposal territory?

### **Summary of GES Conclusions**

The GES Economic Evaluation and Service Reliability Report is included in Appendix VII to this report. In summary, the GES report concludes the following:

1. SMUD addressed concerns of local jurisdictions related to loss of property taxes and franchise fees through the adoption of Memorandums of Understanding.
2. SMUD proposes terms and conditions to hold current SMUD customers harmless from all costs to acquire and serve the annexation territory including the incremental power supply costs. LAFCo proposes terms and conditions to address this issue in its Findings.
3. GES estimates the fair market value of PG&E assets to be \$110.0 Million.
4. GES estimates that there are positive economic benefits that will most likely range from \$165.0 Million to \$380.0 Million.
5. GES estimates that SMUD should be able to provide reliable service, service at least equal to current PG&E service.
6. GES believes a two percent reduction in Yolo rates is sustainable until all costs related to annexation have been paid.
7. GES has analyzed power supply costs to serve the proposal territory. The difference in power supply costs between SMUD and PG&E is only five percent

over the twenty year study period. The analysis assumes that SMUD's power supply costs are lower but the difference falls within a reasonable range.

### **LEGAL BASIS TO VALUE UTILITIES FOR CONDEMNATION PURPOSES**

LAFCo staff has requested both SMUD and PG&E to provide documentation that set forth their respective positions on valuation methodology for condemnation of a public utility. SMUD and PG&E have each submitted its response. LAFCo has contracted with the law firm of Davis Wright and Tremaine to analyze the respective submissions. The legal analysis is contained in Appendix VI. This analysis discusses several issues that have been raised by PG&E and SMUD.

The legal analysis makes the following overall conclusion:

*"We conclude that in determining the just and equitable compensation SMUD would be obligated to pay PG&E for the condemned facilities, the fact finder will most likely consider various valuation methodologies, assuming the evidence supporting the valuation methodology is otherwise competent and admissible. Further, while the case law often expresses that Replacement Cost New Less Depreciation methodology (RCNLD) often establishes the ceiling and the Original Cost Less Depreciation (OCLD) often sets the floor for any valuation, the courts and the California PUC have not established an absolute one-size-fits-all preference applicable in all instances for the utilization of a particular methodology for the valuation of utility facilities. Rather, in each case, the fact finder has been vested with the authority to accord differing weight to various valuations, based on the specifics of the condemned facilities and to exercise its judgment in determining the compensation amount."*

Davis, Wright, Tremaine has provided an additional opinion in response to testimony presented during the April 5, 2006, Commission hearing and in written comments received subsequently. This response is included in the Addendum.

### **COMPARISON OF SMUD AND PG&E RATE STRUCTURES**

The rate structures of both SMUD and PG&E are relatively complex. Each corporation has different rates for different types of customers. Each utility has a higher rate structure for a higher amount of energy consumed. That is, rates are tiered. Rates also change between summer and winter months. SMUD, as most electric utilities, has a rate structure that charges for use by the number of Kilowatt hours used. The rates in the following table are ***for illustrative purposes only*** and may not reflect actual surcharges implemented in 2008. SMUD proposes that rates within Yolo County will be at least two percent below the rates of PG&E until acquisition and start up debt has been retired.

Currently, the rate differential is approximately thirty percent. Thus, this represents a cost differential of \$30 for every \$100 spent on electricity. Therefore, the \$28 surcharge will be used to pay for the acquisition, start up costs, non-by-passable charges and incremental power supply costs in the annexation territory. This surcharge will decrease as these costs are paid off.

PG&E rates are based on the cost of service principle. These rates are established in proceedings before the CPUC. These rates reflect the cost of providing electric service to all PG&E customers in its franchise area by rate class. These rates include return on and return of invested capital, the power supply cost, operation and maintenance costs.

The rate forecasts between SMUD and PG&E for the twenty year study period result in a rate difference of about twenty percent during many of these years. Also, it appears that SMUD rates will remain below PG&E rates during the entire twenty year study period. GES adjusted the PG&E rate cost to make it more comparable to its system-wide average. **The rate differential is used to calculate the economic benefits (GES Report).**

**Table 7**  
**COMPARISON OF AVERAGE RATES**  
**AND SURCHARGE BY RATE GROUP**

<b>Rate Group</b>	<b>SMUD<sup>24</sup> c/kWh<sup>25</sup></b>	<b>Surcharge c/kWh</b>	<b>Yolo Rate with 2% Discount c/kWh</b>	<b>PG&amp;E<sup>26</sup> c/kWh</b>
Residential	10.40	2.41	12.81	13.07
Small Commercial	11.00	2.58	13.58	13.86
Medium Commercial	10.32	2.00	12.32	12.58
Large Commercial	8.98	2.14	11.12	11.34
Large Industrial	7.90	1.19	9.09	9.28
Agriculture	9.62	1.43	11.05	11.28
Lighting	9.30	4.81	14.11	14.40
System Average	9.94	2.11	12.05	12.30

The SMUD Board of Directors has committed to develop rates for the proposal territory that will remain a minimum of two percent below the most current PG&E rate until all acquisition costs have been paid off and power supply costs are equalized between current SMUD ratepayers and ratepayers in the proposal territory.<sup>27</sup>

<sup>24</sup> SMUD forecast - 2005.

<sup>25</sup> cents per kilowatt hour.

<sup>26</sup> PG&E rates effective January 1, 2006.

<sup>27</sup> Yolo Annexation Feasibility Study, Final Report, Staff Assessment and Recommendations, April 18, 2005, Sacramento Municipal Utility District.

## **YOLO SURCHARGE**

The surcharge for Yolo ratepayers will include the following components to collect sufficient revenues to pay the following costs in full:

1. Acquisition costs to pay PG&E for distribution system.
2. Construction of SMUD facilities to serve the area.
3. Annexation costs.
4. Legal costs.
5. Power supply costs.
6. Offsets or programs to achieve revenue neutrality.
7. Non-by-passable charges, or exit fees, related to debt incurred during the energy crisis.

SMUD's surcharge may fluctuate until the costs and charges listed above have been paid in full. Basically, SMUD rates will remain at least 98 percent of current PG&E rates. For example, if PG&E increases rates to its remaining customers, SMUD's rates for the proposal territory could increase, but will remain at 98 percent or less of the new PG&E rate. Therefore, the pay-back period of the surcharge may fluctuate, depending on both PG&E and the actual costs that SMUD incurs to acquire the Yolo electrical system.

Over time, the surcharge will be decreased as costs have been retired. The District has a number of options related to the surcharge rate and/or the term of the pay-back period. For example, SMUD could lower the surcharge sooner and extend the pay-back period for a longer term. Or, SMUD could keep the maximum surcharge in order to minimize the pay-back period. The District Board of Directors will set this policy depending upon a number of variables. The District has some discretion. However, the basic principle adopted by the Board of Directors is that total acquisition costs and costs to serve the proposal territory will be paid by the ratepayers in the territory to be annexed.

The total cost is dependent upon many variables and assumptions related to projected cost and revenue increases over the study period. Relatively small changes in these assumptions can render significantly different opinions about the economic viability of the annexation.

SMUD's objective is to provide service to its ratepayers at a lower cost and with better reliability than does PG&E. SMUD believes that it can accomplish both of these objectives for the proposal territory.

LAFCo and its consultant have attempted to use conservative assumptions based on likely cost trends and forecasts. SMUD's cost of doing business as well as PG&E cost of doing business will continue to increase to meet increased labor costs, operations and maintenance as well as generation costs.

These costs are dependent on both local and regional markets. SMUD's budget expenditures are split as follows:

40%	Operation, Maintenance and Administration
<u>60%</u>	Generation or Power Supply
100%	Total Costs

Increased costs will be funded by both rate increases and customer growth. To the extent that fixed costs and overhead can be allocated to new customers; rate increases can be minimized or mitigated. That is, there will be economies of scale until new resources have to be added in order to provide the same level of service.

The pro forma income statement below *is for illustrative purposes* but it shows the projected revenue and cost components for the proposal territory.

**SMUD PRO FORMA INCOME STATEMENT FOR PROPOSAL TERRITORY**

**SMUD Pro Forma Income Statement**  
**For Proposal Territory 2008**

		<u>%</u>
Total Estimated Revenue	\$123,319,000	
Cost of Service		
Power Supply	\$ 70,946,000	57.5
Renewable	12,704,000	10.3
Operation & Maintenance	17,210,000	14.0
Other Public Purpose Programs	<u>3,909,000</u>	3.2
Net Revenue	\$ 18,549,000	
Debt Service	<u>\$ 7,725,000</u>	6.3
Estimated Net Income	\$ 10,824,000	8.8

**IMPACT OF NATURAL GAS PRICES (POWER SUPPLY COSTS)**

Power supply costs include energy, capacity, ancillary services, and renewable energy supplies. SMUD will be required to produce power or purchase power to serve the proposal territory. These resources will be a mix of the Cosumnes Power Plant Gas Turbine and new long term energy (power supply) contracts.

The energy prices for the proposal territory are primarily driven by natural gas prices. SMUD has stated that if the annexation is approved by the electorate, it will begin to hedge natural gas. Higher gas prices will reduce the economic benefits SMUD has estimated. A \$1 per MMBtu over the 20-year study period would cause a 3-year extension of the surcharge. The following table compares SMUD's power supply costs with those of PG&E for the annexation territory based upon SMUD's proposed generation mix.

**Power Supply Related to Gas Costs**

**Natural Gas**

SMUD	100%
PG&E	<u>65%</u>
Net Difference	35%

The power supply costs of Yolo ratepayers with SMUD could be up to 35% more sensitive than with PG&E. In other words, if gas prices increase by \$1, Yolo customers would pay SMUD \$.35 more for their power than if the annexation fails the electoral process. This example assumes that gas prices for both SMUD and PG&E increase by \$1 for each entity. SMUD will attempt to negotiate long term gas and other power supply contracts to reduce this financial exposure.

GES has estimated that the difference in power supply cost estimates over the twenty year period is only about *five percent*. GES indicates this is a reasonable difference in power supply cost estimates between SMUD and PG&E. The difference in these forecasts is primarily related to the method of estimating capital costs related to generating resources versus costs of resources in the market place.

GES also indicates SMUD should be able to use a variety of methods to meet its resource needs. For example, SMUD can build power plants, purchase power on the open market or use demand-side management (conservation) programs. Thus, GES utilized SMUD's estimate of power supply costs to calculate the estimated economic impacts because SMUD's long term assumptions appear to be reasonable.

**ANALYSIS OF SYSTEM VALUATION  
OF PACIFIC GAS & ELECTRIC ASSETS**

**Pacific Gas & Electric Estimate of Value**

PG&E has estimated the value of its transmission and distribution system for the proposal territory to be \$516.7 Million. In addition, it has estimated \$50.6 Million for severance, stranded and start up costs or a total cash outlay of \$567.3 Million.

In addition, PG&E estimates that acquisition by SMUD will result in additional costs to all ratepayers, i.e., there are negative economic impacts. PG&E indicates this increased cost is related to higher power supply costs to serve the proposal territory. SMUD will not use its existing hydrogenation or other low cost contracts to serve the proposal territory. The District will have to use natural gas generation and purchased power to serve the proposal territory. Based on these assumptions, PG&E believes that SMUD rates will exceed PG&E rates and the proposal will have no benefit to ratepayers within the proposal territory.

GES reviewed the PG&E facility estimates and concluded that the most likely range of value for the PG&E electrical system would range from \$79 M to \$154 M. This range is established by original cost less depreciation and replacement cost new less depreciation. Further analysis by GES using information provided by the income capitalization method and sales comparison approach, both indicate that the fair market value is at the lower end of this range, or approximately \$110 M, and not the \$516.7 M suggested by PG&E.

**Range of Value**

Based on the assumptions utilized by our consultants, the range of value for the Pacific Gas and Electric plant and equipment to be acquired by SMUD is within the lower range which will result in positive economic benefits within the proposal territory as well as within the District boundaries. The final cost to acquire these assets will be determined by a court or by a settlement between Pacific Gas & Electric Company and SMUD prior to trial. This process will take place only if the electorate approves the proposal. *Therefore, should your Commission order the election, there is an inherent risk associated with the proposal because any final value will not be known prior to the electorate's opportunity to vote on the proposal. SMUD has adopted annexation terms and conditions that place the entire risk (acquisition and start up costs) on ratepayers within the proposal territory, and hold harmless current ratepayers.*

SMUD's project costs are estimated by SMUD, LAFCo and PG&E in the table below.

<b><u>Total Estimated Project Cost</u></b>	<b><u>SMUD</u></b> <b><u>(Millions)</u></b>	<b><u>LAFCo</u></b> <b><u>(Millions)</u></b>	<b><u>PG&amp;E</u></b> <b><u>(Millions)</u></b>
<i>Pacific Gas &amp; Electric Company System Value<sup>28</sup></i>	<b>\$ 86.0</b>	<b>\$110.0</b>	<b>\$516.7</b>
<i>Construct 115 kV 18 mile Transmission Line</i>	<b>11.1</b>	<b>11.1</b>	
<i>Willow Slough Substation</i>	<b>3.0</b>	<b>3.0</b>	
<i>Elverta Substation Upgrade</i>	<b>2.7</b>	<b>2.7</b>	
<i>Hedge Substation Upgrade</i>	<b>0.3</b>	<b>0.3</b>	
<i>Reconstruct Elder Creek-Hedge Trans. Line</i>	<b>1.9</b>	<b>1.9</b>	
<i>Legal Costs</i>	<b>10.0</b>	<b>10.0</b>	
<i>Debt Issuance Costs</i>	<b>1.0</b>	<b>1.0</b>	
<i>Severance From PG&amp;E Distribution System</i>	<b>2.3</b>	<b>2.3</b>	
<i>Miscellaneous Studies and Costs</i>	<b>2.0</b>	<b>2.0</b>	
<i>Distribution Upgrade</i>	<b><u>20.0</u></b>	<b><u>20.0</u></b>	<b><u>\$50.6</u></b>
<b>TOTAL PROJECT COST</b>	<b>\$140.3</b>	<b>\$164.3</b>	<b>\$567.3<sup>29</sup></b>

<sup>28</sup> Includes payment for stranded facilities, going concern value, rights-of-way, etc.

<sup>29</sup> Black and Veatch Study.

**NET ECONOMIC BENEFIT OF THE PROPOSAL**

The estimated net economic benefit to residents within the proposal territory is not guaranteed. However, the net economic benefit estimated by GES is based on conservative assumptions, and could be higher. The actual benefit will likely vary and will be based on the comparison of actual rate differentials between SMUD and PG&E over time. The net economic benefit will increase if the rate differential is large. Likewise, the net economic benefit will diminish if the rate differential is small. Currently, SMUD rates are approximately thirty percent below Pacific Gas & Electric Company rates. Projections indicate that the rate differential will average 20 percent over the 20-year study period.

The net economic benefit is also dependent on new growth in the proposal territory. The faster the rate of growth, the greater the economic benefit to customers within the proposal territory. The surcharge of PG&E buy out is shared by all customers in the proposal territory.

**Basic Evaluation Equation  
for Proposed Annexation**

$$\begin{array}{rclcl} \text{Total Economic} & \geq & \text{Total Acquisition} & + & \text{Total Power} \\ \text{Benefits} & & \text{Costs} & & \text{Supply Costs} \\ \\ \Delta & = & \text{Project will generate} & & \text{Net Economic Benefits} \end{array}$$

For the annexation to be economically feasible, the total economic benefits must be greater than the total acquisition costs plus the total power supply costs to serve the annexed area.

SMUD has estimated the net economic benefit over a twenty year period to be:

	<i>Yolo County Customers</i>	<i>Sacramento County Customers</i>	<i>Total</i>
Net Benefit:	\$249 M	\$155 M	\$404 M

LAFCo's consultant has estimated the net economic benefit over a twenty year period could range from \$165 M to \$380 M.

The total economic benefits are also offset by the assumptions that higher natural gas prices will be used to serve the proposal territory. The net economic benefits estimated above have factored this adjustment or offset into the estimate. The total economic benefit is also dependent upon the value, or cost, of Pacific Gas & Electric Company's distribution system. SMUD estimates that it should pay \$86.0 Million. LAFCo's consultant estimates that the value is likely to range from \$79 Million to \$ 154 Million, reconciled to \$110 Million. During the first several years, the economic benefits are marginal. Benefits remain marginal until exit fees are no longer necessary and when acquisition costs have been paid. Therefore, most of the economic benefits are generated further out in time. Note: SMUD's current base rate with respect to Yolo customers includes a capital component to replace, or purchase, \$90 Million in capital assets.

**SUMMARY OF ESTIMATED ECONOMIC BENEFITS**

The following table summarizes the estimated net economic benefit of the proposed annexation. These benefits are based on a 20 year projection. In fact, additional benefits should continue to accrue after the twenty year period as long as SMUD rates remain lower than PG&E rates.

Estimated Acquisition Cost	Present Value of Economic Impact Over 20 Years	
	Adjusted PG&E Rate Forecast	SMUD's PG&E Rate Forecast
<b>\$163 Million</b> (Assuming No Stranded Facilities) (Purchase Price and Start-Up)	<b>\$190 Million</b>	<b>\$380 Million</b>
<b>\$188 Million</b> (Assuming Stranded Facilities) (Purchase Price and Start-Up)	<b>\$165 Million</b>	<b>\$360 Million</b>

GES concludes that the net economic benefits could range between \$165 M to \$380 M. The lower end of this range represents the benefits that are created by a small difference between the PG&E rates and SMUD's costs of service, and are considered to be the most achievable. The high end represents a larger difference between PG&E rates and SMUD's cost of service. Current rate differential is about 30 percent. Historically, SMUD rates have been lower than PG&E rates. Therefore, it is reasonable to assume that the economic benefits will fall within this range.

Note: The net economic benefits are based on the estimated differential between SMUD and PG&E rates during the twenty year study period. The estimated benefits are subject to fluctuation, i.e., they could be higher or lower.

**ECONOMIC AND SERVICE DELIVERY IMPACTS  
TO AFFECTED RATEPAYERS**

**Remaining Pacific Gas & Electric Customers**

The CPUC has determined that there is no significant impact to PG&E ratepayers if the affected territory is annexed and served by SMUD.

**Rates**

The rates will not be increased as a result of the proposed annexation.

**Service Levels**

The quality of service or service levels for the remaining PG&E customers will not decline if the annexation is successful.

**Risk**

The proposed annexation will not result in any increased risk to the remaining ratepayers in the PG&E service territory.

**Public Utilities Commission Findings**

Under Government Code Sections 56129-56131, the California Public Utilities Commission (CPUC) is required to evaluate publicly owned utility proposals to provide electric service in the service territories of investor owned utilities. Specifically, the California PUC is to provide LAFCo with an advisory opinion on whether or not "the proposed service by [a] district within the territory will 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 CPUC has evaluated the SMUD proposal to annex territory in Yolo County. On November 18, 2005, the California Public Utilities Commission issued Resolution E-3952 which states:

**"Resolution E-3952 concludes that the Sacramento Municipal Utility District's proposal to annex the Cities of Davis, West Sacramento, Woodland and other portions of Yolo County, located in Pacific Gas and Electric Company's service territory, will not substantially impair Pacific Gas and**

**Electric Company's ability to provide adequate service at reasonable rates within the remainder of its service territory."**

**SMUD Customers**

The SMUD Board of Directors has adopted specific terms and conditions which require customers in the proposal territory to pay all the costs of the annexation through a surcharge. This means the Yolo ratepayers will pay higher rates than SMUD's current customers until the costs of annexation are recovered. In addition, the Yolo ratepayers' surcharge will include a component to cover any difference in energy supply costs between the proposal territory and SMUD's current service area.

**Rates**

Current SMUD ratepayers will not pay the costs of annexation. Therefore, their rates will not increase as a result of the proposed annexation.

**Service Levels**

The proposed annexation will not change the service levels or quality of service for SMUD ratepayers. Staff will be hired to serve the affected territory. Maintenance and operations costs for the new staff will be included in the rates paid for in the affected territory.

**Risk**

The SMUD Board of Directors has proposed terms and conditions that require the Yolo customers to bear all annexation costs. LAFCo has revised these terms to include monitoring by LAFCo and greater assurance that current SMUD customers will be held harmless. SMUD concurs with the amended terms and conditions.

SMUD customers will be held harmless from all costs related to this annexation. In fact, SMUD customers should benefit because existing risk related to the CPP generation facility will be diversified or distributed to Yolo customers. This reduction in risk is measured by the projected cost savings to SMUD customers because fixed overhead costs for operations and maintenance, administrative fixed costs, and generation costs will be allocated to about 70,000 more customers.

SMUD has been providing transmission and distribution service to Sacramento residents for sixty years. Therefore, the risk of providing service to Yolo Customers should not be any different than the current risk that SMUD faces when it serves its current customers in Sacramento County.

SMUD has indicated it will hire staff (linemen and others) because of the increased workload. SMUD has the expertise and organization to operate and maintain both

transmission and distribution systems. The costs related to providing this service should be similar.

### **Yolo Customers**

#### **Rates**

The customers within the affected territory will pay a higher rate, or surcharge, to cover the cost of PG&E facilities, stranded costs, the construction of SMUD facilities to serve the annexation area, legal fees--essentially all acquisition costs related to this transaction. The Yolo customers will also pay "exit fees" to cover their share of existing debt incurred by PG&E during the energy crisis. This amount is included in the proposed surcharge. This component of the surcharge will be eliminated once the debt has been paid off. Over time, the surcharge will be eliminated, once acquisition costs and exit fees are paid off.

#### **SMUD Resolution**

Section 5. "Based on the information and comments received, this (SMUD) Board finds that it is reasonable to conclude that a surcharge on Yolo County customers can be developed and implemented that will ensure that the Yolo County customers are financially responsible for the costs of annexation and providing service to the annexed area and that SMUD's existing customers are held harmless and do not subsidize the annexation or costs of providing service to the Yolo County customers."

#### **Service Levels**

SMUD believes that after annexation and the construction of various system improvements, Yolo ratepayers should actually have better service. There should be fewer outages for a shorter duration. This change would occur during the first several years after SMUD begins providing service. The cost related to the system improvements is included within the Yolo ratepayer surcharge.

#### **Risk**

Based on the SMUD Resolution, the Yolo ratepayers in the affected territory will assume all of the business risk if the proposed annexation is approved.

### **SERVICE RELIABILITY/ QUALITY OF SERVICE**

#### **Travel Time Comparison**

Travel time ranges between 8 and 32 minutes for SMUD crews to travel from the 59th Street and Highway 50 Corporation Yard to the proposal territory. The time required for a crew to get to a location in the proposal territory is comparable to crew travel time in

Sacramento County. The following table compares travel time from the SMUD Corporation Yard to job sites in both counties. The map in the Appendix identifies the 30 mile radius from the SMUD Corporation Yard to the proposal territory. The distance from the Corporation Yard to Woodland is comparable to the distance from the Corporation Yard to Folsom. Thus, travel times to the proposal territory are comparable to many areas currently served by SMUD. The following table illustrates estimated travel time in minutes.

***Table 8***  
***Travel Time From SMUD Corporate Yard to***  
***Job Sites in Sacramento County and Yolo County***<sup>30</sup>

<b>Yolo County Locations</b>	<b>Minutes</b>	<b>Sacramento County Locations</b>	<b>Minutes</b>
Woodland County Road 98 & Hwy 16	32	Clay, CA	37
Davis: CR 30 & CR 96	29	149 Guadalupe Drive, Rancho Murieta, CA	32
West Sacramento: Gregory Ave & Jefferson Blvd.	12	6237 Fountain Square Drive, Citrus Heights, CA	20
1350 Halyard Drive West Sacramento City Hall	8	Herald, CA	29
23 Russell Blvd, Davis City Hall	20	50 Natomas Street Folsom City Hall	23
300 First Street Woodland City Hall	27	Galt, CA	26

**Reliability Measurement Methodology**

The California Public Utilities Commission, in decision 96-09-045, established policies on how regulated utilities are to measure and report reliability statistics. SMUD uses more stringent reporting methods than required by the CPUC. SMUD defines a "sustained outage" as any outage that lasts one minute or longer. PG&E defines a sustained outage as any outage that lasts five minutes or longer. SMUD also includes outages due to secondary and single transformer problems as sustained outages whereas PG&E does not.

<sup>30</sup> SMUD Review of Electric System Reliability and Stranded Facilities Regarding the SMUD Annexation Application, Sacramento Municipal Utility District, March 15, 2006.

**Reliability Comparison Between SMUD and PG&E**

PG&E has not provided reliability indices for the proposal territory. However, PG&E has submitted indices for a portion of the proposal territory and its Mission Division (San Francisco).

SMUD has adjusted its measurements for determining reliability to reflect the CPUC methodology so that the comparison between SMUD and PG&E illustrated below is based on the CPUC methodology.

SMUD believes that PG&E Sacramento Division is comparable to the SMUD service area. Nonetheless, the following table includes information related to PG&E's Mission Division.

The information indicates that SMUD has better reliability than does PG&E. That is, fewer outages that are of a shorter duration than does PG&E, the current service provider.

**Table 9**  
**Comparison of SMUD and PG&E**  
**System Average Interruption Duration (SAIDI) Index<sup>31</sup>**

<b>Year</b>	<b>SMUD-CPUC Method Excluding Major Events (Minutes)</b>	<b>PG&amp;E Sacramento Division Excluding Major Events (Minutes)</b>	<b>PG&amp;E Mission Division Excluding Major Events (Minutes)</b>
<b>2000</b>	65.70	151.7	92.4
<b>2001</b>	72.45	216.0	87.3
<b>2002</b>	47.36	165.4	65.5
<b>2003</b>	50.07	214.4	73.8
<b>2004</b>	53.59	183.6	75.5
<b>Average</b>	57.83	186.2	78.9

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<sup>31</sup> Ibid.

**Table 10**  
**Comparison of SMUD and PG&E SAIFI Statistics**  
**System Average Interruption Frequency Index<sup>32</sup>**

<b>Year</b>	<b>SMUD-CPUC Method Excluding Major Events (Outages/Year)</b>	<b>PG&amp;E Sacramento Division Excluding Major Events (Outages/Year)</b>	<b>PG&amp;E Mission Division Excluding Major Events (Outages/Year)</b>
<b>2000</b>	0.996	1.299	1.101
<b>2001</b>	1.118	1.163	1.202
<b>2002</b>	0.773	1.277	0.823
<b>2003</b>	0.769	1.110	0.880
<b>2004</b>	0.782	1.241	0.971
<b>Average</b>	0.892	1.218	0.995

Comparison to other utilities is another method to measure the reliability performance of an electric system. Tables 9 and 10 compare SMUD's reliability indices to the investor owned utilities in the state. As can be seen in the SAIDI table, SMUD's outage duration index was higher than those of the two southern California utilities (SCE and SDG&E) during 200-2003, but significantly lower than P.G.&E.'s during that period. In years 2003 and 2004, SMUD's duration index is relatively close to both SCE's and SDG&E's (excluding the firestorm that affected 15 percent of SDG&E's facilities in 2003). For years 2003 and 2004, PG&E's duration index was double SMUD's average duration. This is largely due to the fact that PG&E has designed much of the overhead system as radial extension off the mainline resulting in longer outage durations before service is restored. In addition, PG&E has designed its 200 amp underground system using non-load break elbows which increases switching time for restoration of service. Conversely, SMUD has used load break elbows for many years, which reduces the switching time for restoration of service.

A review of the SAIFI Table 10 shows that SMUD's frequency of outages is more in line with PG&E's than the two southern California utilities. All three of the investor owned utilities operate a parallel transmission system where an outage at the 60 or 115 kV does not result in a customer outage. SMUD's 69 kV system (which serves the majority of the District's customers) is radial, so an outage at the 69 kV level affects many thousands of customers. If the sub-transmission outages are subtracted out of the frequency index, the District's SAIFI is more in line with the frequency of both SCE and SDG&E. This indicates SMUD's distribution outage frequency is slightly greater based on SMUD's less expensive 69 kV system design. GES Engineers and Appraisers has reviewed the information and data submitted by SMUD and believes that it is accurate.

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<sup>32</sup> Ibid.

**REVENUE NEUTRALITY: PROPERTY TAX REVENUE AND FRANCHISE FEE LOSSES TO LOCAL JURISDICTIONS**

PG&E pays both property taxes and franchise fees to local jurisdictions within its franchise service area. SMUD, a public entity, is exempt from many taxes including franchise fees and property taxes. SMUD is not required to pay either a franchise fee or property tax on its equipment if these facilities are located within its District boundary.

A franchise fee is usually paid through the process of issuing an IOU to a local government for the utility's right to install equipment in public streets and roads. An IOU is also required to pay property taxes on its equipment and facilities. The State Board of Equalization accepts the IOU and remits the property tax back to local jurisdictions.

Local jurisdictions in Yolo County currently receive the following property tax revenue and franchise fees.<sup>33</sup>

Franchise Fees	\$1,220,000
Property Tax Revenue	<u>710,000</u>
Total Revenue	\$1,930,000

SMUD has met with the local jurisdictions and reached an agreement with all of the jurisdictions that will lose property tax revenue and franchise fees. The Memorandum of Understanding is attached as Appendix III.

**SECTION 99 PROPERTY TAX EXCHANGE AGREEMENT**

SMUD has reached an agreement with Yolo County and both parties have entered into a Property Tax Exchange Agreement. This Agreement is in addition to the MOU described above.

**PROPOSED BOUNDARY**

The proposal territory contains approximately 212 square miles. The R.W. Beck Study examined a conceptual area similar to the proposal territory. SMUD evaluated the Beck Study and revised the boundary prior to submission of their application. SMUD adjusted the proposed boundary to minimize stranding facilities and to try to avoid duplication of facilities. The Beck Study analyzed several service delivery options that include several different combinations of cities and unincorporated area within the proposal territory.

On the whole, from an electrical transmission and distribution system as well as service delivery perspective, it makes the most sense to serve the proposal territory as set forth in SMUD's amended application because the electric transmission and distribution system between each of the cities is interconnected and operated as one sub-system. Not three or more separate systems. Based on the current and proposed transmission and distribution

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<sup>33</sup> 2004. PG&E correspondence to LAFCo dated September 16, 2005, Pg. 65-67.

design, there is no valid reason to evaluate multiple boundary alternatives. R.W. Beck initially studied several service delivery options and reached the same conclusions based on economics and engineering design.

SMUD's creation of the proposal boundary was selected for the following stated reasons:

1. Operational considerations related to existing transmission and distribution systems;
2. The goal to limit severance issues and minimize stranded facilities;
3. The ability to enhance reliability;
4. Consideration of physical boundaries such as rivers, creeks, roads, etc.;
5. City boundaries and Spheres of Influence; and
6. No parcel splits, islands, or peninsulas.

### **ELECTION PROCESS**

The Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 requires that annexation by a gas or electric public utility within an area served by an investor-owned utility be approved by the voters. Government Code Section 56876 provides that the Commission call the election within either the affected territory or within both the affected territory and the current service territory of the district.

On January 12, 2006, SMUD adopted Resolution No. 06-01-08 that amends its Resolution of Application regarding the election. If the proposal is approved by your Commission, SMUD requests that your Commission order the election within the proposal territory of Yolo County. SMUD will call the election within its District boundary, located in both Sacramento and Placer Counties. Thus, a majority of Yolo, Sacramento and Placer residents must approve the ballot measure in the November 2006 election for annexation to be successful.

Legal Counsel has reviewed this issue and determined that the election is required for the proposal territory as a whole and not on a jurisdictional basis. (See Addendum.) Furthermore, the jurisdictions have agreed to an election within the entire proposal territory.

### **REPRESENTATION ON SMUD BOARD**

Upon a successful election by the electorate on this issue, the SMUD Board of Directors will redistrict ward boundaries pursuant to Public Utilities Code Section 11857.1. The

SMUD Board shall, by Resolution, adjust the boundaries of any ward.<sup>34</sup> After the wards have been established, voters of both Yolo and Sacramento will have the right to vote for Directors in their respective wards.

SMUD Directors are elected by ward for four (4) year terms. Directors have staggered terms and are elected at a general election. Currently, SMUD's registered voters elect **seven directors from seven wards**. Each ward has approximately 175,000 residents. Upon annexation, Yolo residents will likely be represented by one or more Directors, depending upon how the District reconfigures its wards. The Board of Directors of the District, under the Municipal Utility District Act, has the authority, by resolution or ordinance, to fix the boundaries of the wards for the purpose of electing Directors. **LAFCo has no authority over this process.**

*The number of Directors (7) is established by statute; therefore, any proposal to increase Board representation would require special legislation.*

It is unlikely that Yolo County voters will have a ward to exclusively represent Yolo County on the SMUD Board of Directors. There is insufficient population in the territory proposed for annexation to create a stand-alone ward. Thus, the redrawn ward boundary will, most likely, include a combination of Yolo and Sacramento County voters, as determined by the SMUD Board of Directors. Sacramento County voters, by virtue of their plurality, will continue to elect a majority of Directors to the SMUD Board.

### **ENVIRONMENTAL IMPACT REVIEW AND ANALYSIS**

The Sacramento Local Agency Formation Commission directed URS, Inc., to prepare an Environmental Impact Report (EIR) to provide LAFCo and the public with information on the potential environmental impacts related to the proposed SMUD Sphere of Influence and annexation of territory within Yolo County. The Draft Environmental Impact Report and Final Environmental Impact Report are available on the LAFCo website: [www.saclafco.org](http://www.saclafco.org). In addition, these documents were reviewed by your Commission, LAFCo staff, and its consultant, Planning Partners.

The LAFCo document is a Program EIR<sup>35</sup> with some project level analysis. As such, additional environmental review will be required. The LAFCo Program EIR identified nine (9) program components, generally described as follows:

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<sup>34</sup> The process is set forth in the Municipal Utility District Act (MUD Act). In addition, the powers and duties of the Directors are set forth in this statute.

<sup>35</sup> A Program EIR is an EIR which may be prepared on a series of actions that can be characterized as one large project and are related: geographically, as logical parts in the change of contemplated actions, in connection with issuance of rules, regulations, plans, or other general criteria to govern the conduct of a continuing program, or as individual activities carried out under the same authorizing statutory or regulatory authority and having general similar environmental effects which can be mitigated in similar ways.

**Program Component**

**Description**

- |       |   |
|-------|---|
| 1     | Sphere of Influence Amendment and Annexation  |
| 2     | SMUD Acquisition of PG&E Equipment and Infrastructure that Serves the Affected Territory  |
| 3     | Execution of MOU's or Property Tax Agreements With All Affected Yolo County Jurisdictions That Provide Compensation for Property Tax and Franchise Fee Losses |
| 4 & 5 | Reconstruction of Existing Electrical Facilities within Sacramento County Located in Rights-of-Ways and Easements   |
| 6     | Future Acquisition of Easements and Construction of a 15-18 Mile 115 KV Transmission Line from SMUD's Elverta Substation to a point near the City of Woodland |
| 7     | Future Acquisition of Real Property for a 1 to 3 Acre Substation Site Located between the City of Davis and the City of Woodland                              |
| 8     | Future Upgrade of PG&E Distribution System in the Affected Territory to Provide More Adequate Reliability   |
| 9     | SMUD Ownership, Operation and Maintenance of Electric Distribution System in the Affected Territory   |

**Public Comment Period**

The 45-day public comment period on the Draft EIR commenced January 6, 2006 and closed February 21, 2006 at 5:00 P.M. Responses to all comments submitted are contained in the Final EIR.

**Public Workshops Conducted by Sacramento LAFCo**

The following public workshops were held to receive public comment on the Draft EIR.

- |                  |                                      |
|------------------|--------------------------------------|
| January 18, 2006 | Davis City Hall                      |
| January 23, 2006 | Woodland/ Yolo LAFCo                 |
| January 25, 2006 | Woodland/ Yolo County Board Chambers |
| January 26, 2006 | West Sacramento City Hall            |

February 1, 2006  
April 5, 2006

Commission Hearing, Sacramento  
Commission Hearing FEIR, Sacramento

### **Final Environmental Impact Report**

The Final EIR has determined that there will be both direct and indirect significant environmental impacts. (See Final EIR and Addendum.) A Summary of Mitigation Measures is attached in the Addendum. Following, under separate cover, is the environmental consultant's proposed Findings of Fact and Statement of Overriding Considerations for Project Impacts that remain significant and unavoidable.

LAFCo issued the Final EIR on March 24, 2006 that responded to public comments received on the Draft EIR. On April 5, 2006, the Sacramento Local Agency Formation Commission held a public hearing on the Final EIR. At that time additional oral and written comments were received. The Addendum to this Staff Report responds to comments received at that hearing. Resolution No. LAFC 1314 incorporates the MMRP and Best Management Practices to address the significant impacts identified in the Final EIR.

### **LAFCO FACTORS**

#### **Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000**

Local Agency Formation Commissions are charged with four principal purposes under the Cortese-Knox-Hertzberg Act:

1. Discouraging urban sprawl;
2. Preserving open space and prime agricultural lands;
3. Efficiently providing government services; and
4. Encouraging the orderly formation and development of local agencies based upon local conditions and circumstances.<sup>36</sup>

#### **LAFCO Annexation Review Factors**

The Cortese-Knox-Hertzberg Act contains a list of factors LAFCo is to consider when reviewing an annexation proposal.<sup>37</sup> Each of those factors is listed below, followed by a summary of LAFCo's analysis of the factor in the context of SMUD's annexation proposal. Detailed additional analysis is contained in the Appendix and referenced throughout this report. In certain areas, reference is made to the EIR.

1. **Factor: Population and population density; land area and land use; per capita assessed valuation; topography, natural boundaries, and**

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<sup>36</sup> Government Code Section 56301.

<sup>37</sup> Government Code Sections 56668 and 56668.3.

**drainage basins; proximity to other populated areas; the likelihood of significant growth in the area, and in adjacent incorporated and unincorporated areas, during the next ten years.**

The proposal territory encompasses approximately 212 square miles with a population of approximately 150,000 people. The Yolo area jurisdictions, pursuant to their land use planning authority, have adopted General Plans that include growth projections for the proposal territory.

Your Commission has prepared an Environmental Impact Report for this project. The EIR indicates that the annexation could potentially impact growth within the proposal territory. For example, if rates and service are cost effective, annexation could contribute to growth in the proposal territory. Nonetheless, the EIR notes that there are multiple factors that influence growth rate. Additionally, SMUD plans to provide service consistent with local land use planning in the proposal territory.

2. **Factor: Need for organized community services; the present cost and adequacy of governmental services and controls in the area; probable future needs for those services and controls; probable effect of the proposed annexation and of alternate courses of action on the cost and adequacy of services and controls in the area and adjacent areas.**

This report summarizes the cost and adequacy of existing electric service, and the likely effect of annexation by SMUD on the cost and adequacy of electric service in the proposal territory. In general, staff finds it likely that SMUD will be able to serve existing and future customers in the proposal territory at lower cost and at at least the same, if not improved, service levels as PG&E.

3. **Factor: The effect of the proposed annexation and of alternative actions, on adjacent areas, on mutual social and economic interests and on the local government structure of the County.**

The proposal territory consists of urbanized and agricultural areas. The provision of electric service should not result in adverse social or economic impacts, and, in fact, will likely result in positive economic effects in the proposal territory and SMUD's existing service area. The proposed annexation will have no effect on areas adjacent to the proposal territory or on the local government structure of Yolo County.

4. **Factor: The conformity of both the proposal and its anticipated effects with both the adopted commission policies on providing planned, orderly, efficient patterns of urban development, and the policies and priorities set forth in the Cortese-Knox-Hertzberg Act Section 56377 (i.e., policies regarding conversion of open space).**

The proposed annexation should not induce or facilitate the conversion of open space and agricultural lands. Provision of electric service by SMUD will be consistent with local

land use plans and is not intended to cause land use changes. The information provided by SMUD and the evaluation contained in this staff report indicates that SMUD is an efficient and cost effective service provider. The proposal territory is contiguous to the SMUD service territory and the electrical systems can be integrated as discussed in the plan for service.

5. **Factor: The effect of the proposal on maintaining the physical and economic integrity of agricultural lands as defined in the Cortese-Knox-Hertzberg Act Section 56016.**

As with open space, it is not expected that annexation of the Cities of Woodland, Davis, West Sacramento and the unincorporated territory between and surrounding these cities, by SMUD for the provision of electric service will have any significant effect on the physical and economic integrity of agricultural lands within the proposal territory. SMUD service will be consistent with the land use planning determinations of the proposal cities and Yolo County. Electric service by SMUD is not intended to independently cause land use changes.

The EIR has identified potential agricultural impacts from construction of facilities. SMUD will be required to mitigate for loss of habitat, open space and agricultural land in accordance with Yolo County Preservation Policies. In addition, SMUD will work with property owners in siting and design of facilities to minimize impacts regarding agriculture.

6. **Factor: The definiteness and certainty of the boundaries of the territory, the non-conformance of proposed boundaries with lines of assessment or ownership, the creation of islands or corridors of unincorporated territory, and other similar matters affecting the proposed boundaries.**

The SMUD proposal does not split assessor parcels or communities; nor will it create islands or corridors of unincorporated territory.

7. **Factor: Consistency with city or county general and specific plans.**

The provision of electric service is consistent with the General and Specific Plans of the City of Davis, the City of Woodland, the City of West Sacramento, and the County of Yolo.

8. **Factor: The Sphere of Influence of any local agency which may be applicable to the proposal being reviewed.**

SMUD's proposed Sphere of Influence would not have any significant impact on the Sphere of Influence of any other local jurisdiction or special district. SMUD's Sphere of Influence could be amended and the area be annexed, however, SMUD could not begin to serve the territory until the voters within Yolo County authorize SMUD to provide

service. In addition, the SMUD Board of Directors has adopted a resolution calling for a vote by current SMUD residents regarding annexation. The proposed Sphere of Influence Amendment and proposal territory boundaries is consistent with approved, or, in the case of West Sacramento, proposed, extension of the cities' boundaries over the next twenty years.

9. **Factor: The comments of any affected local agency.**

The City Councils of the Cities of Woodland, Davis and West Sacramento and the Board of Supervisors of Yolo County have adopted a joint resolution requesting that SMUD annex the proposal territory for the provision of electric service. Notice of the proposed annexation has been sent to affected local agencies within Yolo, Sutter and Sacramento Counties. No negative responses have been received by your staff and the Yolo area jurisdictions continue to support annexation.

10. **Factor: The ability of the newly formed or receiving entity to provide the services which are the subject of the application to the area, including the sufficiency of revenues for those services following the proposed boundary change.**

*SMUD has provided documentation and LAFCo and its consultants have evaluated the information. LAFCo staff believes, based on the information presented that SMUD can provide service at rates that are less than the rates of PG&E. SMUD's application explains how SMUD proposes to finance the annexation and set rates in the proposal territory to ensure sufficiency of revenues after annexation.*

11. **Factor: Timely availability of water supplies adequate for projected needs.**

This factor is not applicable to SMUD's proposal to provide electric service in Yolo County.

12. **Factor: The extent to which the proposal will affect a city or cities and the county in achieving their respective shares of the regional housing needs as determined by the appropriate council of governments.**

This factor is not applicable to SMUD's proposal to provide electric service in Yolo County.

13. **Factor: Any information or comment from landowners.**

Your staff and this Commission has held Workshops to receive public testimony on the Draft EIR and the Final EIR, and has considered all timely written comments. Additionally, LAFCo has considered oral and written comments regarding the annexation and electric service proposal.

14. **Factor: Any information relating to existing land use designations.**

As is common throughout California's Central Valley, the land in the proposal territory is zoned residential, commercial, industrial and agricultural.

15. **Factor: Whether the proposed annexation will be for the interest of landowners or present or future inhabitants within the district and within the territory proposed to be annexed to the district.**

*Based on a detailed view of SMUD's annexation proposal, staff concludes that the territory SMUD proposes to serve will have lower rates and better service reliability than the territory currently receives from PG&E. Your staff has evaluated this proposal and documentation submitted by SMUD and its consultants, PG&E and its consultants, LAFCo's consultants, and others. Your Executive Officer believes that based on the assumptions stated, current SMUD ratepayers and proposal territory ratepayers are likely to experience benefits as a result of this annexation. The benefits to be derived are dependent in large part on the rate differential between SMUD rates and PG&E rates. The greater the differential, the greater the economic benefit. The net benefit is also a factor of the price SMUD will have to pay PG&E for its distribution system and the cost of stranded facilities. The lower the cost, the greater the benefit will be.*

*If PG&E cannot agree to a sales price, it will be necessary for SMUD to condemn these facilities and the court will need to set the value of PG&E property. Your Executive Officer believes that the probable range, based on economic theory, appraisal practice and legal decisions would be between \$79.0 Million and \$154.0 Million, reconciled to \$110.0 Million as indicated by GES. Based on this range, plus other construction costs, there will be net economic benefits for both SMUD customers and Yolo ratepayers in the proposal territory. LAFCo's consultant has estimated the net economic benefit would likely range from \$165.0 Million to \$380.0 Million. Your Executive Officer believes that---based on the information that has been provided---this estimate is reasonable and attainable.*

## CONCLUSION

*Local Agency Formation Commissions are charged with four principal purposes under the Cortese-Knox-Hertzberg Act: (1) discourage urban sprawl, (2) preserve open space and prime agricultural lands, (3) provide efficient governmental services, and (4) encourage orderly development of local agencies. The proposed Municipal Service Review , Sacramento Municipal Utility District Sphere of Influence Amendment and Annexation of Territory in Yolo County is unconditionally consistent with principles (3) and (4). The SMUD proposal is less obviously absolute concerning principals (1) and (2). The proposed SMUD annexation will allow for the provision of lower cost and more reliable service, thereby enhancing the provision of efficient services. One cannot state that the provision of electric service by one provider over another can discourage urban sprawl or preserve open space and prime agricultural lands. That could, perhaps, only be achieved by denying the provision of electricity to the undeveloped proposal territory.*

*SMUD has coordinated with the local governments within the annexation territory. SMUD has reached an agreement with all of the affected jurisdictions related to the future loss of property taxes and franchise fees. SMUD is not responsible for land use planning. However, SMUD has the capacity to serve the current population as well as projected growth within the proposal territory. SMUD's provision of electric service to the proposal territory should not have any impact on other Northern California electric customers. It also appears that there will be economic benefits to both the annexation territory and current SMUD customers.*

*The proposed annexation is a win-win situation for all parties except Pacific Gas and Electric Company. The current SMUD ratepayers are held harmless per the provisions outlined in SMUD's Resolution of Application. The Yolo ratepayers will fund all transaction costs and increased power supply costs through a surcharge. The revenue losses by local jurisdictions are offset, as previously described. Ultimately, based on the assumptions outlined in this report, Yolo customers within the proposal territory should have lower rates for electric service. Yolo customers within the proposal territory should also have improved reliability (fewer outages of shorter duration) after necessary system improvements are made.*

***I recommend your Commission amend the Sacramento Municipal Utility District Sphere of Influence to include the territory proposed for annexation. I recommend your Commission approve the Sacramento Municipal Utility District annexation proposal to include the Cities of Woodland, Davis, West Sacramento and the unincorporated Yolo County territory proposed for annexation.***

Respectfully submitted,

**SACRAMENTO LOCAL AGENCY FORMATION COMMISSION**

Peter Brundage  
Executive Officer

PB:Maf  
(Valuation Theory and Methodology)