April 23, 1999

**To:** Board of Directors (Water Planning and Resources Committee—Information)

**From:** General Manager

**Submitted by:** Debra C. Man
Chief of Planning and Resources

**Subject:** Information on PG&E Hydroelectric System Divestiture

## RECOMMENDATION

For information only.

## EXECUTIVE SUMMARY

As a consequence of the deregulation of California's electric generation market, Pacific Gas and Electric (PG&E) has proposed divesting its California hydroelectric and related water management facilities from its regulated utility to its unregulated subsidiary, U.S. Generation Company. These facilities include 68 power houses and 136,000 acres of land at an overall book value $1.4 billion, with a potential market value of $4.1 billion. The PG&E proposal is subject to approval of the California Public Utilities Commission (CPUC). The Federal Energy Regulatory Commission (FERC), which issues licenses governing the terms and conditions of hydroelectric facility operation, must approve the divestiture and will continue to regulate the facilities. Three California bills have been introduced at the California legislature concerning hydroelectric facility transfer and operations. The California Senate Energy Utilities and Communications Committee has scheduled weekly hearings to consider these issues.

The proposed divestiture also stimulated discussion of potential local and statewide impacts on both power and water operations arising from new ownership. This is a potentially important issue for CALFED, since operational changes resulting from the change of ownership may impact water quality, water supply, and fisheries.

The Association of California Water Agencies (ACWA) has intervened in the initial regulatory proceeding on hydroelectric facility valuation, and anticipates continued active participation in divestiture matters at the CPUC. ACWA members want the local utilities currently served by PG&E to have the right of first refusal to purchase the hydro facilities. PG&E's detailed proposal is expected to be filed with the CPUC in late April. The CPUC decision is projected to occur by the end of 1999.

## DETAILED REPORT

The California electric generation market is being deregulated under AB 1890 (Brulte), Statutes of 1996. As a consequence, Pacific Gas and Electric (PG&E) has proposed divesting its California hydroelectric and related water management facilities from its regulated utility to its unregulated subsidiary, Maryland-based U.S. Generation Company. PG&E's hydro assets are substantial and include 68 power houses with total capacity of 3,890 megawatts (MW), contract rights to irrigation district power production (1,062 MW), 99 reservoirs, 174 dams, and 136,000 acres of land. The assets have a book value of $1.4 billion, with a potential market value of $4.1 billion. In addition to review by the California Public Utilities Commission (CPUC), the transfer will undergo a CEQA review on an independent schedule.

The facilities are currently licensed by the Federal Energy Regulatory Commission (FERC), which has jurisdiction over the terms and conditions of hydroelectric facility operation. The license operating conditions will likely be unchanged by an ownership change, since any effort to change such conditions will trigger a much more comprehensive and lengthy review of the request to transfer the license to a new owner.

Current investor-owned utility hydroelectric generating units provide a significant portion of California's electricity demand. Because these facilities can raise or lower output to quickly follow power demands, they are an integral part of the Ancillary Services (supplemental generation) market. Divestiture of the PG&E hydro assets to a single unregulated entity may result in that entity having significant market power (competitive edge) in Ancillary Services, thereby driving up costs.

The PG&E proposal is subject to approval of the CPUC, which has jurisdiction so long as the facilities are owned by a regulated utility. Details of PG&E's proposal are expected to be filed with the CPUC in late April. A CPUC decision on the PG&E proposal is projected to occur by the end of 1999. The Association of California Water Agencies (ACWA) intervened in the initial CPUC proceeding to determine the appropriate methodology for valuing the hydroelectric units, and plans to actively participate in the proceeding addressing PG&E's divestiture proposal. Some ACWA members, particularly the rural counties represented by the Regional Council of Rural Counties (RCRC), want the local utilities currently served by PG&E to have the right of first refusal to purchase the hydro facilities. The California Senate Energy Utilities and Communications Committee is also holding weekly on issues associated with divestiture.

The following three bills have been introduced in the California legislature regarding hydroelectric facility transfer and operations.

- SB 1183 (Leslie). Would give counties and local utilities having a FERC-license the right of first refusal and would exempt the divestiture from CEQA. This bill has been the focus of ACWA/RCRC efforts.
- SB 1063 (Bowen). Would block the divestiture.
- SB 797 (Costa and Bowen). As originally written, would have facilitated the divestiture. The bill was subsequently amended to create a legislative review of divestiture issues.

ACWA's positions, identified in Attachment 1, are that: (1) agencies that share a water supply with PG&E or purchase water from PG&E shall not have those rights diminished; (2) if PG&E

hydroelectric facilities are divested, local water agencies shall have the right of first refusal to those facilities; and (3) the CPUC should not extend its scope of authority beyond its traditional purposes: specifically not to water rights, reoperation of hydroelectric facilities, determination of new water or increased in-stream flows.

PG&E's proposed divestiture has stimulated discussion of potential local and statewide impacts on both power and water operations arising from a change of ownership. This is a potentially important issue for CALFED, since operational changes resulting from the change of ownership may impact water quality, water supply, and fisheries. The rural counties in which the facilities are located are also concerned about potential adverse effects arising from divestiture, and seek assurances that the hydro facilities will benefit local development in the rural counties. The present discussion presents an opportunity to address both sets of concerns.

Staff is participating in the ACWA discussions. ACWA has advised the active participants that it may propose a supplemental assessment to continue the funding of the effort, for which staff may be seeking the Board's approval in the future.

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**Attachment 10-22A**

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# ACWA Hydro Divestiture Position Points

- Agencies that share a water supply with PG&E or purchase water from PG&E shall not have those rights diminished.

- If PC&E hydroelectric facilities are put up for sale on the open market or if PG&E transfers its hydroelectric facilities to an unregulated affiliate, local water agencies shall have the right of first refusal on those facilities.

- The CPUC shall not extend its scope of authority beyond its traditional purposes: specifically not to water rights, re-operation of hydroelectric facilities, determination of new water or increased in-stream flows.