

Statement by Thomas E. Bottorff
Senior Vice President, Regulatory Relations
Pacific Gas and Electric Company
Before
Sacramento Local Area Formation Commission
December 7, 2005
Regarding SMUD Annexation Application

Good evening, Chair and Commissioners. My name is Tom Bottorff.

I am Senior Vice President for Regulatory Relations for Pacific Gas and Electric Company. For the past several years, I have been responsible for customer service at PG&E, and in my current position I oversee all ratemaking at the company. I appreciate the opportunity to appear before you tonight as you begin your important task of determining whether it is in the public interest to approve a fundamental change in the electric services provided to 70,000 electricity customers PG&E currently serves in Yolo County.

You have just heard a presentation from representatives of SMUD, and no doubt you have read some of the lengthy correspondence from SMUD over the past couple months, making statements that are at odds with PG&E's point of view. I am sure there will be plenty of time for both sides to argue the facts in the courts and other forums, and I want to assure you that PG&E will be responding in detail to SMUD's letters as well as your own requests for information, including your recent letter dated November 17 which we received a few days ago.

What I want to talk to you about tonight is two things:

First, the process we believe you – and we and SMUD – should follow in determining where the “public interest” lies in reviewing SMUD’s application over the next several months.

Second, why PG&E’s own analysis of SMUD’s application indicates that the annexation would substantially increase the cost of electricity and other public services to residents and customers in both Yolo and Sacramento Counties.

First, what process should LAFCo follow? We believe that LAFCo’s role is to protect the public interest – both in Yolo and Sacramento counties, and to approve SMUD’s proposal *if but only if* SMUD has *clearly* demonstrated that it is in the public interest for Yolo customers to be served by a public utility different from the utility that has served them for many decades.¹ And in making that determination, we also believe LAFCo must determine that SMUD’s existing customers in Sacramento County will not be harmed by the takeover.

In this regard, it is SMUD’s burden, not PG&E’s, to answer key questions before you, including:

- Will electric rates go up or down for either SMUD or Yolo customers if the annexation is approved?
- Will the environment in Yolo and Sacramento counties be improved or degraded as a result of SMUD’s takeover proposal?

¹ California Government Code sections 56653, 56668, 56668.3.

Based on the facts and data we have analyzed regarding each of these questions – which we provided to you in our comprehensive September report and extensive data prepared at your request—SMUD’s proposal is full of uncertainties and risks to both Yolo County customers and to SMUD’s existing customers, and therefore is not in the public interest of either Yolo or existing SMUD customers.

For example, SMUD says that electric rates to Yolo customers will go down, and rates to existing SMUD customers will not go up as a result of the takeover.

PG&E’s analysis indicates the opposite: Under any legitimate scenario, electric rates to Yolo customers will go up significantly if SMUD takes over our facilities and service. Depending on the time period over which the acquisition costs are recovered, SMUD’s surcharged electric rates to Yolo customers will be 10 percent and as much as 20 percent or more higher than PG&E’s rates if SMUD were to begin serving Yolo customers in 2008.² The only way SMUD can reduce this increase is if it raises rates to its existing SMUD customers in Sacramento County to keep rates down in Yolo.

How do we know this? The arithmetic is simple – SMUD must acquire our facilities at fair market value in order to serve Yolo customers, and SMUD also must buy large amounts of natural gas to support the additional power it must purchase or produce to serve those customers.

² PG&E Report to Sacramento LAFCo Regarding SMUD’s Proposed Annexation within Yolo County, dated September 16, 2005, revised September 28, 2005 (“PG&E Report”) Volume 1, pages 73- 75.

Our analysis indicates SMUD has underestimated the cost to acquire our facilities by \$435 million because its inventory of our facilities is woefully incomplete,³ it undervalued the facilities it did count, and because it is using the wrong appraisal method for “fair market value.” Specifically, SMUD has based its estimated value on the original cost of the facilities, less depreciation, or “book value.”⁴ As I communicated with the SMUD Board in May and LAFCo staff in June, and as we described in our response to LAFCo’s data request in September, original cost is not an appropriate means of representing fair market value—it is not even close to market value. Even in the recent Supreme Court case many of you have heard of regarding the government taking of property for redevelopment,⁵ there was no question as to whether the government was obligated to pay fair market value. Here, SMUD is proposing to pay far less than fair market value under an appraisal method for which it cannot cite a single example of use in a contested takeover case such as this.

PG&E has used replacement cost new less depreciation (RCNLD), which is an accepted means of representing fair market value, and which PG&E and public agencies have used as a basis for recently negotiated sales. In fact, when SMUD acquired PG&E’s facilities in Sacramento County many decades ago, it was at

³ PG&E Report, Volume 1, page 38 and attached Black & Veatch report.

⁴ SMUD Application, July 29, 2005, p. 4, fn. 5 and p. 13.

⁵ *Kelo v. City of New London*, 545 U.S. ___, 2005 U.S. LEXIS 5011 (June 23, 2005).

greater than replacement cost, not original cost or book value.⁶ More recently, when SMUD acquired our Folsom facilities, it did not acquire them at original cost, it acquired them at significantly more than original cost. Original cost less depreciation is simply not the true measure of fair market value here, no more than it is when any other business or home is taken by the government.

Beyond this difference in valuation approaches, there are a number of other deficiencies in SMUD's estimates, as we discussed in detail in our September submission.

Our analysis indicates SMUD assumes it will be able to buy gas to serve Yolo beginning in 2008 at less than \$5.00 per MMBtu.⁷ But, as everyone knows, natural gas is currently costing far more than that for future deliveries; in fact it is well above \$8 per MMBtu in 2008⁸ –significantly higher than what SMUD is assuming.

The SMUD Board President told the Sacramento Bee in May, 2005 that “If natural gas prices go through the roof, SMUD would raise its hand to Yolo voters and say, ‘We’ve got a problem.’”⁹ Commissioners, it’s clear that gas prices have gone through the roof, and that SMUD has a problem. And while SMUD may try to argue that PG&E’s rates are similarly impacted by gas price changes, the fact is

⁶ California Railroad Commission Decision (D.) 35985, 44 CRC 467 (1942).

⁷ PG&E Report, Volume 1, page 51, Table 5.

⁸ Current futures prices for natural gas for delivery in 2008 (E.g. December 6, 2005, \$8.26 to \$10.79 per MMBtu) can be found at <http://online.wsj.com/public/resources/documents/FuturesPDF.pdf>.

⁹ *Sacramento Bee*, May 20, 2005.

that our diverse portfolio of resources provides a much better hedge against higher gas costs than SMUD's. SMUD's claim that PG&E's pending electric rate increase for 2006 demonstrates that PG&E's rates are more closely tied to gas prices is 180 degrees wrong; in fact, our 2006 rates prove the opposite. Specifically, we have a mix of \$10 and \$11 per MMBtu gas in our forecast for 2006 rates.¹⁰ We should ask SMUD what its rates in Yolo would be if it were using \$11 per MMBtu gas --not the less than \$5.00 per MMBtu it assumes for 2008 in its annexation application.

In addition to higher gas prices, Yolo low income and low usage customers would lose one of the most important electric rate protections enacted by the Legislature in recent years.¹¹ This protection applies only to investor-owned utilities and not SMUD. This protection prevents PG&E from raising rates to residential electric customers on "baseline quantities" of electricity they use. This means that a substantial percentage of Yolo County households will see no rate increases for at least the next 6 years and perhaps longer, under the State law applicable to PG&E but not SMUD. If SMUD takes over Yolo, low income and low usage customers will lose this legislatively mandated "rate cap" protection.

Furthermore, SMUD has promised the Yolo cities and Yolo County that SMUD will enter into agreements to make up the loss of tax revenues and fees for

¹⁰ PG&E Report, Volume 1, page 68.

¹¹ Stats 1st Ex Sess 2001- 2002 ch 4 section 4, effective February 1, 2001.

public services that PG&E pays each year to these local government entities.¹² We estimate these lost tax and franchise fee revenues at \$2.2 million per year to Yolo cities, special districts and the County,¹³ and the amount is growing. But we have yet to see any specific proposal by SMUD, the Cities or Yolo County to put a utility user tax on the ballot to make up the lost taxes and fees, and there is no other way for SMUD to make up the losses without further violating its pledge to not increase the rates of existing SMUD customers as a result of the takeover.

In regard to the environment, we believe SMUD has dragged you and the residents of Yolo and Sacramento Counties into an egregious violation of the California Environmental Quality Act – “CEQA” – by refusing to perform a full environmental analysis of the impacts of SMUD’s proposed new 18-mile Elverta-Woodland transmission line and construction of other new facilities SMUD says are needed in order to complete the takeover in rural and sensitive habitats of Sacramento and Yolo counties.¹⁴ Why has SMUD refused to evaluate and determine the specific route for the new transmission line and other new facilities and their impacts on the farms, wildlife habitats and other sensitive areas in the two counties (not to mention the airport) *before* sending you the annexation application?

¹² SMUD Resolution 05-05-08, May 19, 2005, section 10 and Attachment B.

¹³ PG&E Report, Volume 1, pages 64- 68.

¹⁴ SMUD Application, July 29, 2005, p. 57; Sacramento SACo Notice of Preparation for the Program Environmental Impact Report, September 1, 2005, p. 12.

Finally, there is the issue of why SMUD has not asked LAFCo to provide existing SMUD customers in Sacramento County the right to vote on the matter. We do not know why SMUD continues to refuse to allow its existing customers in Sacramento County to vote, but we believe LAFCo, as a representative of *Sacramento County* voters, should—and indeed must—ask why and then require such a vote in Sacramento County. We believe SMUD should allow a vote by its existing customers, for one simple reason—SMUD needs to explain how it plans to protect its existing customers in Sacramento County from paying for any costs or cost overruns for the Yolo takeover—particularly when SMUD’s existing proposal already commits Sacramento County voters to pay “hidden” costs of the Yolo takeover such as:

- Sacramento County customers pay additional costs of providing power to serve Yolo, because SMUD must use its existing resources to serve the additional Yolo load and because SMUD has promised Yolo to only increase the Yolo surcharge when the gas prices needed to generate or procure power exceed \$1 per MMBtu above SMUD’s October, 2004 gas price forecast.¹⁵ This hidden subsidy represents

¹⁵ SMUD Board Resolution 05-07-01, Attachment C, paragraph 3.c.

\$250 million in higher costs to existing SMUD customers over the 20 year time-frame.¹⁶

- SMUD proposes to use cash paid by Sacramento County customers to acquire the Yolo facilities, and then replace the cash with new debt paid for by Sacramento County customers. This cash is currently on SMUD's books to offset future rate increases to existing SMUD customers.¹⁷
- Existing service yards paid for by Sacramento County will serve Yolo at Sacramento customers' costs.
- And SMUD has not committed to maintain separate finances and books in order to preclude continued subsidies of Yolo by Sacramento County.

Of course, SMUD has gone to great lengths to try to dispute all our facts and all our analysis, and we realize that your process of independent evaluation is just beginning. I want you to know that PG&E takes very seriously LAFCo's duty to perform an independent evaluation of SMUD's proposal and to obtain full and complete information from PG&E on the relevant facts. We believe you can and should pursue an open and complete process to review and reconcile the disputes over the facts that we have with SMUD. We already provided you a box full of

¹⁶ PG&E Report, Volume 1, page 56, and Volume 3, section 5.5.

¹⁷ PG&E Report, Volume 1, page 63.

information in September, and we intend to provide additional information as requested in your recent letter to us, with the exception of original cost information which we have not assembled, and as mentioned earlier do not believe is relevant. We also support your effort to retain a genuinely independent consultant and expert to review this information for you, and we will cooperate fully with that consultant. In our September submission, we offered LAFCo the opportunity to inspect our maps at our Florin-Perkins office, and we extend the same offer to your consultants.¹⁸ We also are willing to work with SMUD to provide appropriate access to these documents.

The bottom line in our cooperation and responsiveness to LAFCo should be not “Look at what SMUD says,” but “Look at what PG&E has done.” If you, your staff or consultants do not believe we are responsive, our door is open, the phone is available, you should contact us directly and we will work it out.

We are ready to roll up our sleeves and sit down with you and your consultants and go through the documents and numbers for whatever time it takes. We ask you to require the same of SMUD, with the same level of detail. At the end of the process, we believe you will agree with us that SMUD has not met its burden to change the electric service we have provided to Yolo customers for nearly a hundred years.

¹⁸ PG&E Report, cover letter, page 2.

And the risks of making a mistake for 70,000 customers in Yolo County are enormous. Are you willing to take a risk that those 70,000 customers will pay significantly higher electric rates than SMUD is projecting, when SMUD is only committing to a near term 2% rate reduction over only "five to ten years" starting no earlier than October, 2008?¹⁹ Is such a risk worth taking when SMUD has broken its promise on rate surcharges in the past?²⁰ Commissioners, I believe such a risk is not worth taking. Instead, I am here today to tell you that PG&E intends to continue to provide safe and reliable electric service at reasonable rates to our customers in Yolo for another hundred years and beyond.

Thank you, and I and our other PG&E representatives on the panel with me would be happy to answer any questions you might have.

¹⁹ SMUD News Release, July 18, 2005, at http://www.smud.org/news/releases/05archive/07_18annexsurcharge.pdf.

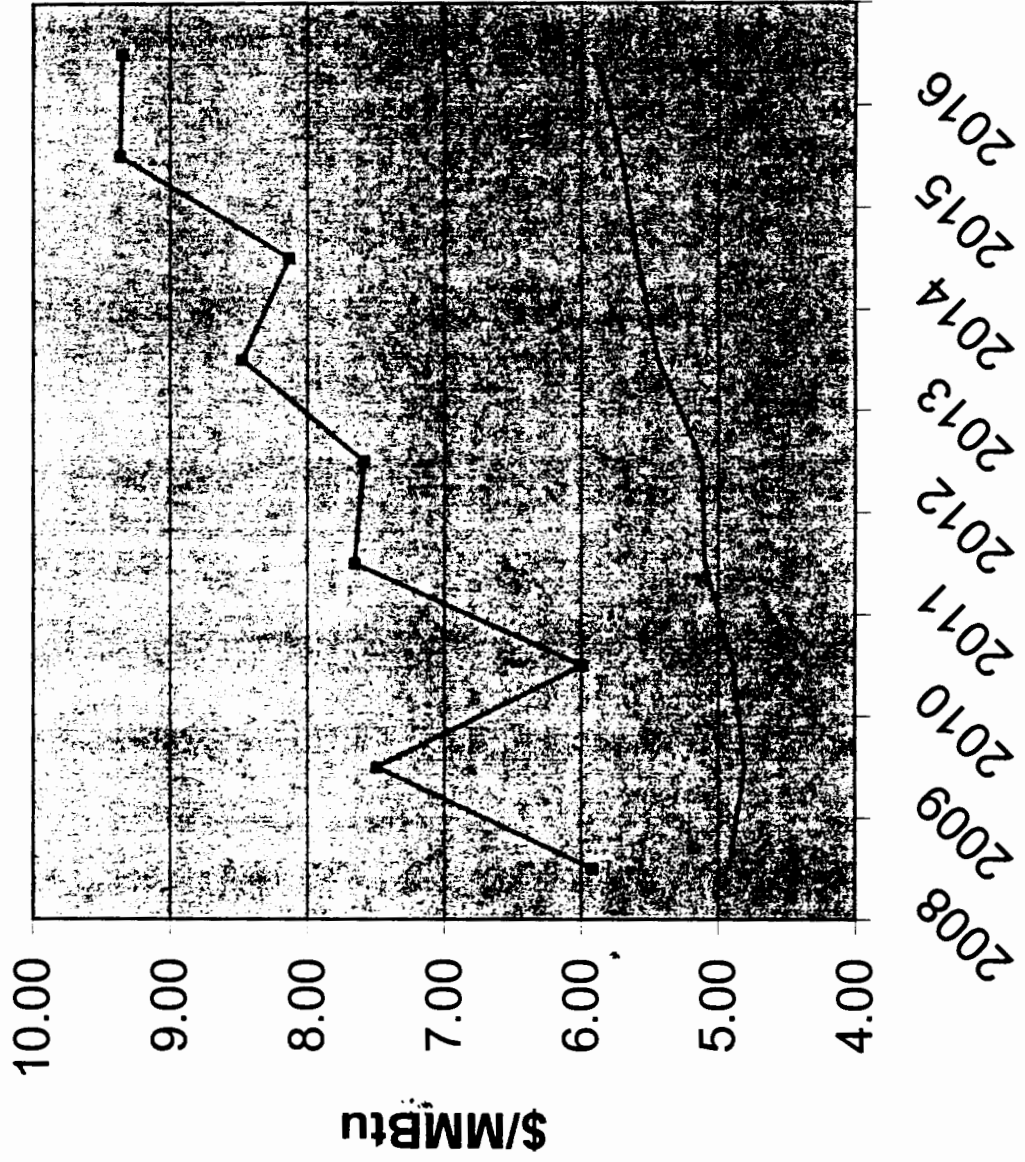
²⁰ "SMUD's Folsom annexation veered from plan," *Sacramento Bee*, April 28, 2005, p. B-1.

Verifiable Inventory Errors

60 76 (21%)	miles of transmission lines*
416 595 (30%)	miles of overhead distribution circuits*
260 353 (26%)	miles of underground distribution circuits
180 375 (52%)	miles of overhead and underground low voltage circuits
3,439 5,785 (41%)	overhead transformers*
1,601 2,111 (24%)	pad-mounted transformers*
969 1,377 (30%)	sub-surface transformers
10,560 19,744 (47%)	poles*

***Visible to the naked eye**

Gas Price Forecasts - Nominal



—■— CEC Sept 05 Fig 5_5
Nominal
— SMUD Appendix F, P.
44 Nominal