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Decision 88-01-063 January 28, 1988

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) for authorization to implement a plan of reorganization which will result in a holding company structure.	Application 87-05-007 (Filed May 6, 1987)

Richard K. Durant, Stephen E. Pickett, and Joseph A. Vallecorsa, Attorneys at Law, for Southern California Edison Company, applicant.

Grueneich & Lowry, by Dian Grueneich and Marcia Preston, Attorneys at Law, for California Department of General Services; Joan S. Ortolano, Attorney at Law, for Pacific Telesis Group; Peter N. Osborn, Roy M. Rawlings, and G. J. Sullivan, Attorneys at Law, for Southern California Gas Company; William S. Shaffran, Attorney at Law, for City of San Diego; Michael Shames, Attorney at Law, for Utility Consumers Action Network; Law Office of Kathryn Burkett Dickson, by Joel R. Singer, Attorney at Law, for Toward Utility Rate Normalization; Reich, Adell, & Crost, by Paul Crost, Attorney at Law, for IBEW Local 47, AFL-CIO and Utility Workers of America, Local 246; Marron, Reid & Sheehy, by Melanie S. Best, for Marron, Reid & Sheehy; and Robert Feraru, for the Public Advisor, interested parties.

James Rood, Attorney at Law, and Kenneth C. Chew and Mark Bumgardner, for the Division of Ratepayer Advocates.

O P I N I O N

By this decision we authorize Southern California Edison Company (Edison) to implement its proposed plan to reorganize and create a holding company structure.

I N D E X

Introduction

By this application, Edison, a California public utility electrical corporation,[1] requests Commission approval under Section 854 of the Public Utilities Code (PU Code) to restructure its organization.[2] The restructuring would result in Edison and its unregulated, nonutility subsidiaries becoming separate, wholly-owned subsidiaries of a holding company, with present holders of Edison's common stock becoming the shareholders of the holding company. Specifically, Edison requests authorization to convert 100 percent of its issued and outstanding common stock into the common stock of a newly-formed corporation, SCE Holding Company, through a separate, newly-formed corporation, Edison Merger Company. (See Chart 1.) The two new companies would be incorporated under California law with Edison owning all the outstanding stock of Holding Company and Holding Company owning all the outstanding stock of Merger Company. Edison, Holding Company, and Merger Company would approve and execute an Agreement of Merger[3] under which, subject to various conditions including shareholder approval, Edison will become a subsidiary of Holding Company through the merger of Merger Company into Edison.

In the merger, the common stock of Edison would be converted share-for-share into common stock of Holding Company. As a result, Holding Company would become the sole owner of all Edison common and former Edison common shareholders would become common shareholders of Holding Company. Also, after shareholder approval,

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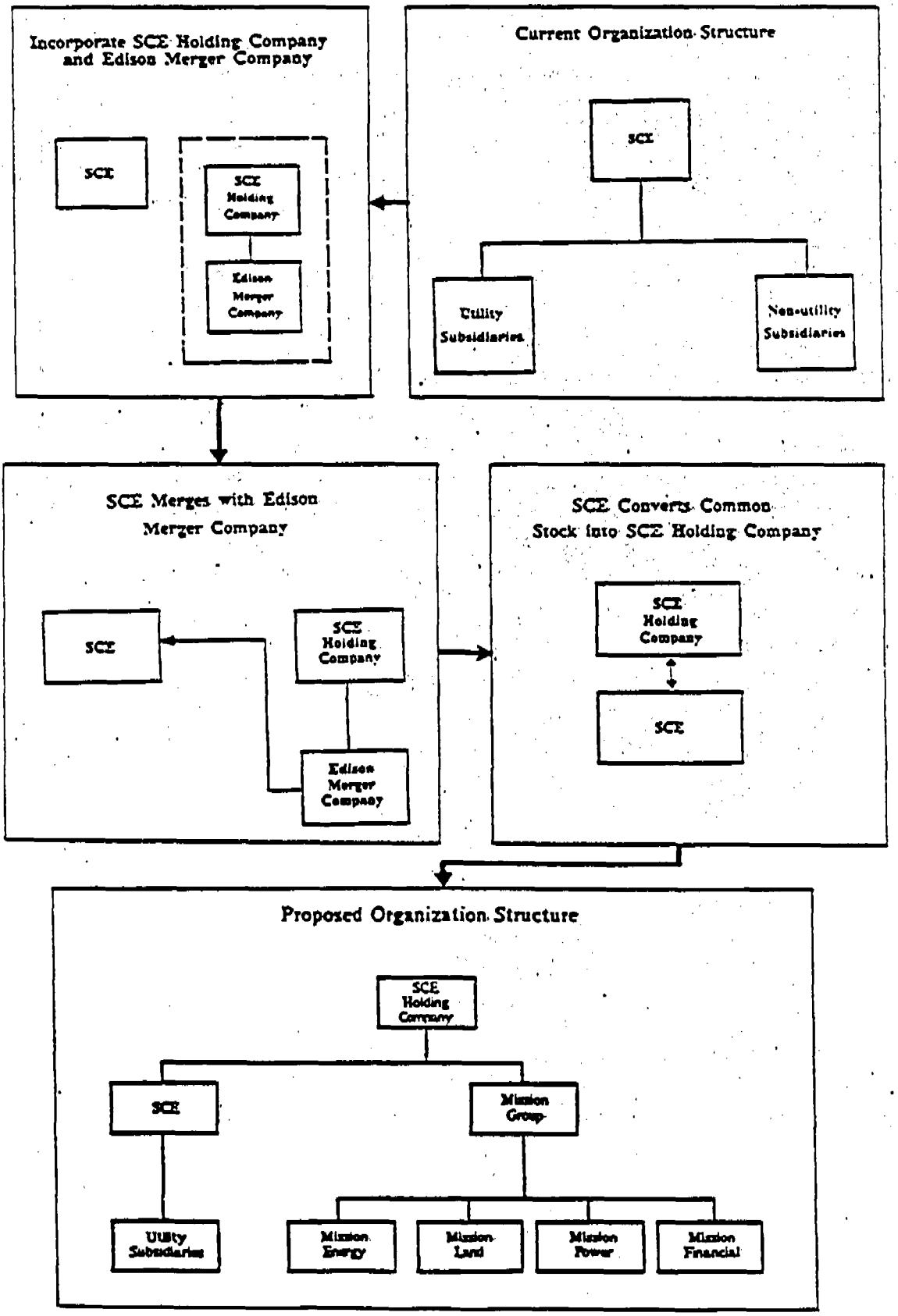
1 See Appendix A for a description of Edison's operation.

2 Section 854 provides in part: "No person or corporation... shall...acquire or control either directly or indirectly any public utility organized and doing business in this state without first securing authorization to do so from the commission..."

3 See Attachment B to Chapter 3 of Exhibit SCE-2.

A.87-05-007

CHART 1



the outstanding shares of Edison's original preferred stock will be converted into the same number of shares of Holding Company preferred stock. Edison's debt securities and outstanding shares of preferred and preference stock would remain with the utility and be unaffected by the reorganization. All of the common stock which Edison owns in its unregulated, nonutility subsidiaries would be transferred to Holding Company. However, the merger transaction would not result in Edison transferring any of its utility assets or property to any other company and the relationships of the remaining regulated utility subsidiaries to Edison would be unchanged. Appendix B contains Edison's present and proposed organization and a description of Edison's subsidiaries.

In addition to obtaining approval of this Commission, Edison needs a number of other approvals. Edison would ask the Securities and Exchange Commission (SEC) for an exemption from the provisions of the Public Utility Holding Company Act as an intrastate holding company under Section 3(a)(1) of that act.[4] A copy of the request for exemption would be sent to the Commission when it is submitted to the SEC. Edison would ask the Internal Revenue Service for a ruling that the contemplated conversion of shares is tax free for Edison and its shareholders. Approval would be needed from certain creditors and notification to others under agreements now in effect. Finally, shareholder approval is necessary. Holding Company securities would be registered with the SEC and Edison would submit to the SEC for review and comment the proxy materials by which Edison would solicit the legally required shareholder approvals for its plan. A copy of those materials would be sent to the Commission prior to solicitation.

Six days of hearings on Edison's proposal were held in San Francisco from September 28 through October 7, 1987 before

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4 15 U.S.C. 79c(a)(1).

Administrative Law Judge (ALJ) Albert C. Porter at which time all parties were given an opportunity to appear and be heard. In addition to Edison's presentation through two witnesses, the Commission's Division of Ratepayer Advocates (DRA) and Toward Utility Rate Normalization (TURN) presented witnesses and exhibits. Local 47 of the International Brotherhood of Electrical Workers (IBEW) presented an exhibit by its Business Manager which was received with cross-examination waived by all parties. Counsel for IBEW represented without challenge that a witness for Utility Workers Union Local 246, if called to testify, would join in the IBEW presentation. The matter was submitted on briefs filed October 23, 1987 by Edison, DRA, TURN, IBEW, Pacific Telesis Group, and Southern California Gas Company (SoCal Gas).

DRA and IBEW would accept Edison's proposal with certain conditions; TURN opposes the request. Pacific Telesis and SoCal Gas oppose the DRA recommendation of a 5 percent royalty payment to Edison by Holding Company affiliates, and SoCal Gas opposes TURN's proposed conditions if the reorganization is approved.

Comments on the ALJ's Proposed Decision which was filed November 17, 1987, were received from Edison, DRA, and TURN. The two minor technical corrections recommended by Edison were incorporated in this decision.

Edison's Case

Edison's general proposition is that the proposed reorganization is a reasonable response to the changing business environment in the electric utility industry. Edison believes its proposal will provide management with the flexibility to respond quickly to nonutility business changes and opportunities without diminishing the Commission's ability to effectively regulate utility operations. For some time Edison has had interests in nonutility enterprises which it operates as subsidiaries of the utility. Edison claims it does not currently plan a major expansion of these activities.

Edison claims the proposed reorganization is intended to accomplish two things. First, it would provide clear organizational separation of the utility and nonutility businesses. This separation would facilitate the Commission's review and regulation of utility operations. It is also advantageous to ratepayers and the utility because it minimizes the possibility of inadvertent subsidies between regulated and unregulated businesses. Second, it would provide a corporate structure that enhances management's ability to take advantage of nonutility business opportunities that might arise.

Edison called John E. Bryson, its Executive Vice President and Chief Financial Officer, as a policy witness. Bryson testified that the proposed reorganization is needed to face the new challenges resulting from partial deregulation of the traditional electric utility business. He stated that construction and operation of new electric generating plants, once exclusively a utility function, is increasingly being undertaken by unregulated power producers. Bryson claims that as competition in the electric utility industry grows, it is important to clearly distinguish between utility and nonutility enterprises, a separation which will provide protection for both the utility's customers and its shareholders. According to Bryson, a holding company structure will provide that clear separation between utility and nonutility businesses, thereby ensuring that each segment of the corporation stands on its own while allowing an audit trail for the Commission in its review of transactions between them. Most importantly, Bryson maintains that the proposal will not affect the Commission's ability to ensure that reliable and fairly priced utility service is maintained with no diminution in the level and quality of service and the proposal will have no adverse effect on Edison's customers.

Edison called James S. Pignatelli, Director of the Revenue Requirements Department, to explain the regulatory aspects

of Edison's proposal and the method by which the holding company would be formed. Pignatellli testified that to ensure that the interest of utility customers will be protected and that they will remain indifferent to Edison's proposed reorganization, Edison considered several factors for which appropriate policies would have to be established so that the Commission's ability to regulate utility operations and to clearly separate utility and nonutility activities and costs would not be impaired. Those factors are:

1. Commission access to information.
2. Accounting and record-keeping practices.
3. Financial effects of nonutility operations.
4. Human resource effects of such operations.
5. Transactions between utility and nonutility affiliates.

Pignatelli addressed each of the above factors in his presentation (see Exhibit SCE-2) testifying as follows:

1. Access to information. By statute, the Commission has access to all relevant books and records, the authority to prescribe such additional accounting and record-keeping practices as may be necessary for effective regulatory oversight, and access to all relevant financial information for both the utility and nonutility affiliates. This authority comes from PU Code Sections

314(a) and 314(b).[5] Under Edison's proposed reorganization, the utility, the holding company, and all nonutility affiliates would be subject to Sections 314(a) and (b), ensuring Commission access to all books and records necessary to effectively regulate the utility.

2. Accounting and record keeping. Although present Commission standards for utility accounting and record keeping are sufficient to provide the oversight necessary to ensure that utility customers are unaffected by the reorganization, under PU Code Section 792[6] the Commission can prescribe additional accounting and record-keeping standards which may be necessary to maintain proper regulatory oversight. In addition, Edison would provide reports regarding transactions between the utility and its nonutility affiliates in a form and manner that will assist in the regulatory review of these transactions. Based on experience after the reorganization, Edison would work with the Commission staff to develop additional accounting practices and records if they are

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5 These sections state in part:

314(a) "...the commission...may, at any time, inspect the accounts, books, papers, and documents of any public utility."

314(b) "Subdivision (a) also applies to inspections of the accounts, books, papers, and documents of any business which is a subsidiary or affiliate of, or a corporation which holds a controlling interest in, an electrical...corporation with respect to any transaction between the electrical...corporation and the subsidiary, affiliates, or holding corporation on any matter that might adversely affect the interests of the ratepayers of the electrical...corporation."

6 Section 792 states in part: "The commission may...prescribe the forms of accounts, records, and memoranda to be kept by ... public utilities, including...the receipts and expenditures of moneys, and any other forms, records, and memoranda which in the judgment of the commission may be necessary to carry out any of the provisions of this part."

needed. Edison agrees to make available to the Commission all publicly filed financial records of the holding company and its nonutility subsidiaries, consolidated or not, including all reports that may be required by the SEC.

3. Financial effects. Because the Commission has authority over the utility's capital structure, financing, and cost of capital for ratemaking purposes, it can protect utility customers from financial effects resulting from nonutility activities. The Commission approves all new debt, preferred stock, and common equity issued by the utility which prevents significant deviations from the approved capital structure, the key to ensuring that the utility maintains its financial integrity. In addition to that financial control, the Commission approves any guarantee of debt obligations by the utility for utility or nonutility affiliates. Under the proposal, the Commission will, of course, continue to determine the utility's capital structure and return on common equity on a stand-alone basis, independent of the operations of the nonutility affiliates. Because of the stand-alone approach, the capital ratios and return on equity will reflect only the risks and costs of the utility operation. The proposed reorganization may, in fact, assist the Commission in this process by clearly separating utility and nonutility operations and performance.

4. Human resources. There is a concern that under a reorganization such as Edison proposes, nonutility affiliates could siphon off utility personnel expertise to the detriment of the utility and its customers, commonly referred to as "brain drain."

One form of such a diversion might occur if utility management is preoccupied with nonutility activities to the detriment of utility activities. With the exception of the fully-compensated sharing of a small number of corporate officers, Edison will follow a policy of maintaining at all times a utility

management team dedicated solely to utility activities so that utility operations will not be neglected by management as a result of nonutility activities.

Another diversion can occur if valuable utility personnel leave the utility to work for its nonutility affiliates, thereby weakening the utility. Although, as with any business, employees come and go and must be free to pursue career opportunities, including those at nonutility affiliates, Edison will not require or coerce utility employees to go to work for nonutility affiliates. Any utility employee who elects to move to a nonutility affiliate is required to resign from the utility; this will not change under the holding company plan. Movement of employees should be minimal because of the size of nonutility activities relative to utility activities.

Finally, Edison will agree to provide the Commission a list of all utility employees who resign from the utility and move to a nonutility affiliate.

5. Transactions between the utility and affiliates. With the oversight available to it from a legal and ratesetting standpoint, the Commission can easily prevent preferential business arrangements between the utility and its nonutility affiliates. The Commission currently reviews Edison's transactions with nonutility affiliates to assure that customers are unaffected by such dealings. The holding company organization will not diminish that review. For instance, the process of reviewing utility power purchase and sales agreements, with whomever they are executed, through the Energy Cost Adjustment Clause procedure will continue unchanged.

Edison will not give affiliates access to or priority for power purchase agreements, and will not provide nonutility affiliates with terms and conditions more beneficial than those available to third parties. Edison will not provide affiliates with utility customer data unless that data is transferred at

market value and is made available to third parties under the same terms and conditions it is available to affiliates.

Because the Commission can review contractural dealings of the utility with third parties, it can ensure that such arrangements do not operate to the detriment of utility customers. And Edison will not require the purchase of any goods or services from a nonutility affiliate as a condition of any arrangement between the utility and a third party.

Subsidies in transactions between the utility and its nonutility affiliates is a fundamental concern with the expansion of a utility into nonutility businesses. These subsidies can occur when assets are transferred or services are exchanged between the utility and nonutility affiliates. However, the proposed reorganization will actually help the Commission prevent such subsidies because the holding company structure will provide a distinct organizational separation of utility and non utility activities. In addition, Edison has established proposed policies governing all transactions between the utility and nonutility affiliates under the reorganization which are designed to minimize the likelihood of subsidies occurring. Under those policies, Edison will keep a record of all transactions involving the transfer of assets or the use of services that occur between the utility and all nonutility affiliates. The record will identify the nature of each transaction and the terms and conditions applying to it. Thus the Commission will have a record to review, if necessary, to prevent subsidies from occurring. Also, transfers of assets from the utility to an affiliate will be at the higher of book value or current market value. Acquisition of an asset by the utility from an affiliate will be booked at no more than the market value of the asset. Services provided an affiliate by the utility will be priced at no less than the fully-allocated cost of the service including a five percent add-on to the labor portion of the

cost. And the utility will pay no more than reasonable market value to an affiliate for services provided to the utility.

Pignatelli also explained the method by which the holding company organization would be formed. As noted earlier, Edison is using the term "holding company" as it is defined in the Public Utility Holding Company Act of 1935 which defines a holding company as "any company which directly or indirectly owns, controls, or holds the power to vote, 10 per centum or more of the outstanding voting securities of a public utility."

The reorganization will be implemented using a legal mechanism known as a Reverse Triangular Merger or RTM. The process is described in the Introduction section of this decision and is illustrated on Chart 1. The initial corporate functions within the holding company will be those which serve the utility and nonutility groups on an ongoing basis. In addition, Edison anticipates that the Board of Directors of SCE Holding Company and the Southern California Edison Company will be identical, Holding Company and Edison may have a few officers in common, and the corporate staff of the new holding company will be very small.

DRA's Position

The witness for DRA was Mark Kent Bumgardner, a public utilities financial examiner. Bumgardner presented an exhibit which covered the position of the DRA on Edison's proposal. DRA does not oppose the reorganization provided that:

1. Edison's Qualifying Facilities (QF) affiliates are not allowed to operate any new QF operations inside Edison's service territory.

2. Edison's nonutility affiliates[7] are required to pay five percent of their gross

7 See "Mission Group" Appendix B, Page 2.

revenues to Edison for the intangible benefits they receive from their association with Edison.

3. Edison bills its affiliates in a manner which will provide the most benefit to Edison's ratepayers.

When the Commission authorized San Diego Gas & Electric Company (SDG&E) to form a holding company by D.86-03-090 dated March 28, 1986, in A.85-06-003, it added 20 conditions to the authorization that SDG&E would have to meet if it formed the holding company. In a data request to Edison subsequent to Edison's filing of this application, the DRA asked Edison to indicate its position on the 20 SDG&E conditions in D.86-03-090. At a prehearing conference in this matter held June 30, 1987, Edison briefly set forth its position on the 20 conditions while indicating, with DRA concurrence, that it had been meeting with DRA to see how many of the conditions could be stipulated to.

Thereafter, in July 1987, Edison filed testimony by Pignatelli (Exhibit SCE-3), supplementing that filed with its application, for the purpose of indicating Edison's position with regard to each of the 20 SDG&E conditions. Subsequent to that filing, Pignatelli presented Exhibit 1 at the hearings in September. Exhibit 1 is a joint exhibit of Edison and DRA setting forth areas of agreement and disagreement between Edison and DRA on Edison's proposal. The disagreements now boil down to the first two noted above, QF operations and the 5 percent royalty payment.[8]

On the issue of Edison's purchases from QF affiliates, Bumgardner testified that even though the Commission has adopted a

8 We discuss in detail later the 20 SDG&E conditions vis-a-vis the positions of the parties and the stipulation of Edison to most of the conditions.

policy which allows utilities to accept bids from their QF affiliates,[9] there is a potential for self dealing between the utility and its QF affiliates at ratepayer expense, particularly within Edison's service area. As an example, Bumgardner cited a current DRA investigation of a non-standard contract between Edison and a QF affiliate which has resulted in higher purchased power costs than DRA believes necessary. He stated that the close relationships of Edison and its affiliates make it impossible for Edison to provide data to third parties under the same terms and conditions it is available to affiliates. Because of the close inter-relationships and the resulting potential for self dealing, DRA recommends against allowing Edison affiliates to operate any new QF operations inside Edison's service territory.

DRA recommends the Commission put a condition on the holding company formation that would require Edison's nonutility affiliates to pay five percent of their gross revenues to Edison for the intangible benefits they receive from their association with Edison. DRA cites the SDG&E decision where the Commission found that a utility's affiliates receive a number of intangible benefits from their association with the utility and impose difficult-to-quantify costs on utility ratepayers. Bumgardner claims the royalty payment recommended by DRA provides compensation to ratepayers for such benefits. DRA has made a similar

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9 By D.87-05-060, dated May 29, 1987, in the ongoing OIR-2 proceeding, the Commission stated: "We will allow utilities to accept bids from their QF affiliates. The restrictive approach we adopted in D.86-03-090 in connection with SDG&E's holding company proposal predates our adoption in D.86-07-004 of the second price auction for final Standard Offer 4. We think that the auction process itself helps insure the propriety and reasonableness of utility dealings with their affiliates." (Mimeo p. 17.)

recommendation under the present organization of Edison in Edison's current rate case, A.86-12-047. Bumgardner points to the following as the considerations which led to his recommendation.

In the business plans of Edison affiliates which the DRA reviewed, the affiliates admitted that their success was the result of several factors stemming from their relationship with Edison, one being having Edison as a financially strong and highly reputable parent with excellent organizational resources. Also, clients of the affiliates could trust that they would be dealt with ethically. And the affiliates have easy access to Edison's management employees and their expertise, allowing the affiliates to avoid maintaining expensive staffs of experts, office space, and associated support functions. With Edison as a backup, they can expand and contract their operations without worrying about excess or insufficient resources.

Some of the services which subsidiaries of Edison have received are use of Edison's employees to perform feasibility studies, preliminary engineering studies, engineering and construction, and maintenance and operation of energy related equipment and facilities.

Edison's affiliates close association with Edison provides them with access to "insider information," that is, valuable knowledge in the possession of Edison not generally available to third parties.

Bumgardner testified that the DRA determined the 5% royalty on gross income of Edison's affiliates by equating it to the price which independent parties would pay for an equivalent type of service; specifically, DRA compared the services Edison provides to its affiliates with the services a franchiser provides to a franchisee. DRA determined that it is common practice for the franchisee to pay the franchiser a royalty based on a percentage of

the franchisee's gross income; DRA found that the average percent of gross is between 4 and 8 percent and chose 5% as a conservative figure.

Bumgardner presented Exhibit 15 which he claims lists the intangible benefits five of Edison's nonutility affiliates[10] received from their association with Edison. The intangible benefits he lists are:

Utility Name Recognition
Utility Reputation
Utility Financial Stability
Trained/Experienced Officers and Technical Personnel
Access to Management and Technical Personnel
Lower Costs of Expanding Services
Ability to Expand and Contract As Needed
Access to Insider Information
Access to Technical Knowledge
Assistance in Getting Started

Bumgardner did not put a value on the benefits, but claimed they are typical of the benefits he would expect the 5% royalty to cover.

TURN's Recommendations

TURN recommends the Commission not approve Edison's request because it poses undue risks for ratepayers. TURN's witness was Sylvia F. Hancock of Hancock Utility Consultants, LTD. Hancock testified that if the Commission does not accept TURN's position and decides to approve the reorganization, the Commission

10 See Appendix B, Page 1, Non Utility-Related, First-Tier, except Associated Southern Investment Co.

should impose the following conditions in addition to those agreed to by Edison.

1. Affiliate QF sales to Edison should be prohibited.

2. When feasible, non-discriminatory access by competitors of Edison's unregulated affiliates to Edison resources which Edison provides to affiliates should be assured.

3. Payment of franchise fees by unregulated affiliates to Edison for remaining discriminatory access to Edison resources should be provided for.

4. The Commission should have unrestricted access to parent company and affiliate books and records which are essential to the Commission's regulatory function.

5. The Commission should have the ability to constrain the pace and scope of the holding company's diversification in order to reduce the risk to ratepayers.

6. A payment should be required for unregulated affiliate use of Edison's resources based on projected level of use.

7. Provision of goods or services to Edison by unregulated affiliates at a cost in excess of Edison's cost to provide the same goods or services directly to ratepayers should be prohibited.

Hancock testified that the proposed reorganization, which is primarily aimed at facilitating diversification, will diminish the company's incentive and ability to provide adequate electric utility service at reasonable cost, its primary function. The holding company structure will not adequately insulate Edison ratepayers from the increased risks or potential subsidies that may result from diversification efforts. As diversification is accelerated, the Commission's oversight of that diversification will be reduced, thus increasing the risks to ratepayers compared

to risks from diversification under the current organization. Hancock stated that it is impossible to specify conditions that will, with reasonable certainty, preclude subsidization and impairment of service. Also, Hancock claims diversification may obstruct competition because the unregulated affiliates may have discriminatory access to unique utility resources not available to their competitors in addition to receiving other subsidies in the form of services from Edison at below-market costs.

Based on her review of Edison's presentations and responses to TURN data requests, Hancock believes the proposed reorganization is prompted by a desire to construct and operate new, unregulated electric generating plants using surplus cash flow accruing because of the completion of major utility construction programs. And even though Edison told TURN it does not intend to increase the pace of diversification by forming a holding company, Edison acknowledged that the ability of a holding company to directly issue equity capital could expedite the funding of nonutility projects. Therefore, Hancock maintains a holding company would permit Edison to use anticipated surplus funds and creative financing to rapidly expand its nonutility investments with a minimum of interference from the Commission. Hancock attacked Edison's assertion that Commission oversight under the holding company plan would be more effective because of the clear separation of entities, something Edison claims is a ratepayer benefit. She claims that, on the contrary, because the Commission would no longer have the ability to restrict the pace and nature of diversification, Edison's provision of utility service at the lowest reasonable cost would be impaired.

As an alternative to a holding company structure devoted to rapid expansion of nonutility activities, Hancock suggests other more innovative uses of any surplus funds. One would be to reduce the rate of recovery of utility investment which would reduce the surplus and reduce Edison's cost of service thereby lowering

utility rates and making Edison more competitive with alternative power suppliers. She claims this would be a form of ratepayer investment. Another possibility would be stock repurchases or extraordinary dividend payouts, a form of stockholder investment. Hancock believes such investments would be preferable for either ratepayers or stockholders instead of letting Edison's management do it through diversification considering the relative risks and benefits involved.

Hancock is also concerned about the cost of capital under the holding company compared to the present organization. If the utility cost of capital is determined on a stand-alone basis, which is what Edison and the DRA expect and recommend, ratepayers would not share in any reduction in capital costs which might be achieved through diversification. On the other hand, it is expected investors will demand a higher return on holding company equity than Edison equity; but if that return is not achieved by the holding company, the Commission may have to make up for the low earnings of the holding company through Edison's return so that the ability to attract capital required for utility operations at a reasonable cost is not impaired. Also, holding company management may be more inclined to invest in facilities which bring the higher return expected for the holding company rather than invest in utility plant that could reduce cost of service but is not needed to maintain the level of service.

Hancock believes that sharing of top management between the utility and holding company in the initial stages of the reorganization would not benefit the utility. Managers will have an extra incentive to make sure the holding company succeeds. This could divert talent and attention away from Edison during a period when it faces new competitive challenges.

Hancock finds fault with Edison's proposed guidelines for affiliate transactions, claiming the best allocation scheme can be frustrated when management has an incentive to do so. She believes

the holding company organization will not diminish Edison's incentive or ability to shift costs from unregulated ventures to its utility operations. She proposes some safeguards if the reorganization is approved. The Commission should require proof that any service provided by an affiliate to Edison cannot be provided more reasonably by in-house services. Transfer of assets and services from the utility to affiliates should be at the higher of fully allocated cost or competitive market price.

The relationship of Edison and its QF affiliates under the holding company structure is of major concern to TURN. Hancock testified that the holding company structure will facilitate expanded investment by Edison affiliates in QFs which will increase the risk that Edison will not minimize its utility power supply costs. Also, the holding company's interests will be better served by increasing payments to QFs even though this raises costs to Edison's customers. Hancock believes the gravest risk to ratepayers is that Edison will forego cost-saving investments or purchases of non-QF power that could reduce its avoided costs and short-run marginal operating costs in order to increase payments to both affiliated and non-affiliated QFs. The only way to prevent possible manipulations, according to Hancock, is to prohibit sales by affiliated QFs to Edison as a condition for approval of the holding company proposal.

Position of the Unions

IBEW, Local 47, and Utility Workers Union of America (UWUA), Local 246, (Unions) are the exclusive bargaining representatives for several thousand Edison employees. The Unions have not taken a position on Edison's request. However, if the holding company reorganization is approved, the Unions urge the Commission to adopt certain conditions designed to protect workers against erosion of their benefits and conditions of employment. IBEW presented the testimony of Rae Sanborn, Business Manager and Financial Secretary of Local 47. Carl Wood, Business Agent for

diminution of the Commission's ability to regulate Edison effectively or Edison's ability to provide reliable utility service at reasonable rates.

TURN is the only participant in this proceeding that recommends Edison's request be denied. We are not convinced by TURN's witness and arguments that approval of the request will be harmful to Edison's ratepayers particularly in view of the conditions we will discuss shortly and impose. TURN's concerns that the reorganization poses undue risks for ratepayers is not supported by the record. For example, nowhere in TURN's presentation is there a reference to any harmful effects of the present extensive diversification by Edison. (See Appendix B, Page 1.)

TURN argues that the holding company structure will reduce regulatory control, increase the risk of cross subsidies, and subordinate utility management to the holding company, all to the detriment of ratepayer interests. We do not agree that the Commission needs to exert direct authority over the holding company to regulate the utility effectively and thereby protect ratepayers. The holding company structure will not preclude the Commission from ordering what is necessary to insure adequate service. The utility must still respond to Commission orders regardless of what the parent may do. There is always the risk when affiliates and the utility do business together, holding company organization or not, that improper allocations will result in higher costs of service and, therefore, higher rates than necessary. But we believe the safeguards we will adopt through the guidelines which control intercorporate transactions under the holding company structure will provide the proper oversight. We have the staff capability of auditing transactions under the current structure and believe that ability will be unaffected under a holding company structure, particularly in view of the right of access the Commission has to records under any form of organization. What TURN fails to

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the holding company organization will not diminish Edison's incentive or ability to shift costs from unregulated ventures to its utility operations. She proposes some safeguards if the reorganization is approved. The Commission should require proof that any service provided by an affiliate to Edison cannot be provided more reasonably by in-house services. Transfer of assets and services from the utility to affiliates should be at the higher of fully allocated cost or competitive market price.

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Local 246 of UWUA joined in and supported Sanborn's testimony. The Unions' proposed conditions are:

1. No work presently performed by union-represented employees of Edison be contracted, transferred, nor assigned to any subsidiary of the holding company, other than Edison.

2. No operational nor support functions which currently involve union-represented workers be contracted, transferred, nor assigned to any subsidiary of the holding company, other than Edison.

It is well settled that the Commission does not have nor want the power to impose the conditions proposed by the unions. (Pac. Elec. Ry. (1944) 45 CRC 426, 430; Pac. Tel. v CPUC (1950) 34 C. 2d 821, 827; Rich. S. Raf. Fy. & Tr. Co. (1953) 52 CPUC 585, 586) The Unions' request will be denied.

The Issues

The issues to be decided in this case are:

1. Should the Commission authorize Edison to establish a holding company?

2. If the Commission approves Edison's request, what conditions should be imposed?

Reorganization Approval

We are convinced by Edison's presentation that times in the electric power industry are changing and Edison should be allowed to position itself to meet the changes. Competition is dictating a whole new method of operating in the industry. The separation between the utility and nonutility businesses may even make it easier for the Commission to delineate its responsibilities and thereby focus on the issues which affect ratepayers. Under the proposal, given the conditions we will require, there should be no

diminution of the Commission's ability to regulate Edison effectively or Edison's ability to provide reliable utility service at reasonable rates.

TURN is the only participant in this proceeding that recommends Edison's request be denied. We are not convinced by TURN's witness and arguments that approval of the request will be harmful to Edison's ratepayers particularly in view of the conditions we will discuss shortly and impose. TURN's concerns that the reorganization poses undue risks for ratepayers is not supported by the record. For example, nowhere in TURN's presentation is there a reference to any harmful effects of the present extensive diversification by Edison. (See Appendix B, Page 1.)

TURN argues that the holding company structure will reduce regulatory control, increase the risk of cross subsidies, and subordinate utility management to the holding company, all to the detriment of ratepayer interests. We do not agree that the Commission needs to exert direct authority over the holding company to regulate the utility effectively and thereby protect ratepayers. The holding company structure will not preclude the Commission from ordering what is necessary to insure adequate service. The utility must still respond to Commission orders regardless of what the parent may do. There is always the risk when affiliates and the utility do business together, holding company organization or not, that improper allocations will result in higher costs of service and, therefore, higher rates than necessary. But we believe the safeguards we will adopt through the guidelines which control intercorporate transactions under the holding company structure will provide the proper oversight. We have the staff capability of auditing transactions under the current structure and believe that ability will be unaffected under a holding company structure, particularly in view of the right of access the Commission has to records under any form of organization. What TURN fails to

consider is the overwhelming size of the utility operation compared to the whole; the utility revenues are currently more than 98% of the total revenues from all operations. Based on the record, that relationship is not likely to change markedly in the short term under the holding company organization.

TURN asserts that the holding company formation may decrease the utility's ability to meet its capital needs. There are two sides to that argument. It is entirely possible that the strength of the organization that develops under a profitable holding company operation will make it easier to raise capital; and most likely the cost of that capital could be less. The record shows that subsidiary operations are generating excellent profits, and nothing on the record indicates that the holding company structure will change that. In any case, the capitalization of the utility will be handled on a stand-alone basis, just as it is today.

We conclude that TURN has not supported its recommendation that the application should be denied out of hand. However, we also conclude that stringent conditions should be put on our approval in order to minimize the risk to Edison's ratepayers.

In that regard, one strong factor that convinces us to approve the reorganization is the position of the DRA, which has worked diligently toward compromises and accords with Edison that had their genesis in the SDG&E decision. We will now discuss the conditions we will impose, most of which have been agreed to by Edison and the DRA. However, TURN recommends in many cases more stringent conditions. We reference the conditions to those we imposed in the SDG&E decision and take them one by one for discussion. For example, SD-1 is Condition 1 we imposed in the SDG&E application. E-1 would be Edison's version of the condition if Edison has one to match it.

Conditions for Approval

SD-1 The Commission shall have access, as it deems necessary, to the books and records of SDO Parent Co., Inc., its affiliates and subsidiaries. Such books and records shall be produced within this State upon request by the Commission, its employees or its agents. Requests for production made by the Commission's employees or agents are deemed presumptively valid, material, and relevant. Any objections to such requests shall be timely raised by SDG&E, SDO or its affiliates before the administrative law judge or assigned commissioner to the proceeding in which such objections arise. In making such an objection, respondents shall demonstrate that the request is not reasonably related to any issue properly before the Commission and, further, is not reasonably calculated to result in the discovery of admissible evidence in the proceeding.

SD-2 SDO Parent Co., Inc., and each of its subsidiaries shall obtain the written agreement of their joint ventures to produce, upon request of the Commission or its employees or agents, the books and records of the joint venture as they may be related to transactions with SDG&E, said production to be in accordance with the provisions pertaining to the books and records of SDO and its subsidiaries.

E-1 Edison shall ensure that the Commission has access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of Public Utilities Code Section 314.

Edison proposes and DRA agrees to replace SD-1 and 2 with the condition noted because of the new provisions in PU Code Section 314(b). (See Footnote 5.) TURN proposes the Commission adopt the more stringent conditions contained in the SDG&E decision because Section 314(b) does not provide for unconditional access to the books and records of the holding company but only provides

access to information on transactions "that might adversely affect the interests of ratepayers."

At the request of the ALJ, parties briefed the legislative history of the changes in Section 314(b). The history of the current Section 314 provisions show that it was this Commission that sponsored the changes in the bill apparently in response to what the Commission saw as problems in accessing records of holding companies which control public utilities. The most recent change was, in fact, made as a direct result of the the SDG&E holding company case. Of particular note is Attachment 1 to TURN's brief, which is a copy of the floor analysis furnished by the author of Senate Bill 2331 to the Senate prior to the vote on the bill.[11] The relevant part of the analysis states:

> "In the recent PUC decision allowing SDG&E to form a holding company, the PUC imposed a number of conditions with respect to access to books and records. These conditions, uncontested by SDG&E, include establishing a valid presumption for PUC information requests and an objection proceeding which can be followed by a utility, holding company or affiliate; expansion of the PUC's ability to request information on 'joint ventures'; and allowing the PUC the right to require certain accounting procedures to protect against 'cross subsidization'.
>
> "This bill would allow the PUC to request information on <u>any matter that might adversely affect the interests of ratepayers</u> of a public utility -- not confined to rates or expenses -- and would include utility holding companies among those that must supply this information." (Emphasis added.)

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11 The vote taken on August 21, 1986 shows 57 Ayes and 3 Noes. Listed as a supporter of the bill among others is TURN.

It is quite clear that the Legislature intended some limitation on the Commission's access to the books and records of the holding company because the exact words used in the bill analysis and underscored in the above quote are contained in Section 314(b). However, the limiting language is couched in very broad terms and parties are placed on notice that we intend to interpret it broadly in fulfilling our regulatory oversight responsibility.

TURN maintains that even if the Commission were to adopt E-1, it would leave the determination of which requests are consistent with the requirements of Section 314 to future litigation, and it fails to explicitly assign Edison the burden of proof when making a claim that a given request is beyond the scope of Section 314. However, under cross-examination, Edison witnesses made it very clear that the holding company would cooperate to the fullest with the Commission while not giving up its right of appeal to the Commission when it thought access was not proper. Edison Witness Pignatelli covers this at Transcript Pages 108, 114, and 119, and Edison's policy witness Bryson at Transcript Pages 142 and 228. In particular, Bryson testified that in the case of disputes, Edison would take the matter before the presiding administrative law judge and if the ALJ "ruled that access should be available, then the company would adhere to that." (TR 142.)

We agree with TURN that it is valuable to have the elements of a specific administrative procedure in place to clarify that Edison and its affiliates will have the burden of demonstrating the unreasonableness of requests for information made under Section 314. In addition, recent discovery disputes involving Edison point to the need for a defined procedure for resolving such questions. We expect that Edison and its affiliates will either comply promptly with DRA and CACD requests for information, or will prepare an immediate showing to demonstrate

why such requests are allegedly beyond the bounds of jurisdiction or relevance.

Accordingly, we will add the following language to amend E-1 to reflect the substance of SD-1:

> Edison is placed on notice that the Commission will interpret Section 314 broadly as it applies to transactions between Edison and the holding company or its affiliates and subsidiaries in fulfilling its regulatory responsibilities as carried out by the Commission, its staff and its authorized agents.
>
> Administratively, requests for such books and records made by the Commission, its staff or its authorized agents shall be deemed presumptively valid, material and relevant. Any objections to such requests shall be timely raised before the administrative law judge or assigned commissioner in the proceeding in which such objections arise. In order to sustain an objection to such a request, respondents shall have the burden of showing that the request is not reasonably related to any issue properly before the Commission and, further, is not reasonably calculated to result in the discovery of admissible evidence in the proceeding.

As SB 2331 clarified the extent of Commission authority regarding access to books and records, it is not necessary to adopt the specific language of SD-2 regarding the Commission's authority over joint ventures.

SD-3 SDG&E, SDO Parent Co., Inc., SDO's subsidiaries and the joint ventures of SDO and/or its subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of nonutility activities by SDG&E customers.

E-2 Edison, Edison's holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of nonutility activities by Edison's customers. These procedures and controls are explained in Edison's Corporate Policies and Guidelines for Affiliate Transactions.[12] This document is attached hereto, and by this reference is made part of these conditions. Edison's policies include the application of a five-percent markup on fully loaded labor costs billed to nonutility affiliates for the use of Edison employees. This billing policy, as well as Edison's Corporate Policies and Guidelines for Affiliate Transactions, will be reviewed in subsequent Edison General Rate Cases.

As will be noted, Edison's proposed condition is more complete than the comparable SDG&E condition and also adopts an extensive set of guidelines not included in the SDG&E condition. We find Edison's proposal will protect against cross-subsidization of nonutility activities by the utility.

SD-4 SDO Parent Co., Inc., its subsidiaries and the joint ventures of SDO and/or its subsidiaries shall keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

E-3 Edison's holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

12 Attached to this decision as Appendix C.

Edison's proposed Condition E-3 is identical to SD-4. No parties opposed it or offered an alternative. We will adopt it.

SD-5 The officers and employees of SDO Parent Co., Inc., and its subsidiaries shall be available to appear and testify in Commission proceedings without subpoena.

E-4 The officers and employees of Edison's holding company and its subsidiaries shall be available to appear and testify in Commission proceedings.

Edison's E-4 deletes the provision that witnesses should appear without subpoena. Edison agrees with and commits to the principle that nonutility affiliates' officers and employees should be available to testify before the Commission on all relevant matters. However, Edison believes that requiring such testimony without subpoena is both unnecessary and an extra jurisdictional act and should not be imposed as a condition of holding company formation. DRA agrees with the revision.

TURN argues that requiring attendance without subpoena assures that all necessary officers and employees will be available to testify. Because not all Edison affiliates will be located in California and the Commission's subpoena power does not extend beyond California, (TURN cites Walker v. Boyle (1925) 75 Cal App 152, 242 P. 115), the Commission may lack authority to subpoena certain affiliate employees.

We remind TURN and emphasize to Edison in particular that it is the utility's burden to prove its contentions in any proceeding before the Commission. To fail to produce witnesses as necessary or required on the technicality of non-jurisdiction would be a grave mistake because of the power the Commission has to invoke penalties. (See for example, D.93367 of Pacific Telephone and Telegraph Company (6 CPUC 2nd 441, 490).) We see no need for the subpoena provision and will adopt E-4 but with the additional clarifying phase, "as necessary or required."

SD-6 SDG&E shall furnish the Commission with:

a. the quarterly and annual financial statements of SDO Parent Co., Inc., including annual consolidated and consolidating balance sheets of SDO and its consolidated subsidiaries;

b. annual statements concerning the nature of intercompany transactions concerning SDG&E and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

c. the balance sheets of the nonconsolidated subsidiaries of SDO; and,

d. all periodic reports filed by SDO with the Securities and Exchange Commission.

e. SDG&E shall submit, as a separate exhibit in its next general rate case, an audit of all transactions between SDG&E and affiliated enterprises, to be performed by an outside auditing firm which shall be selected and supervised by the Commission's Public Staff Division. The need for subsequent audits will be determined in SDG&E's next general rate case.

E-5 Edison shall furnish the Commission with:

a. The quarterly and annual financial statements of its parent holding company, including consolidating workpapers of the holding company and its subsidiaries;

b. Annual statements concerning the nature of intercompany transactions concerning Edison and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

c. The balance sheets and income statements of the nonconsolidated subsidiaries of the holding company;

d. All periodic reports filed by the holding company with the Securities and Exchange Commission; and

e. Edison shall submit, as a separate exhibit in its next general rate case, an audit of all transactions between Edison and its nonutility affiliates, to be performed by an outside auditing firm which shall be selected and supervised by the Commission's Public Staff Division. The need for subsequent audits will be determined in Edison's next general rate case.

E-5 is equivalent to SD-6. None of the parties had comments or suggestions for change. E-5 will be adopted.

SD-7 Within ninety (90) days following the close of its fiscal year, SDO Parent Co., Inc., shall provide the Commission with a detailed statement of (a) the projected capital budgets of SDO and each of its subsidiaries for the current year and each of the next two years including estimated financing requirements and construction plans, and (b) sources of capital to be used in funding said capital budgets for the current year.

Edison opposes this condition, offering no alternative but pointing to the information that would be provided under E-5, 9, 10, 12, and 13 as sufficient to serve the purpose of regulatory oversight. Edison notes that in the SDG&E holding company decision the Commission said SD-7 could be helpful in identifying those instances in which the holding company might be unduly relying on utility dividends to finance its nonutility functions. Edison believes this condition is unnecessary for the protection of ratepayers because the Commission, under the other conditions proposed by Edison, will have the ability to ensure that the equity required to support the utility will not be used to finance nonutility ventures. For example, E-9 addresses the capital structure of the utility and provides for maintenance of the capital ratios found reasonable in Edison's general rate cases. DRA agrees the provision is not needed.

TURN, however, takes issue with the deletion of SD-7 and other changes proposed in the areas of financing such as SD-16 and

17. TURN believes information on capital budgets is necessary to ensure the financial health of the utility. It maintains that without advance notice but only with after-the-fact data, the Commission is powerless to determine the effect capital changes will have on the utility. Under the holding company scheme, TURN claims equity investment in the utility can only come from the holding company, and therefore the Commission must be aware beforehand of what is being planned concerning capital investments. TURN believes a condition such as SD-16 is absolutely essential to protect ratepayers from injudicious expansion of nonutility activities. TURN also believes that divestiture of subsidiaries could affect the financial health of the utility and therefore should be reviewed by the Commission.

We believe the reports provided for in the conditions Edison proposes will be sufficient information for the Commission to discharge its regulatory obligations. TURN's witness Hancock testified that the nonutility investment under the holding company could as much as triple over the next five years. That would take it to perhaps 5 or 6% of the holding company's revenues. We do not see that as a cause for alarm. Provision of the nonutility proposed budgets to and review of them by the Commission is not necessary to the Commission's function. We do not regulate the nonutility activities and don't wish to get involved with management functions of the holding company such as budgets. The one thing we must make sure of is that the activities of the holding company and its nonutility enterprises do not adversely affect the ratepayers of the utility. Put another way, Edison's ratepayers should be indifferent to transactions between any and all entities of the holding company enterprise. This standard of "ratepayer indifference" is the one which guides us in these matters. We believe the conditions worked out by Edison and DRA on financial controls and reporting are adequate to support our regulatory function and they will be adopted.

SD-8 SDG&E shall notify the Commission in writing within thirty (30) days prior to any transfer to SDO Parent Co., Inc., or its affiliates of any asset or property exceeding a fair market value of $100,000, whether or not considered by the utility to be necessary or useful in the performance of its public utility obligations. This condition shall not include transfers of funds for investment under a cash management system.

E-7 Edison shall notify the Commission in writing within thirty (30) days prior to any transfer to the holding company or its nonutility affiliates of any utility asset or property exceeding a fair market value of $100,000, whether or not considered by the utility to be necessary or useful in the performance of its public utility obligations. This condition shall not include transfers of funds for investment under a cash management system.

E-7 is equivalent to SD-8. It will be adopted.

SD-9 SDO Parent Co., Inc., shall avoid a diversion of management talent that would adversely affect SDG&E. SDG&E shall provide to the Commission annual reports identifying nonclerical personnel transferred from SDG&E to SDO or SDO's subsidiaries.

E-6 Edison shall avoid a diversion of management talent that would adversely affect the utility. Edison shall also provide to the Commission an annual report identifying nonclerical personnel transferred from Edison to its parent holding company or any of the holding company's nonutility subsidiaries.

E-6 is equivalent to SD-9. It will be adopted.

SD-10 Market, technological or similar data transferred, directly or indirectly, from SDG&E to a nonutility affiliate shall be made available to the public subject to the terms and conditions under which such data was made available to the nonutility affiliate.

E-8 Market, technological, or similar data transferred, directly or indirectly, from Edison

> to a nonutility affiliate shall be transferred at market value. This condition will ensure that the utility is compensated and that ratepayers are indifferent to the transaction. However, if such data is related to the production of electricity by a Qualifying Facility in which an Edison nonutility affiliate has an ownership interest, then the Commission's procedures for disclosure, as set forth in the Commission's decisions in OIR-2, or its successor proceedings, shall apply.

TURN takes issue with Edison's proposal because it believes market and technological data should not be used solely to benefit affiliates. We read Condition E-8 as not limiting access to information to affiliates. Also, E-8 makes clear that transfers to affiliates must be at market value to protect ratepayers. (See Appendix C, Section II B.2. for the detail of how market value will be determined.) We will adopt E-8.

SD-11 Neither SDO Parent Co., Inc., nor any of its subsidiaries shall contract to sell electric energy to SDG&E for resale by SDG&E.

Edison does not propose adoption of this condition. DRA and TURN believe a similar provision should be adopted.

By D.86-07-004 in the OIR-2 proceeding the Commission determined that if an electric utility showed need for a deferrable resource addition within a specified period, it must acquire such an addition from qualifying facilities through a bidding process. The development of this bidding process was the subject of D.87-05-060 issued in May of this year. By that decision we allow utilities to accept bids from their QF affiliates finding that QF affiliate participation in the bidding process would benefit ratepayers. DRA is quite candid in its Exhibit 9, Witness Bumgardner, Page 2-7, and in its brief in this proceeding, Page 11, that it would like the Commission to reconsider its findings in D.87-05-060, and find in this proceeding that even with the auction process, there is a potential for self-dealing between the utility

and its QF affiliates, particularly within its own service area, at ratepayer expense. Therefore, DRA recommends that a condition be imposed on the reorganization which would prohibit Edison from entering into any new contracts for power with QF affiliates in Edison's service territory. TURN makes similar recommendations. There was a point made during this proceeding in response to a motion by Edison to exclude testimony on this issue, that the record in OIR-2 did not consider the holding company/utility/QF affiliate relationship. The ALJ denied Edison's motion on the grounds that OIR-2 may not have considered such a relationship. However, no evidence was offered to show that it was excluded from consideration.

We reject the recommendations of DRA and TURN because we have addressed this matter in the OIR-2 proceeding where it properly belongs. We have already concluded that the OIR-2 bidding process will not advantage utility affiliates in the choice of winning bidders. While there may also be issues associated with the operational relationships between an Edison-affiliate QF and Edison (i.e., those dealings that would occur after the bidding process chose an Edison-affiliate to supply power to Edison), we choose not to specify broad rules for those relationships at this time. In keeping with all relevant Commission decisions, we will expect Edison to minimize the cost of service for its regulated operations and to deal fairly and evenhandedly with all QFs; we will be prepared to examine any evidence to the contrary if and when it is presented. The other conditions we impose should preserve the information relevant to such an investigation as well as our staff's ability to examine such information.

SD-12 SDO Parent Co., Inc., shall maintain a balanced capital structure in SDG&E, as determined to be reasonable by this Commission in SDG&E's most recent general rate case decision. SDG&E shall not permit retained earnings to be transferred to SDO where doing so would decrease its net equity

ratio below that last adopted in a general rate proceeding.

E-9 Edison shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in Edison's most recent general rate case decision. Edison's equity shall be retained such that the Commission's adopted capital structure will be maintained on average over the period the capital structure is in effect for ratemaking purposes.

Edison's minor changes in this condition clarify and make the condition more realistic. E-9 will be adopted.

SD-13 The dividend policy of SDG&E shall continue to be set by the SDG&E Board of Directors as though SDG&E were a comparable stand-alone utility company.

E-10 The dividend policy of Edison shall continue to be established by Edison's Board of Directors as though Edison were a comparable stand-alone utility company.

SD-14 SDG&E shall not guarantee the notes, debentures, debt obligations or other securities of SDO Parent Co., Inc., or any of SDO's subsidiaries without first obtaining the written consent of this Commission to do so.

E-11 Edison shall not guarantee the notes, debentures, debt obligations, or other securities of its parent holding company or any of its subsidiaries without first obtaining the written consent of this Commission.

SD-15 The capital requirements of the utility, as determined to be necessary to meet its obligation to serve, shall be given first priority by the Board of Directors of SDO Parent Co., Inc., and SDG&E.

E-12 The capital requirements of the utility, as determined to be necessary to meet its obligation to serve, shall be given first priority by the

Board of Directors of Edison's parent holding company and Edison.

E-10, 11, and 12 are identical to the SDG&E provisions and will be adopted.

SD-16 Without prior notice to the Commission, SDO Parent Co., Inc., shall not invest greater than fifteen percent (15%) of its total capital assets in nonutility subsidiaries. The Commission may institute an investigation on its own to consider issues raised by the surpassing of the fifteen percent (15%) level.

E-13 On a quarterly basis, Edison shall provide the Commission with a report detailing the utility's proportionate share of the holding company's i) total assets; ii) total operating revenues; iii) operating and maintenance expense; and iv) number of employees.

SD-17 SDO Parent Co., Inc., shall not sell, transfer or divest any of its subsidiary operations without first providing confidential notice to the Commission of the transaction. Said notice shall be provided not later than forty-five (45) days prior to the close of the transaction.

We discussed conditions such as SD-16 and 17 under SD-7 and make the same conclusion we did there. We will adopt Edison's proposed E-13 for SD-16 and no equivalent condition for SD-17.

SD-18 SDO Parent Co., Inc., and SDG&E shall appear as respondents to an investigation, to be commenced by this Commission in which a system of benchmark payments, consistent with the reimbursement of expenses to ratepayers, intercompany transactions, and cross-subsidy estimates, shall be established. Said respondents shall present their best estimates as to the levels and bases for estimation of affiliate payment "benchmarks" which should be adopted by the Commission.

E-14 Where product rights, patents, copyrights, or similar legal rights are transferred from the

> utility to the parent holding company or any of its nonutility subsidiaries, a royalty payment may be required to ensure that ratepayers receive appropriate compensation. Such royalty payments shall be developed on a case-by-case basis.

This is the so-called royalty issue. DRA recommends, with TURN's support, that Edison's rates should be set as if Edison had received above-the-line income from its nonutility affiliates equal to 5% of the affiliates' annual gross income. DRA not only recommends this as a condition for approval of the reorganization in this case but also as a ratemaking adjustment in Edison's current general rate case, A.86-12-047. Assuming there is some benefit to affiliates from association with the utility, we don't believe this is the method that should be used for imputing royalty revenue.

The name and reputation of a utility is not an asset to which ratepayers have a claim. Indeed, the Commission has never included good will in the rate base of a utility for ratemaking purposes. It follows that ratepayers have never had to pay through rates a return on the value of good will. Ratepayers have paid nothing for the enhancement of the utility's name and reputation. Those have been built by the management of the utility if they are of any value. Also, those things which build up the name and reputation of a utility such as institutional advertising and charitable contributions have not been included in the cost of service for ratemaking.

DRA has not shown that a royalty payment of 5% of nonutility affiliates' gross income bears a relationship to any costs or benefits from the affiliates' association with the utility. Any cost to ratepayers by having the affiliates associated with the utility will be accounted for by the conditions we will impose on acceptance by Edison of this decision. DRA's witness Bumgardner listed some 10 intangible "benefits" the affiliates receive by association with Edison, but, as with all . .

things which are intangible, he was unable to put a value on the "benefits." His use of the relationship between franchisers and franchisees as an analogy of the relationship between Edison and its affiliates to justify his 5% recommendation, a figure within the range of the relationships he studied, is flawed because the underlying comparison is improper. By definition, a franchise relationship is unique and distinct from both a utility-parent and utility-affiliate relationship. In the usual relationship the franchiser grants to the franchisee the right to conduct a business identical in nature to the franchiser's business, usually within a specific geographic location. The franchisor typically provides a comprehensive plan on how to organize and operate the business including marketing information, size, appearance, and location of facilities, logos, advertising, displays, hiring and training of employees, duties and attire of employees, and detailed information on business operations such as product preparation and sources of supply.

On the other hand, as can be seen in Appendix B, Page 2, each of the proposed nonutility affiliates under the reorganization plan will be conducting a business unique to that affiliate. Each will have its own business scheme. Edison will not be providing any key ingredients prepared from secret formulas, any management services not otherwise reimbursed under the proposed guidelines in Appendix C, any national or local advertising, any comprehensive guides on how to do it, or anything else at a cost to ratepayers that won't be specifically paid for by the nonutility affiliate.

Given the comprehensive transfer pricing policies Edison must adopt if it goes ahead with the holding company reorganization, there should be no significant uncompensated costs incurred by utility ratepayers as a result of Edison's diversification efforts. Under the policies proposed, Edison will be compensated for transfers to affiliates of proprietary and

technical intellectual property to which ratepayers have a legitimate claim.

It is claimed that many transferred employees have useful and marketable skills they gained while employed by the utility. This does not justify a fixed royalty payment to the utility. The utility and its ratepayers have no claim on the marketable skills, as distinct from confidential knowledge, of employees who leave a utility, wherever they may go. Had the employees gone to businesses not at all associated with Edison, there would be no payment to the utility for the general skills the employee accrued while working for the utility. In fact, the record shows that the diversification will expand the employment opportunities of personnel thereby increasing Edison's ability to attract and retain high-quality people to the benefit of Edison's ratepayers.

Bumgardner also cites the utility's credit rating as alleged associational benefits which justify DRA's affiliate royalty recommendation.

PU Code Sections 817 and 830 prohibit a utility from issuing debt or equity securities for nonutility purposes, and from guaranteeing the obligations of other corporations, including affiliates and parent corporations, without specific Commission authorization. Edison has also agreed in Condition E-11, that it will not guarantee the obligations of its parent company or its affiliates.

The above-cited restrictions on the use of utility credit ensure that ratepayers will be insulated from the financial nonutility operations and also undercuts the rationale for the DRA's affiliate royalty recommendation insofar as it is based on alleged benefits to affiliates from the utility's credit rating. If the utility is prohibited from using its credit standing to finance nonutility operations, there simply cannot be any benefit to utility affiliates from the utility's credit worthiness.

Based on the above discussion we will reject the recommendations of DRA and TURN for royalty payments and adopt E-14. The conditions and accompanying guidelines we will adopt provide for ample opportunity to make such determinations, thereby resulting in fair treatment for the utility and protection of ratepayer interests.

Ultimately, it will be management's decision that determines the future path of diversification and affiliate transactions. A high road result will most probably come from management decisions that structurally separate regulated and unregulated operations, protect the regulated company's name, identity, capital, personnel, technology, "know how" and business income and pay a fair price for all interests of value received by the affiliate from the regulated company. The "other road" is full of uncertainties and other dangers caused by confusion of the regulated company's property and interests with the business of the affiliate. We prefer the high road because it is the smooth and sure road into the future.

SD-19 SDO Parent Co., Inc., and SDG&E, appearing as respondents in the investigation instituted in Condition Eighteen, shall also present their best estimates as to the appropriate valuation method for the estimation of royalty payments for the transfer of DFIS.

SD-20 Neither SDO Parent Co., Inc., nor its subsidiaries shall provide interconnection facilities and related electrical equipment to SDG&E, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to SDG&E unless the third party may obtain and provide facilities and equipment of like or superior design and quality through competitive bidding. SDO and its subsidiaries may participate in any competitive bidding for such facilities and equipment.

E-15 Neither Edison's holding company nor its subsidiaries shall provide interconnection facilities and related electrical equipment to Edison, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to Edison, unless the third party may obtain and provide facilities and equipment of like or superior design and quality through competitive bidding. The holding company and its nonutility subsidiaries may participate in any competitive bidding for such facilities and equipment.

SD-19 was unique to SDG&E. E-15 is similar to SD-20 and will be adopted.

Findings of Fact

1. Edison is an electric public utility incorporated and organized under the laws of the state of California.

2. Edison requests authority under PU Code Section 854 to implement a plan of reorganization which will result in a holding company structure.

3. The objective of the reorganization plan is to have Edison and its unregulated, nonutility subsidiaries become separate, wholly-owned subsidiaries of the holding company.

4. As a result of the reorganization plan, the utility-related companies owned by the holding company will consist of the current corporation, Southern California Edison Company, and its utility-related subsidiaries.

5. Edison is seeking to reorganize into a holding company structure in order to more clearly separate its utility operations from its nonutility operations, and to better position itself to respond to the changing business environment in the electric utility industry.

6. Edison's business environment has changed and requires a flexible, responsive business structure.

7. The separation between the utility and nonutility lines of business helps ensure that utility customers will not be

affected by nonutility activities and that the Commission's ability to effectively regulate the utility will not be diminished.

8. The proposed reorganization is designed to result in a corporate structure which enhances management's ability to take advantage of nonutility business opportunities should they arise while not diminishing the Commission's ability to effectively regulate utility operations.

9. The proposed reorganization will not affect the Commission's ability to ensure that reliable utility service is maintained.

10. The proposed reorganization will not affect the Commission's ability to ensure that customers bear only the reasonable costs of providing utility service.

11. The Commission's ability to ensure an adequate level of service to utility customers will not be reduced by the holding company structure.

12. Effective regulation of the utility is dependent upon the Commission's ability to obtain and evaluate information concerning the utility.

13. Edison has developed corporate policies and principles which facilitate the Commission's ability to regulate utility operations and separate utility and nonutility activities.

14. DRA and Edison have agreed on a set of conditions which they believe will:

a. Ensure that all costs incurred by the utility which result from activities undertaken by Edison's affiliates are fully recovered from the affiliates;

b. Provide the Commission with access to all recorded and other information necessary to thoroughly analyze Edison's costs and monitor the relationships between Edison and its nonutility affiliates;

c. Ensure that Edison ratepayers are insulated from all effects of nonutility activities;

d. Preserve the regulatory control which the Commission currently has over Edison's activities; and

e. Ensure the financial health of utility operations.

15. Under revised Condition E-1, the Commission will have access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of Public Utilities Code Section 314. In cases where Edison or its affiliate disputes the appropriateness of a request for information under Section 314, the burden will fall upon Edison or its affiliate to demonstrate why the request is improper or inappropriate.

16. Under the proposed conditions, Edison, the holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries will employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission.

17. Systems of accounting, procedures and controls related to cost allocations and transfer pricing are documented in Appendix C, Edison's Corporate Policies and Guidelines for Affiliate Transactions.

18. Under the proposed conditions, transfer pricing policies include the application of a five percent mark-up on fully-loaded labor costs billed to nonutility affiliates for the use of Edison employees.

19. Under the proposed conditions, Edison's holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries will keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

20. Under revised Condition E-4, the officers and employees of Edison's holding company and its subsidiaries will be available to appear and testify in Commission proceedings.

21. Under the proposed conditions, Edison will furnish the Commission with:

a. The quarterly and annual financial statements of its parent holding company, including consolidated work papers of the holding company and its subsidiaries;

b. Annual statements concerning the nature of intercompany transactions concerning Edison and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

c. The balance sheets and income statements of the nonconsolidated subsidiaries of the holding company;

d. All periodic reports filed by the holding company with the Securities and Exchange Commission; and

e. As a separate exhibit in its next general rate case, an audit of all transactions between Edison and its nonutility affiliates, to be performed by an outside auditing firm which shall be selected and supervised by the Commission's Division of Ratepayer Advocates. The need for subsequent audits will be determined in Edison's next general rate case.

22. Edison will avoid a diversion of management talent that would adversely affect the utility. Under the proposed conditions, Edison will provide to the Commission an annual report identifying nonclerical personnel transferred from Edison to its parent holding company or any of the holding company's nonutility subsidiaries.

23. Under the proposed conditions, Edison will notify the Commission in writing within thirty (30) days prior to any transfer to the holding company or its nonutility affiliates of any utility asset or property exceeding a fair market value of $100,000, whether or not considered by the utility to be necessary or useful in the performance of its public utility obligations. This

condition does not include transfers of funds for investment under a cash management system.

24. Under the proposed conditions, market, technological, or similar data transferred, directly or indirectly, from Edison to a nonutility affiliate will be transferred at market value. This condition will ensure that the utility is compensated and that ratepayers are indifferent to the transaction. If such data are related to the production of electricity by a qualified facility ("QF") in which an Edison nonutility affiliate has an ownership interest, the proposed conditions specify that the Commission's procedures for disclosure, as set forth in the Commission's decisions in OIR-2, or its successor proceedings, will apply.

25. Under the holding company structure, Edison will maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in Edison's most recent general rate case decision.

26. Under the holding company structure, Edison's equity will be retained such that the Commission's adopted capital structure will be maintained on average over the period the capital structure is in effect for ratemaking purposes.

27. Under the proposed conditions, the dividend policy of Edison will continue to be established by Edison's Board of Directors as though Edison were a comparable stand-alone utility company.

28. Under the proposed conditions, the capital requirements of the utility, as determined to be necessary to meet its obligation to serve, will be given first priority by the Board of Directors of Edison's parent holding company and Edison.

29. Under the proposed conditions, Edison will provide the Commission with a report on a quarterly basis detailing the utility's proportionate share of the holding company's (a) total assets; (b) total operating revenues; (c) operating and maintenance expense; and (d) number of employees.

30. Where product rights, patents, copyrights, or similar legal rights are transferred from the utility to the parent holding company or any of its nonutility subsidiaries, a royalty payment may be required to ensure that ratepayers receive appropriate compensation. Such royalty payments will be developed on a case-by-case basis.

31. Under the proposed conditions, neither Edison's holding company nor its nonutility subsidiaries will provide interconnection facilities and related electrical equipment to Edison, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to Edison, unless the third party can obtain and provide facilities and equipment of like or superior design and quality through competitive bidding; however, the holding company and its nonutility subsidiaries may participate in any competitive bidding for such facilities and equipment.

32. Royalty or affiliate payments charged to nonutility subsidiaries for alleged intangible benefits from their association with the utility are unfair and discriminatory to Edison and its subsidiary companies.

33. Many intangible benefits alleged by DRA are tangible and will be fully compensated by Edison's proposed transfer pricing mechanisms.

34. Intangible benefits, to the extent they exist at all, have never been reflected in rates and have never imposed any cost to utility customers.

35. DRA's proposed royalty of five percent of gross income is not supported by the record.

36. The conditions we adopt today appropriately and conclusively address those instances where there could be uncompensated benefits to the affiliates arising from their connection with the utility.

37. Ratepayers should be held harmless or indifferent to transactions between any and all entities of the holding company enterprise. It is this standard that guides our decision in these matters.

38. The restrictions and safeguards adopted in OIR-2, do not preclude Edison from purchasing electricity from QF affiliates within its service territory.

39. The proposed reorganization has no affect on the utility's relationship with its QF affiliates. The ownership of any given QF, whether it be by a utility, a holding company, a totally unaffiliated firm, or a combination of the above, is immaterial to the Commission's restrictions on the utility's practices with regard to QFs under the restrictions and safeguards imposed in OIR-2.

40. As a matter of regulatory policy, the Commission does not issue orders on labor-management issues where the subject matter is better left to collective bargaining between the company and the unions representing its employees.

41. Nothing in this decision is intended to alter any previous Commission decisions regarding PURPA, OIR-2, qualifying facilities, or their relationships with regulated utilities.

Conclusions of Law

1. The Commission has the authority under PU Code Section 854 to grant Edison's proposed reorganization. That section of the Code provides that the Commission must affirmatively authorize the transfer of ownership or controlling interest in a public utility.

2. Granting the application to reorganize will not have an adverse impact on the public interest, provided it is subject to specific conditions designed to protect the ratepayers.

3. The Commission has access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of Public Utilities Code Section 314. The Commission also has appropriate administrative procedures for resolving disputes regarding the exercise of this authority.

4. The Commission may require Edison, Edison's holding company, and each of its subsidiaries and joint ventures of the holding company and/or its subsidiaries to employ accounting and other procedures and controls related to cost allocations and transfer pricing that ensure and facilitate full review by the Commission to protect against cross-subsidization of nonutility activities by Edison's customers.

5. The Commission may require Edison's holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries to keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

6. In D.87-05-060, the Commission addressed the issue of allowing QF affiliates to bid on deferrable resource additions and expressly authorized them to do so subject to certain safeguards adopted in that decision.

7. The ownership of any given QF, whether it be by a utility, a holding company, a totally unaffiliated firm or a combination of the above, is immaterial to the Commission's restrictions on utility's practices with regard to QF's under the restrictions and safeguards imposed in D.87-05-060.

8. The conditions proposed by IBEW and UWUA should be rejected.

9. Edison should be granted authority to carry out its proposed reorganization subject to the conditions discussed and adopted in this decision.

10. Authorization to reorganize Edison's corporate structure should be made contingent upon the acceptance by Edison of the conditions adopted herein.

O R D E R

IT IS ORDERED that:

1. Southern California Edison Company (Edison) is authorized to effect the reorganization proposed in this application. Such authority is contingent on acceptance by Edison, SCE Holding Company, and Edison Merger Company of the following conditions:

1. Edison shall ensure that the Commission has access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of Public Utilities Code Section 314. Edison is placed on notice that the Commission will interpret Section 314 broadly as it applies to transactions between Edison and the holding company or its affiliates and subsidiaries in fulfilling its regulatory responsibilities as carried out by the Commission, its staff and its authorized agents. Administratively, requests for such books and records made by the Commission, its staff or its authorized agents shall be deemed presumptively valid, material and relevant. Any objections to such requests shall be timely raised before the administrative law judge or assigned commissioner in the proceeding in which such objections arise. In order to sustain an objection to such a request, respondents shall have the burden of showing that the request is not reasonably related to any issue properly before the Commission and, further, is not reasonably calculated to result in the discovery of admissible evidence in the proceeding.

2. Edison, Edison's holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of nonutility activities by Edison's customers. These procedures and controls are explained in Edison's Corporate Policies and Guidelines for Affiliate

Transactions. This document is attached hereto, and by this reference is made part of these conditions. Edison's policies include the application of a five-percent markup on fully loaded labor costs billed to nonutility affiliates for the use of Edison employees. This billing policy, as well as Edison's Corporate Policies and Guidelines for Affiliate Transactions, will be reviewed in subsequent Edison General Rate Cases.

3. Edison's holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

4. The officers and employees of Edison's holding company and its subsidiaries shall appear and testify in Commission proceedings, as necessary or required.

5. Edison shall furnish the Commission with:

   a. The quarterly and annual financial statements of its parent holding company, including consolidating workpapers of the holding company and its subsidiaries;

   b. Annual statements concerning the nature of intercompany transactions concerning Edison and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

   c. The balance sheets and income statements of the nonconsolidated subsidiaries of the holding company;

   d. All periodic reports filed by the holding company with the Securities and Exchange Commission; and

   e. Edison shall submit, as a separate exhibit in its next general rate case, an audit of all transactions between Edison and its nonutility affiliates, to be performed by an outside auditing firm which shall be

selected and supervised by the Commission's Division of Ratepayer Advocates. The need for subsequent audits will be determined in Edison's next general rate case.

6. Edison shall avoid a diversion of management talent that would adversely affect the utility. Edison shall also provide to the Commission an annual report identifying nonclerical personnel transferred from Edison to its parent holding company or any of the holding company's nonutility subsidiaries.

7. Edison shall notify the Commission in writing within thirty (30) days prior to any transfer to the holding company or its nonutility affiliates of any utility asset or property exceeding a fair market value of $100,000, whether or not considered by the utility to be necessary or useful in the performance of its public utility obligations. This condition shall not include transfers of funds for investment under a cash management system.

8. Market, technological, or similar data transferred, directly or indirectly, from Edison to a nonutility affiliate shall be transferred at market value. This condition will ensure that the utility is compensated and that ratepayers are indifferent to the transaction. However, if such data is related to the production of electricity by a Qualifying Facility in which an Edison nonutility affiliate has an ownership interest, then the Commission's procedures for disclosure, as set forth in the Commission's decisions in OIR-2, or its successor proceedings, shall apply.

9. Edison shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in Edison's most recent general rate case decision. Edison's equity shall be retained such that the Commission's adopted capital structure will be maintained on average over the period the capital structure is in effect for ratemaking purposes.

10. The dividend policy of Edison shall continue to be established by Edison's Board of Directors as though Edison were a comparable stand-alone utility company.

11. Edison shall not guarantee the notes, debentures, debt obligations, or other securities of its parent holding company or any of its subsidiaries without first obtaining the written consent of this Commission.

12. The capital requirements of the utility, as determined to be necessary to meet its obligation to serve, shall be given first priority by the Board of Directors of Edison's parent holding company and Edison.

13. On a quarterly basis, Edison shall provide the Commission with a report detailing the utility's proportionate share of the holding company's i) total assets; ii) total operating revenues; iii) operating and maintenance expense; and iv) number of employees.

14. Where product rights, patents, copyrights, or similar legal rights are transferred from the utility to the parent holding company or any of its nonutility subsidiaries, a royalty payment may be required to ensure that ratepayers receive appropriate compensation. Such royalty payments shall be developed on a case-by-case basis.

15. Neither Edison's holding company nor its subsidiaries shall provide interconnection facilities and related electrical equipment to Edison, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to Edison, unless the third party may obtain and provide facilities and equipment of like or superior design and quality through competitive bidding. The holding company and its nonutility subsidiaries may participate in any competitive bidding for such facilities and equipment.

2. Edison shall file a written notice with the Commission, served on all parties to this proceeding, of its agreement to the above conditions. Failure to file such a notice within 30 days of the effective date of this decision shall result in the lapse of the authority granted by this decision.

3. The conditions proposed by the International Brotherhood of Electrical Workers and the Utility Workers Union of America are rejected.

This order becomes effective 30 days from today.

Dated January 28, 1988, at San Francisco, California.

STANLEY W. HULETT
President
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

I will file a written dissent.

/s/ DONALD VIAL
Commissioner

I will file a concurring opinion.

/s/ G. MITCHELL WILK
Commissioner

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Victor Weisser, Executive Director

AB

APPENDIX A

Edison's Operation

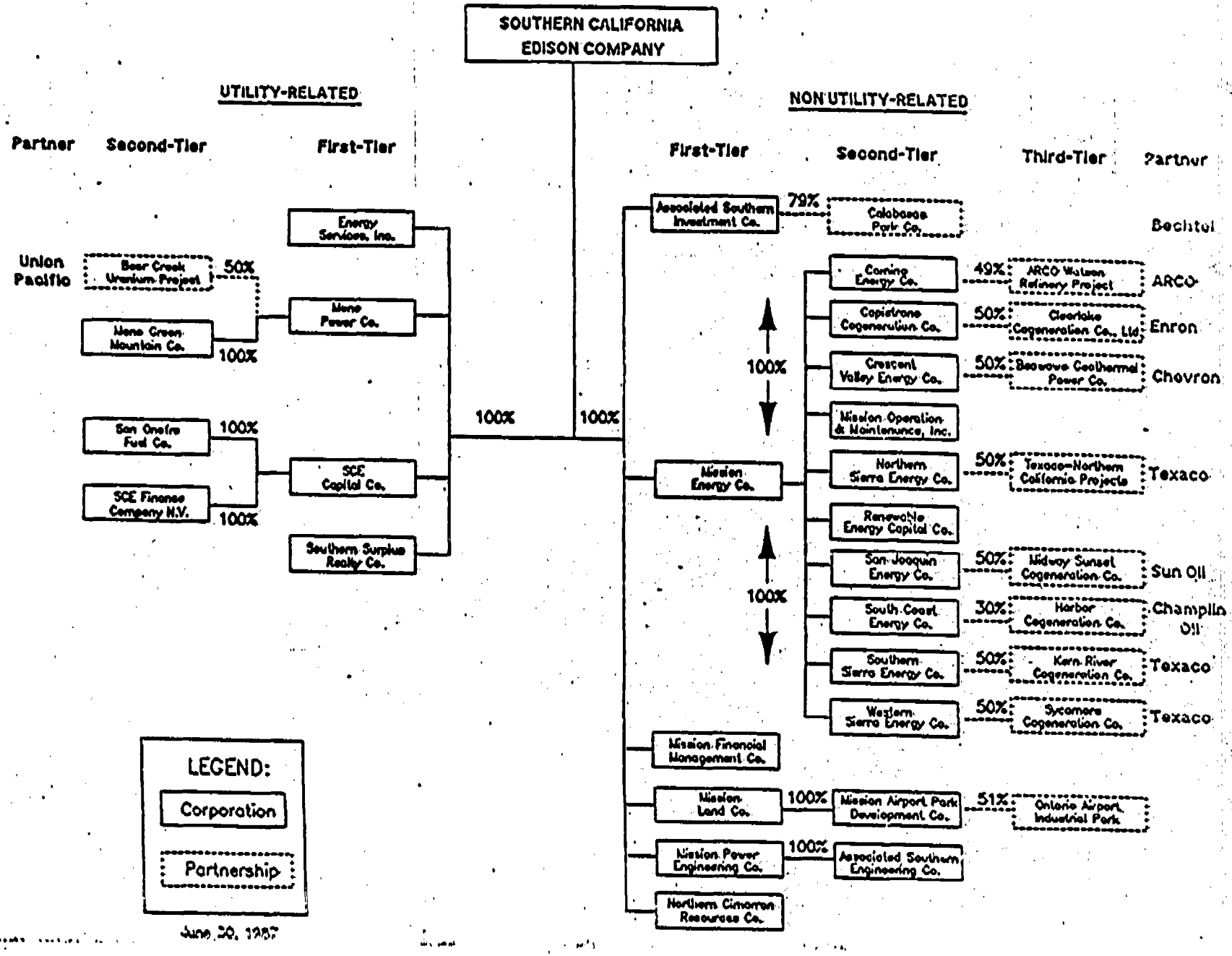
Edison is engaged in the business of generating, transmitting, and distributing electric energy in portions of Central and Southern California. In addition to its properties in California, it owns, in some cases jointly with others, facilities in Nevada, Arizona, and New Mexico, its share of which produces power and energy for the use of its customers in California. In conducting such business, Edison operates an interconnected and integrated electric utility system.

Edison owns and operates 11 fossil-fuel steam electric generating plants, 2 combustion turbine plants, 1 diesel electric generating plant, and 36 hydroelectric plants. It has an 80% interest in San Onofre Nuclear Generating Station ("SONGS") Unit 1, and a 75% interest in SONGS Units 2 and 3, all located in Central and Southern California. In addition, Edison owns a small fossil-fuel steam electric generating unit and a small combustion turbine unit in Arizona (the "Axis Plant"), and a 48% interest in Units 4 and 5 of a coal-fired steam electric generating plant in New Mexico ("Four Corners Project"), which are operated by another utility. Edison also operates two coal-fired electric generating units in Clark County, Nevada ("Mohave Project"), in which it owns a 56% undivided interest; it also operates 4 Hoover hydroelectric generating units owned by others and located on the Arizona side of the Hoover facility. Edison owns an undivided 15.8% interest in Palo Verde Nuclear Generating Station Units 1, 2, and 3, located in Arizona, which are operated by Arizona Public Service Company. All of Edison's out-of-state facilities generate or transmit electrical energy and/or capacity for use predominantly by Edison's California customers.

Edison's service territory is located in 15 counties in Central and Southern California, consisting of Fresno, Imperial, Inyo, Kern, Kings, Los Angeles, Madera, Mono, Orange, Riverside, San Bernardino, Santa Barbara, Tulare, Tuolumne, and Ventura Counties, and including about 150 incorporated communities, as well as outlying rural territories. Edison also supplies electricity to other electric utilities under special contracts for distribution and other use by them.

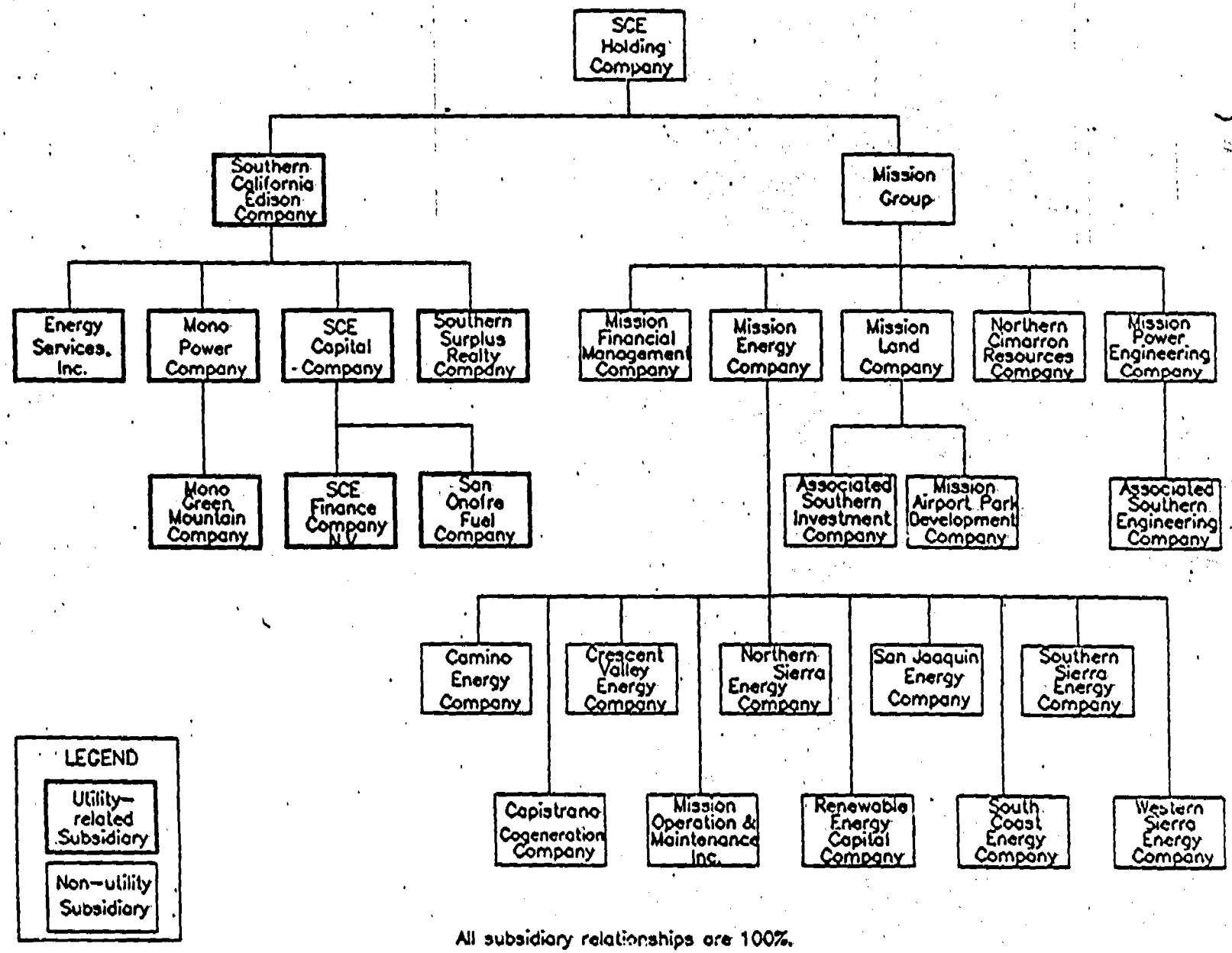
(END OF APPENDIX A)

ORGANIZATION CHART OF COMPANY SUBSIDIARIES



June 20, 1987

PROPOSED ORGANIZATIONAL STRUCTURE



All subsidiary relationships are 100%.

SOUTHERN CALIFORNIA EDISON COMPANY

LIST OF SUBSIDIARIES

Subsidiary	Primary Business Activities
1. Associated Southern Engineering Company, a California Corporation	Engineering and construction services for third parties in the energy field.
2. Associated Southern Investment Company, a California Corporation	Investment in and management of mineral rights.
3. Beer Creek Uranium Company, a Colorado Partnership	Development and operation of uranium mine and mill in Wyoming. (Currently winding down.)
4. Beowawe Geothermal Power Company, a California Partnership	A partnership consisting of Crescent Valley Energy Company and Chevron in a geothermal project.
5. Calabasas Park Company, a California Partnership	Ownership and operation of real estate interests at Calabasas Park.
6. Calabasas Park Company, Inc., a California Corporation	Ownership and operation of real estate interests at Calabasas Park. (Inactive)
7. California Electric Power Company, a California Corporation	Inactive corporation resulting from merger with Edison.
8. Camino Energy Company, a California Corporation	Production of energy from a cogeneration project.
9. Conservation Financing Corporation, a California Corporation	Inactive company which was used to carry out CPUC-required residential conservation projects.
10. Crescent Valley Energy Company, a California Corporation	Production of energy from a geothermal project.
11. Electric Systems Company, a California Corporation	Development of commercial projects demonstrated to be feasible by Edison's Advanced Engineering Department.
12. Energy Services, Inc., a California Corporation	Operation and maintenance of energy-related non-Edison equipment and facilities.

SOUTHERN CALIFORNIA EDISON COMPANY

LIST OF SUBSIDIARIES

Subsidiary	Primary Business Activities
13. Harbor Cogeneration Company, a California Partnership	A partnership consisting of South Coast Energy Company and Champlin in a cogeneration project.
14. Kern River Cogeneration Company, a California Partnership	A partnership consisting of Southern Sierra Energy Company and Texaco in a cogeneration project.
15. Mission Energy Company, a California Corporation	Ownership and coordination of the activities of energy subsidiaries, including qualifying facilities as defined by the Public Utility Regulatory Policies Act of 1978.
16. Mission Land Company, a California Corporation	Ownership and coordination of the activities of industrial parks and other real property-related projects.
17. Mission Power Engineering Company, a California Corporation	Engineering and construction services for third parties in energy field.
18. Mono Power Company, a California Corporation	Exploration for and development of mineral fuel resources.
19. Mono Green Mountain Company, a California Corporation	Development of uranium properties.
20. Northern Cimarron Resources Company, a California Corporation	Acquisition and development of mineral properties.
21. Northern Sierra Energy Company, a California Corporation	Production of energy from a cogeneration project.
22. Ontario Airport Industrial Park, a California Corporation	Ownership and future development and operation of an industrial park.
23. Renewable Energy Capital Company, a California Corporation	Inactive company which was used to finance renewable energy projects.

SOUTHERN CALIFORNIA EDISON COMPANY

LIST OF SUBSIDIARIES

	Subsidiary	Primary Business Activities
24.	San Joaquin Energy Company, a California Corporation	Production of energy from a cogeneration project.
25.	SCE Capital Company, a Delaware Corporation	Used to facilitate Edison financings.
26.	South Coast Energy Company, a California Corporation	Production of energy from a cogeneration project.
27.	Southern California Edison Finance Company N.V., a Netherlands Antilles Corporation	Used to raise capital through the European market.
28.	Southern Sierra Energy Company, a California Corporation	Production of energy from a cogeneration project.
29.	Southern Surplus Realty Company, a California Corporation	Purchase and sale of excess real estate not required by Edison.
30.	Sycamore Cogeneration Company, a California Partnership	A partnership consisting of Western Sierra Energy Company and Texaco in a cogeneration project.
31.	Western Sierra Energy Company, a California Corporation	Production of energy from a cogeneration project.

(END OF APPENDIX B)

A.87-05-007

APPENDIX C

SOUTHERN CALIFORNIA EDISON HOLDING COMPANY

CORPORATE POLICIES AND GUIDELINES FOR

AFFILIATE TRANSACTIONS

APPENDIX C

SOUTHERN CALIFORNIA EDISON HOLDING COMPANY

CORPORATE POLICIES AND GUIDELINES FOR AFFILIATE TRANSACTIONS

TABLE OF CONTENTS

APPENDIX C

SOUTHERN CALIFORNIA EDISON HOLDING COMPANY

CORPORATE POLICIES AND GUIDELINES FOR AFFILIATE TRANSACTIONS

I. INTRODUCTION

A. Purpose

The purpose of these policies and guidelines is to set forth business practices to be observed in the relationship between Southern California Edison Company (Edison) and the nonutility subsidiaries under the Southern California Edison Holding Company. All transactions between these parties are to be guided by the policies and guidelines stated herein. These policies and guidelines will be modified as experience dictates, in order to assure fair reimbursement of costs associated with transactions with affiliates on an ongoing basis.

These policies and guidelines have been developed to ensure that prompt and fair compensation or reimbursement is given/received for all assets, goods and services transferred between Edison, the Holding Company, and the nonutility subsidiaries and that information reported to the Holding Company meets the reporting requirements observed by the Holding Company. The flow of information, and transfers of assets, goods and services among these parties is to be conducted in accordance with the policies put forth in this document.

B. Implementation

Each subsidiary is responsible for implementation of the policies within its organization. Procedures will be developed by each subsidiary to assure that affiliate employees are cognizant of, and can properly implement, the corporate policies. All intercompany transactions must be adequately documented. As described herein, internal control measures are to be maintained to insure that policies are observed and that potential or actual deviations are detected and corrected.

In the event that a situation arises that has not been addressed by the policies and guidelines contained herein, the situation shall be brought to the attention of the applicable officers of the Holding Company for review and/or approval.

C. Organizational Guidelines

1. Nonutility Subsidiaries

As a general policy, resource sharing and intercompany transactions will be minimized to assure sufficient separation between the utility and the nonutility subsidiaries. The following corporate organizational objectives have been established to prevent one entity from being burdened or benefited by another:

- Nonutility subsidiary companies will acquire, operate and maintain their own facilities and equipment where feasible.

- Nonutility subsidiary companies, to the extent practical, will retain their own administrative staffs.

- Each nonutility subsidiary will provide, to the extent practical, its own financial needs, i.e., banking arrangements, credit lines, insurance requirements, etc.

The nonutility subsidiaries are wholly owned by The Mission Group. This structure assures that the Chief Executive Officer of The Mission Group is in a position to direct and integrate the requirements of the nonutility activities, while permitting Edison's management to focus on utility operations. The consolidation of the nonutility subsidiaries under The Mission Group assists in the achievement of the corporate objective of the minimization of intercompany transactions required between Edison and the nonutility subsidiaries.

2. Holding Company

The Holding Company itself will be organized in a manner which results in effective control and efficient utilization of service organizations maintained by the utility. Initially, there will be shared corporate officers and directors between Edison and the Holding Company. This organizational structure will remain in effect until experience dictates the necessary staffing for the Holding Company. The utilization of existing Edison departments to provide the minimal level of services required by the Holding Company will result in efficiencies in the near term.

Corporate functions such as shareholder services, corporate accounting and consolidation, and corporate planning and budgeting will be performed by Edison employees; the fully loaded cost of these services will be billed to the Holding Company and nonutility subsidiaries. As discussed in detail in Section II-D, the cost of these services will be allocated using a three-step process:

- The first step consists of directly assigning all costs which can be identified specifically with an activity to that activity. For example, direct labor costs of employees in Edison departments which provide identifiable services to the Holding Company will be directly charged based on the employees' wage rates, including all labor loadings. The majority of the direct costs of the Holding Company will be allocated to the subsidiaries based on the multi-factor formula discussed under Step #3 below. Certain costs, such as expenses related to the establishment of the Holding Company, will not be allocated to the subsidiaries.

- The second step involves allocating indirect costs of corporate functions which benefit more than one activity but are not separately identifiable. Indirect costs which are functionally

related will be allocated based on causal or beneficiary relationships. For example, the cost of shareholder services will be allocated based on equity investment and advances to subsidiaries.

- The third step consists of allocating remaining indirect costs by a formula representing the overall activity of each subsidiary. The formula will be based on each subsidiary's proportionate share of (1) total assets, (2) operating revenues, (3) operating and maintenance expense, and (4) number of employees. The factors included in the formula will be reviewed in conjunction with each general rate case, or as applicable in intervening years.

Fully loaded compensation and expenses of the shared corporate officers (including their support personnel) will be allocated to the Holding Company based upon the higher of (1) five percent or (2) the allocation percentage derived from application of the multi-factor formula discussed above. The allocation percentage will be revised as necessary in order to appropriately reflect the executives' oversight provided.

APPENDIX C

II. TRANSFERS OF ASSETS, GOODS OR SERVICES

A. General

The purpose of the corporate transfer pricing policies and guidelines in this section is to assign a monetary value to all assets, goods or services transferred between Edison, the Holding Company, and the nonutility subsidiaries. The transfer pricing methodology will maintain separate accountability of the various entities and will ensure that transactions between utility and nonutility affiliates do not harm the utility or its customers.

The objectives to be achieved in accounting for transfers between subsidiaries involve the appropriate (1) identification, (2) valuation, and (3) recording of transactions between Edison, the Holding Company, and the nonutility subsidiaries. There are three general types of transfers that will occur:

- Transfers of assets or rights to use assets.
- Transfers of goods or services produced, purchased or developed for sale.
- Transfer of goods or services not produced, purchased, or developed for sale.

Transfers of assets or rights to use assets and transfers of goods or services produced, purchased or developed for sale will be priced at fair market value. Transfers of goods or services not produced, purchased or developed for sale will be priced at fully loaded cost.

B. Transfers of assets or rights to use assets.

1. Identification: Transfers of assets include transfers of tangible real or personal property and intangible property used in a trade or business. Transfers of assets also includes long-term rights to use assets through lease or other arrangements in excess of one year.

   Real property includes:

   - Land
   - Buildings
   - Improvements
   - Mineral rights

Personal property includes:

- Automobiles
- Power operated equipment
- Computer hardware and related software applications
- Furniture

Intangible assets include:

- Copyrights
- Patent rights
- Trade secrets
- Royalty interests
- Licenses
- Franchises
- Rights to access customer files.

Examples of intangible assets that may be transferred include patent rights that arise out of research and development programs, pole attachment rights, and data regarding Edison's customers.

2. Valuation: Transfers of assets or rights to use assets will be valued at current fair market value, which will be determined through methods appropriate for the asset. Examples of methods that may be used include:

   - Appraisals from qualified, independent appraisers.
   - Averaging bid and ask prices as published in newspapers or trade journals.
   - Conducting market surveys.

   The determination of fair market value must be adequately documented to assure that a proper audit trail exists.

   Where product rights, patents, copyrights, or similar legal rights are transferred from Edison to the Holding Company or any of its nonutility subsidiaries, a royalty payment may be required to ensure that ratepayers receive appropriate compensation. Such royalty payments shall be developed on a case-by-case basis.

   Edison will make available to QF's information supplied to any affiliate as required by OIR No. 2.

3. Recording: Transfers of assets or rights to use assets will be recorded through a direct charge based on current market value to the recipient of the transferred asset. However, in order to ease administrative burdens for immaterial transfers, if the book value and estimated current market value of a transferred asset are equal to or less than $100,000, the transfer may be priced at cost at the transferor's option.

   There will be an exception to the above policy if the asset is being transferred from Edison or a utility-related subsidiary, and the estimated market value of the asset is less than the net book value. In such instances, the transfer will be recorded at net book value. This policy will ensure that the utility is not disadvantaged as a result of any transfer. If the asset has appreciated in market value since its acquisition by the utility, the utility will receive the benefit of the appreciation. Conversely, if the current market value is below the net book value, the utility will nonetheless receive full net book value for its assets.

C. Transfers of goods or services produced, purchased or developed for sale.

1. Identification: Transfers of goods or services produced, purchased or developed for sale includes those goods or services intended for sale in the normal course of the subsidiary's business. (Edison's only service produced for sale is its regulated utility service. Therefore, Edison generally would not have transfers of goods or services that would be priced according to the guidelines outlined in this subsection.)

   Goods or services produced, purchased or developed for sale could include:

   - Commercial paper placements
   - Engineering services
   - Facility operations and maintenance services

   The above goods or services would generally be transfers from one nonutility subsidiary to another. Goods or services produced, purchased or developed for sale would usually be the product of resources which are planned and dedicated to providing the goods or services.

2. Valuation: Transfers of goods or services produced, purchased, or developed for sale will be valued at current fair market value. For purposes of applying this policy, fair market value may be based upon:

   - Reference to current realizable values in comparable cash transactions of similar goods or services between non-affiliated parties.

- Published prices.
- Rates established by a regulatory agency.

The determination of fair market value must be adequately documented.

3. Recording: Transfers of goods or services produced, purchased or developed for sale will be recorded through a direct charge to the recipient based upon the current market value of the goods or services.

D. Transfers of goods or services not produced, purchased or developed for sale.

1. Identification: Transfers of goods or services not produced, purchased or developed for sale represents goods or services provided that are incidental to the main business of the provider of the goods and services. Examples would include:

   - Cost of services provided by Edison to the Holding Company or the nonutility subsidiaries.
   - Data processing.
   - Incidental use of vehicles or office space.

   Initially, corporate functions such as shareholder services, corporate accounting and consolidation, and corporate planning and budgeting will be performed for the Holding Company by Edison employees. In addition, the nonutility subsidiaries may contract with Edison for the services of certain support personnel in those instances where it is not practical for the subsidiary to have its own administrative staff. Use of Edison employees by the nonutility subsidiaries will require approval of the appropriate Vice President. In addition, individual Edison employees will not spend more than thirty percent of their total annual hours in providing services to the nonutility subsidiaries. These transactions are covered by the transfer pricing guidelines contained within this subsection.

2. Valuation: Transfers of goods or services not produced, purchased or developed for sale will be valued at fully loaded cost.

3. Recording: Transfers will be recorded through the following three-step process:

APPENDIX C

1. Step #1: Costs will be directly assigned to the user of the goods or services, to the extent practical. Direct charges include:

   - Direct Labor Costs, including applicable loadings, of employees in Edison departments which provide identifiable services to the Holding Company or the nonutility subsidiaries. This could include personnel in departments such as:

     - Audits
     - Corporate Accounting
     - Corporate Planning and Budgeting
     - Law
     - Tax

     Direct labor costs will be based on the wage rates of assigned employees including supervisory and support personnel and the actual number of hours devoted to providing the service. Labor loadings include paid time off, payroll taxes and pensions and benefits. Applicable administrative and general loadings are allocated to nonutility subsidiaries through the general multi-factor allocation procedure. A five percent mark-up will be added to the fully loaded labor cost of Edison employees providing direct services to the nonutility subsidiaries. The five percent mark-up ensures that all unidentified costs, if any, which are related to nonutility operations are charged to the nonutility subsidiaries.

     Facility costs associated with personnel providing services will be based upon recorded facilities costs including current rate of return on Edison facilities used. Labor loadings will be recovered through a factor applied to Direct Labor Costs.

   - Purchases of goods and services including:

     - Materials, including applicable supply expense
     - Office supplies
     - Outside auditors' fees
     - Outside legal fees

   - Required Payments such as:

     - Income taxes
     - Property taxes

- Vehicle and Equipment Costs, which will be based on usage of:
  - Transportation vehicles
  - Construction equipment
  - Office equipment

ii. Step #2: Indirect costs for corporate functions performed by Edison will be allocated on the basis of causal or beneficiary relationships. Indirect costs relate to shared corporate functions for which it would be impractical or unreliable to record actual time incurred.

Indirect costs which are functionally related will be accumulated into homogeneous cost pools and allocated on the basis of causal or beneficiary relationships. The allocated costs will include labor loadings and a return on assets used in providing service. Examples of indirect costs and factors that will be used to allocate them include:

- Equity investment and advances to subsidiaries to allocate the cost of providing service of utility organizations such as:
  - Shareholder Services
  - Investor Relations
  - Long-term Finance
- Number of employees to allocate the cost of providing service of utility organizations such as:
  - Payroll
  - Wage and Salary
  - Employee Records
  - Pension Investments

iii. Step #3: Remaining indirect costs will be allocated by a formula representing the overall activity of each affiliate.

Those indirect costs incurred by Edison that cannot be allocated on the basis of a specific related factor will be apportioned based on a formula which reflects the overall level of activity of each subsidiary.

APPENDIX C

The formula will be based upon each subsidiary's proportionate share of the following factors:

- Total assets
- Operating revenues
- Operating and Maintenance Expense* (excluding cost of sales and income taxes)
- Number of Employees (including equivalent personnel of affiliates providing direct services)

There will be an equal weighting of each factor thereby recognizing each subsidiary's portion of overall corporate activity as measured by total financial resources, revenues, cost of operations, and employee force. The composite of the above factors will be used to allocate the fully loaded cost of Edison departments such as:

- Corporate Communications
- Insurance
- Mailing
- Telecommunications

The multi-factor formula will also be used to allocate to the various subsidiaries the majority of the direct corporate costs of the Holding Company. This would include such costs as fees and expenses paid for meetings of the Holding Company's board of directors, and labor charges and related benefits for Edison personnel who provide services which are directly charged to the Holding Company. Certain costs, such as those related to the establishment of the Holding Company, and acquisition and development activities, will be absorbed by the Holding Company and not allocated to the subsidiaries.

* Operating and Maintenance Expense includes all labor costs of personnel of affiliates providing direct services, even if classified under cost of sales.

APPENDIX C

III. INTERCOMPANY BILLINGS AND PAYMENTS

A. General

Billings for intercompany transactions shall be issued on a timely basis with sufficient detail provided to assure an adequate audit trail and enable the prompt reimbursement from the recipient of the assets, goods or services.

B. Intercompany Billings

Intercompany billings issued for transfers of assets, goods or services will be accompanied by supporting documents. Transfer pricing computations must be documented in order to facilitate verification of methods used to compute cost or fair market value of transferred assets, goods or services. Costs incurred on behalf of the Holding Company or a nonutility subsidiary will be accumulated, priced and billed in an expeditious manner to enable timely payment.

In order to simplify the accounting entries required, only the net nonutility portion of Edison's shared resources will generally be allocated to the Holding Company. None of these costs are to be reallocated to Edison. To the extent practical, shared costs will be billed directly by Edison to the nonutility subsidiaries on behalf of the Holding Company. This policy will create a simplified and more direct audit trail.

Until Edison's next general rate case proceeding, Edison's Electric Revenue Adjustment Mechanism ("ERAM") will be credited for the net amount of Edison costs billed to the Holding Company and the nonutility subsidiaries. This will include the cost of services requested by the nonutility subsidiaries, and their allocable share of holding company costs. However, costs incurred by Edison on behalf of the Holding Company and the nonutility subsidiaries that were never included in Edison's cost of service will not be credited to ERAM. It is Edison's responsibility to demonstrate such expenditures were never included in customer rates. This procedure will insure that Edison's ratepayers are not charged for the costs incurred by Edison and billed to the Holding Company and the subsidiaries.

C. Intercompany Payments

Payments for assets, goods or services received from an affiliate shall be made within thirty (30) days after receipt of the invoice. If reimbursements are not received by the payment due date, late charges will be assessed by the billing company. Intercompany billings and payments will be adequately documented so that an audit trail exists to facilitate verification of the accuracy and completeness of all billings and reimbursements.

See Section IV for billing and payment procedures applicable to federal and state income taxes.

APPENDIX C

IV. INCOME TAX ALLOCATION

A. General

It is the Holding Company's responsibility to file consolidated federal and state income tax returns which include the subsidiaries' taxable income. The tax liability or benefit resulting from the subsidiaries' income or losses is passed on to the subsidiary to coincide with the Holding Company's payment of its estimated tax installments.

B. Income Tax Allocation Methodology

The "stand alone" method will be used to compute the income tax expense of Edison and the other subsidiaries. A subsidiary with a net positive tax allocation will pay the Holding Company the net amount allocated, while a subsidiary with a net negative tax allocation will receive current payment from the Holding Company in the amount of its negative allocation. The payment made to a member with a tax loss will equal the amount by which the consolidated tax is reduced by including the entity's net corporate tax loss in the consolidated tax return.

The "stand alone" basis of income tax allocation requires that each subsidiary account for the tax effects of the revenues, deductions, and credits for which it is responsible. No member of the consolidated group will be allocated an amount for income taxes which is greater than the income tax computed as if such member had filed a separate return. This method is in agreement with the CPUC's established policy for income tax allocation, as discussed in Decision 84-05-036, resulting from Order Instituting Investigation No. 24.

C. Billing and Payment Procedures

Billings for federal and state income taxes will include all supporting calculations to facilitate timely payment. Estimated tax installments are paid to the Internal Revenue Service and the California Franchise Tax Board on the fifteenth day of April, June, September, and December. A final payment is due by March 15 of the following year. Payments made by the subsidiaries for their tax liabilities (or payments received by subsidiaries for their tax benefits) will coincide with the installment tax filings.

APPENDIX C

V. FINANCIAL REPORTING

A. General

All subsidiaries are expected to provide the monthly financial information necessary to compile the Holding Company's consolidated financial statements and to comply with other reporting requirements.

B. Financial Reporting Requirements

The financial information to be reported by the subsidiaries is to include, but is not necessarily limited to, the following:

- Balance sheet
- Income statement
- Cash flow statement
- Interest coverage data

C. Reporting of Intercompany Transactions

All intercompany transactions must be reported, including:

- Intercompany transfers of assets, goods or services
- Intercompany borrowings
- Intercompany receivables and payables
- Intercompany revenues and expenses
- Intercompany interest
- Identification of utility employees which provide services to affiliates

The nature and terms of transactions between Edison, the Holding Company, and the nonutility subsidiaries must be fully described.

D. Specifications

The financial reporting and intercompany transaction information forwarded by the subsidiaries must meet the following specifications:

1. Consistent format: The format of the financial information submitted by each subsidiary will be dictated by the Holding Company's reporting requirements. The captions and organization of the subsidiary financial statements must conform to the presentation utilized in the Holding Company's external financial statements, filed with the Securities and Exchange Commission.

2. Time Constraints: Subsidiary Companies' financial information must be submitted within the time constraints set for the Holding Company. Conformance with the established time frame is required in order to meet the deadlines for preparing consolidated financial statements and computing consolidated interest coverage ratios.

3. Conformance with GAAP: The management of each subsidiary is responsible for accumulating and preparing financial information in accordance with generally accepted accounting principles (GAAP) applied on a consistent basis. Year-end audited financial statements are to be accompanied by notes summarizing significant accounting policies and other disclosures required by GAAP to make the financial statements more meaningful.

4. Regulatory Agencies: Accounting practices mandated by regulatory agencies are to be observed when the subsidiary is within the agency's jurisdiction. In addition, subsidiaries are to comply with the reporting requirements placed on the Holding Company by regulatory agencies. Information regarding intercompany transactions must be presented in a form and manner which will assist in the regulatory review of those transactions.

APPENDIX C

VI. INTERNAL CONTROLS

A. General

Internal accounting controls will be maintained by Edison and the nonutility subsidiaries to provide reasonable assurance that:

1. Intercompany transactions are executed in accordance with management's authorization and properly recorded.

2. Subsidiary assets are safeguarded.

3. Accounting records may be relied upon for the preparation of financial statements and other financial information.

B. Internal Control Requirements

The internal accounting controls include the following elements:

1. Documented Procedures: All accounting policies and procedures for transactions between the utility and nonutility operations will be fully documented. The subsidiaries will develop the necessary procedures and controls to ensure adherence to the corporate policies. Measures must be taken to ensure that the procedures are made available to and are observed by all employees. These procedures will be refined as necessary to ensure the accurate and complete recording of all transactions.

2. Record Maintenance Records will be kept by each subsidiary to substantiate its books of account and financial statements. All intercompany transactions will be documented by records of sufficient detail to facilitate verification of relevant facts. Transfer prices are to be approved by the appropriate division head and will be monitored to assure compliance with transfer pricing policies.

   In addition to accounting records, each subsidiary will maintain other pertinent records such as minute books, stock books, reports, and correspondence. The subsidiaries' records will be retained for the period of time required by corporate and regulatory (CPUC and FERC) record retention policies.

APPENDIX C

VII. EMPLOYEE TRANSFERS

A. General

Transfers of utility employees between affiliates will not come at the expense of the utility business, and will require officer approval.

B. Employee Transfer Guidelines

The following guidelines will be utilized for employee transfers:

1. The staffing of the nonregulated affiliates will not be to the detriment of utility operations.

2. In instances where it may be desirable to move an Edison employee to an unregulated affiliate, senior management approval of both companies involved in the transfer will be required before the transfer can occur.

3. Edison employees will be free to accept or reject employment with the unregulated affiliates and no involuntary transfers will take place.

4. If an Edison employee elects to accept a position with an unregulated affiliate, he or she will be required to resign from Edison.

C. Reporting of Employee Transfers

Edison will provide to the California Public Utilities Commission an annual report identifying nonclerical personnel transferred from Edison to the Holding Company or any of the nonutility subsidiaries.

APPENDIX C

3. Budgeting: Subsidiaries will be responsible for allocating resources and controlling costs. Budgets will be prepared as required for capital expenditures, operating expenditures and personnel staffing. These budgets will be supported by subordinate budgets in sufficient detail to be used as a guide during the budget period.

   Managers will monitor budget performance and take action, if necessary, to control costs. Budgets will be used as a tool to detect and provide early warning of variances from planned expenditures. Explanations for substantial variances will be provided as soon as they are detected.

4. Audits: Each subsidiary must retain auditors to provide audited financial statements. The audits may be performed by internal auditors or outside public accountants. The decision to use an outside public accountant or internal auditors to satisfy the subsidiary's auditing requirements resides with the subsidiary's Board of Directors. The Holding Company has the right to initiate any audit of subsidiary activities deemed necessary. The cost of auditing services performed for nonutility subsidiary companies will be borne by the nonutility subsidiary.

   Intercompany transactions and related transfer prices will be audited to ensure that policies are observed and that potential or actual deviations are detected and corrected in a timely and cost efficient manner. The California Public Utilities Commission has statutory authority to inspect the books and records of a holding company and its nonutility affiliates as they regard transactions with the utility under the same terms as it may inspect the utility's books and records.

APPENDIX C

Attachment A

SOUTHERN CALIFORNIA EDISON HOLDING COMPANY

CORPORATE POLICIES AND GUIDELINES FOR
AFFILIATE TRANSACTIONS

DEFINITIONS

Affiliate: An individual subsidiary company within the Holding Company structure, or the Holding Company itself.

Cost of Sales: The direct cost of goods sold during an accounting period (for Edison, consists of fuel and purchased power expenses).

Fair Market Value: The consideration offered by a willing purchaser of an asset in an arms length transaction, i.e., with a non-affiliated purchaser.

Fully Loaded Cost: The value at which a good or service is recorded in the transferor's accounting records. It includes all applicable direct charges, indirect charges and overheads. (See Attachment B for a listing of the components of fully loaded labor costs for Edison employees.)

Intangibles: An asset having no physical existence, its value being limited by the rights and anticipative benefits that possession confers upon the owner. Includes copyrights, patent rights, trade secrets, licenses, franchises, etc.

Net Book Value: The original cost of an asset, reduced by applicable valuation reserves and offsets (e.g. accumulated depreciation, deferred taxes, and unamortized investment tax credits).

Nonutility Subsidiaries: Subsidiary companies that are established and operated wholly at the risk of the shareholders and are not subsidized by utility ratepayers. Nonutility subsidiary profits or losses are assigned to the shareholders. (See Attachment C for an organization chart of subsidiaries.)

Personal Property: Movable property or assets such as automobiles, equipment, and furniture.

Real Property: Land and land improvements, including buildings and appurtenances.

Transfers of Goods and Services: Items of merchandise or useful work provided by one affiliate to another.

Utility-Related Subsidiaries: Subsidiary companies that support utility operations, and which provide services which otherwise would be performed by Edison itself. Utility-related subsidiary profits or losses are assigned to the ratepayers. (See Attachment C for an organization chart of subsidiaries.)

APPENDIX C

Attachment B

SOUTHERN CALIFORNIA EDISON HOLDING COMPANY

CORPORATE POLICIES AND GUIDELINES FOR
AFFILIATE TRANSACTIONS

COMPONENTS OF FULLY LOADED LABOR COST FOR EDISON EMPLOYEES

- Wages and Salaries
- Paid Time Off
- Legally Required Payments
  - Social Security (FICA)
  - Unemployment Tax (FUTA & SUI)
  - Worker's Compensation
  - Employee Training Tax
- Pensions and Benefits
  - Retirement Plan
  - Sick Leave Severance Payments
  - Stock Savings Plus Plan
  - Group Life Insurance
  - Employee Health Care
  - Dependent Health Care
  - Family Dental
  - Vision Care
  - Long-Term Disability Payments
  - Rehabilitation Expense
  - Electric Service Discount
  - Employee Clubs and Recreation
  - Employee Moving Expense
- Five Percent Labor Mark-Up*
- Facility Costs

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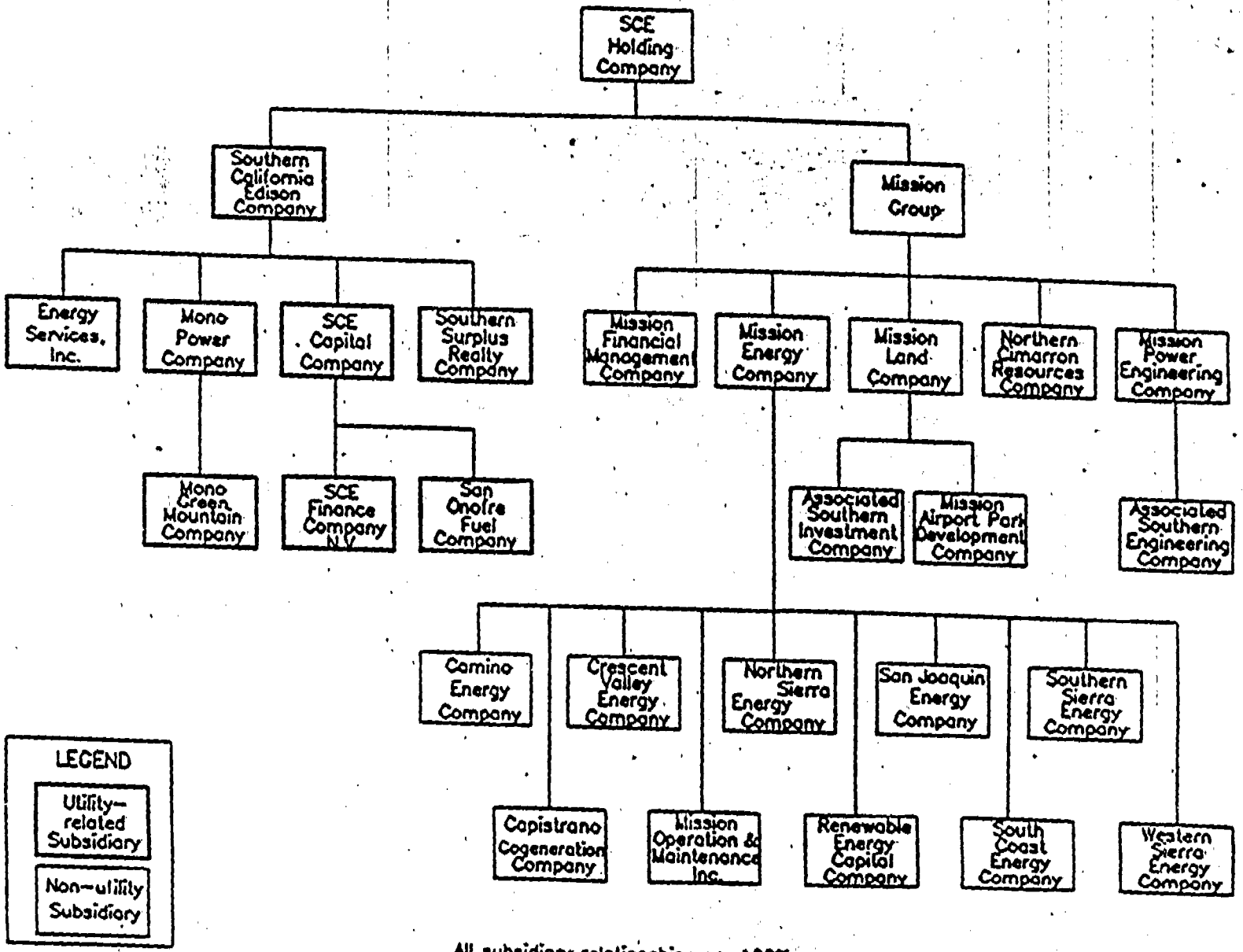
* The mark-up of five percent on fully loaded labor cost ensures that all unidentified costs, if any, which are related to nonutility operations are charged to the nonutility subsidiaries.

PROPOSED ORGANIZATION STRUCTURE



All subsidiary relationships are 100%.

DONALD VIAL, Commissioner, Dissenting:

I strongly dissent from the majority's approval of Southern California Edison's application to form a holding company.

Formation of a holding company and diversification is an attractive means by which the utility's management can continue to control the earnings of an increasingly cash-rich utility at a time when the growth of the utility's rate base has come to a virtual standstill. As this Commission emphasized in its recent landmark SDG&E holding company decision, D.86-03-090, the driving force behind diversification is management's interest in working out with stockholders the disposition of earnings that may no longer be needed for reinvestment in the utility. The choice for utility management is seen largely as one between returning excess earnings to stockholders, making it possible for them to pursue their own investment diversification goals, or of continuing control over the excess earnings to pursue corporate diversification objectives through unregulated affiliates. That is what this order is all about.

As regulators we must understand that the interests of ratepayers are not the focus of management's interest in creating a holding company. To the contrary, ratepayers are almost totally dependent upon CPUC regulatory policies to protect them. Yet, under this decision the most important tool we have for protecting ratepayers -- our regulatory authority -- is seriously undermined. Much of the authority that the CPUC has over SCE and its subsidiaries as a regulated utility is being transferred to a holding company over which we have no direct authority and only limited ability -- primarily what we require in this order as conditions for formation of the holding company -- to control or regulate the new affiliate relationships under the holding company structure. This erosion of regulatory authority becomes critically important when the holding company pursues, through unregulated affiliates, activities which are virtually inseparable from the

historical functions of the regulated, vertically-integrated utility.

One may assert, as the majority does, that the holding company structure insulates ratepayers from the risks and rewards of non-utility enterprises. This contention may have some validity for holding company enterprises that are unrelated or far removed from regulated utility services, but that hardly addresses the situation before us. SCE has made it clear that it is interested in unregulated diversification into areas of its expertise; that is, activities closely related to its historical utility mission, such as the generation of electricity and the related services for the development of alternative energy resources. Thus, I find it disturbing, to say the least, when the majority-approved order seems to imply that the holding company is also being pursued in the interest of ratepayers. The majority is more forthright when it openly recognizes that the ratepayers need some protection or at least to be made "indifferent" to the transfer of SCE assets to a holding company and to SCE's future regulation as a utility under a holding company structure.

The majority claims that they fulfill their obligations to the ratepayers by the conditions imposed on the formation of the holding company. The majority's conditions for the formation of a holding company rely on accounting tools, access to the records of affiliates and so-called transfer-pricing standards to try to control cross-subsidies from the electric utility's ratepayers to the unregulated holding company affiliates. These tools are simply inadequate. They fall far short of really protecting the ratepayer. Instead, it is my position that they actually mask the surrender to corporate management of the Commission's most fundamental responsibility to capture for all ratepayers the economies of scale and scope that are embodied in maintaining a reliable, vertically-integrated electricity network.

My central point is best understood in the context in the Commission's landmark SDG&E holding company decision. There, contrary to today's decision, we made the effort to analyze in detail the forces pushing for diversification among the energy utilities. The problems of regulatory authority under a holding company structure were carefully evaluated in arriving at the set of regulatory and protective conditions that we felt essential to permit SDG&E to transfer its assets to the proposed holding company, SDO Parent Co., Inc. We knew at the time, as is obvious in today's decision, that the CPUC was in its strongest position when approving the formation of a holding company to set forth the regulatory conditions required to fully protect ratepayers.

In this regard, it is to the majority's credit that their adopted conditions regarding access to all transactional information, accounting and auditing controls, and transfer pricing requirements flow out of an adaptation of conditions in the SDG&E decision to SCE. What is disturbing, however, is the careful denial of the two conditions in the SDG&E order that provided for continued exercise of CPUC regulatory authority over closely-related enterprises under the new holding company structure; namely, SDG&E conditions numbered 11 and 18. They deal respectively with QF relationships and the difficult-to-qualify "affiliate payments" issue. As will be pointed out below, the omission is particularly significant in today's SCE order because as a regulated utility, SCE is already deeply involved in QF and related alternative energy activities.

Unlike today's majority, the Commission in the SDG&E holding company decision sought to find solutions to the difficult problem of protecting utility ratepayers from possible adverse benefit/cost flows of closely related affiliate operations. The Commission had been advised, in earlier en banc hearings on the general subject of utility diversification, that under the best of circumstances, accounting tools and physical separations were not

sufficient to prevent hard-to-quantify subsidies from flowing from a regulated utility to closely related holding company affiliates. We were advised to capture them "up front" as best possible when providing for the formation of holding companies.

While recognizing the seriousness of the problem in the SDG&E decision, no immediate solution was available and the Commission refused to be arbitrary. We took a conservative course and ordered further hearings and investigation of the issues, seeking a better grasp of magnitudes of potential benefit/cost flows adverse to utility ratepayers and looking forward to developing a system of generic benchmarks for measuring and applying possible affiliate payments to the utility on a case-by-case basis. What was most significant in that cautious approach was the Commission's unwillingness to give up essential regulatory authority to protect ratepayers while focusing on the flexibility required in dealing with difficult affiliate relationships. As in the case of subsidiaries spawned by the regulated utility itself, the Commission made it clear that we must retain the ability to impute to the utility's regulated revenue stream, on a case-by-case basis when deemed necessary, a portion of the revenues of a closely related affiliate of the holding company.

Again, what followed the Commission's decision is also important to today's order. SDG&E decided not to form its holding company under the conditions imposed by the Commission, citing the retention of CPUC authority to attach revenues of affiliates as the primary reason. Not surprisingly, given utility management's interests in diversification, the word was soon out among utilities that the offensive retention of flexible CPUC power had to go.

In the recent decision in Phase II of the Pacific Bell General Rate Case, D.87-12-067, the Commission's staff sought to apply the SDG&E affiliates payment provision based on their audit findings of specific problems found in the utility/affiliate relationships. The ALJ rejected the DRA's proposal as being

overboard in failing to distinguish between a wide variety of affiliate relationships, but she called for further hearings to better focus and confront the problem on a case-by-case basis as in the SDG&E decision . The majority, over my dissent, rewrote that portion of the decision, effectively sweeping the issue under the rug, and setting the stage for today's order by asserting the sufficiency of monitoring access to records, accounting and auditing controls, along with transfer pricing standards.

It is equally clear that SCE in this crucial decision has become the stalking horse for other energy utilities who are awaiting the outcome of today's decision regarding the crucial issue of retention of essential revenue-imputing authority over closely related utility affiliates. SDG&E has not lost interest in restructuring itself as a holding company. PG&E has recently announced a joint venture with Bechtel for independent energy development, although no particular interest in a holding company was mentioned. The majority, in debate, has affirmed that holding company applications will be handled case-by-case, but I remain skeptical as to what that may mean, given the crucial departure from the SDG&E decision and the new pattern set by the Pacific Bell order and this SCE decision today.

It is difficult to interpret the failure to assert CPUC authority as anything less than a surrender of basic regulatory responsibility to the free-market instincts of utility and holding company management. In this SCE decision, the surrender of authority is especially painful because it is so egregious and unnecessary, even from the perspective of the majority.

The painful story lies in SCE's organizational charts in Appendix B, attached to today's decision. There is one chart that depicts SCE's current company subsidiaries with a listing of subsidiaries under two categories, "utility-related" and "nonutility-related". Another chart shows what happens to the subsidiaries under the now approved holding company structure.

Under utility-related, for example, Mono Power, which supplies uranium to SCE for its nuclear plants, is shown as a utility-related subsidiary along with several others. In our recent SCE General Rate Case decision, D.87-12-066, these "utility-related" subsidiaries were depicted as so closely related to the regulated activities of the utility that it was necessary to treat them as company departments with all revenues imputed to the utility's earnings above the line. In fact, there was a stipulation to this effect by DRA in the adopted decision. With regard to the so-called "nonutility-related" subsidiaries, their fate was not dealt with in the General Rate Case, because that issue was held in abeyance by indirect reference to the then-pending SCE holding company application which is now decided in this decision. At the time of the SCE General Rate Case decision, I raised questions about how SCE distinguished between utility-related and nonutility-related subsidiaries with particular reference to the treatment of the latter's revenues. I was properly advised that my questions should be addressed in today's decision.

Therein lies the rest of the painful story. Today's decision does indeed deal with these so-called "nonutility-related subsidiaries" that existed under CPUC regulation. The chart depicting the SCE holding company structure shows them reorganized under the Mission Group as subsidiaries of the holding company where their revenue streams are all safely beyond the reach of this Commission. But just how "nonutility-related" are these subsidiaries? Many of them are joint-venture QFs selling their energy generation to SCE or other subsidiaries engaged in providing alternative energy services. What, one might ask rhetorically, could be more closely related to the historical functions of the vertically integrated electricity utility? Today's decision actually accepts the utility's classification of these subsidiaries as "nonutility-related" without raising a single question. What is

even more disturbing, the record of this proceeding is virtually barren of any sensitivity to the utiltiy's classification of them as nonutility-related with reference to the loss of CPUC authority issue. At a minimum, this proceeding should be reopened to develop a record on the utility-relatedness of the subsidiaries for the purpose of exploring at least the extent to which CPUC authority over utility-related activities is lost when mislabeled "nonutility-related" subsidiaries become holding company affiliates. Even without such a record, however, the importance of the utility-relatedness of an affiliate remains obvious.

The closer the activities of an affiliate may be to the functions of the regulated utility, such as the generation of electricity, the more difficult it is to control benefit/cost flows that may be adverse to utility ratepayers. Yet, the majority approach effectively invites the holding company managers to spin off unregulated profit centers for the generation of electricity, to participate in breaking up their own vertically integrated utility, and to leave the regulators with significantly reduced authority to make the ratepayers whole.

A still closer look at Edison's QF affiliates provides a good example of these concerns. As indicated above, Appendix B to this order shows that Edison is a partner in a number of large QFs, mostly cogeneration projects at oil refineries or in the oil fields where steam flooding is used to recover heavy oil. Information on these projects submitted to the Commission in Edison's QF status reports shows that they amount to about 1300 megawatts of capacity. Edison's contracts with these QFs date from the 1983-85 period when fixed energy prices and levelized capacity payments were available to QFs in Standard Offer No. 2 and interim Standard Offer No. 4. At that time there was a perceived need to encourage the development of alternative resources for electric generation. Southern California Edison was an early supporter of this goal. The Commission felt that the proper path to this goal was to have

ratepayers assume, through these fixed-price contracts, the risk to new QF projects posed by uncertainties in energy markets.

The QF "goldrush" which resulted from these standard offers, coupled with the subsequent fall in energy prices, may have produced a situation in which electric utility ratepayers are now overpaying for the QF power sold to the utilities under these contracts. At the direction of the Legislature in SB 1970, the Commission is now conducting a joint study with the California Energy Commission to attempt to determine the magnitude of these overpayments, and to recommend policies to cope with this problem.

I recite this history because SCE's application cannot be analyzed in the abstract. It bears on Edison's proposal in this case to move its existing and future QF affiliates from their current position as subsidiaries of the regulated utility to the "nonutility-related" side of the holding company, where they would become subsidiaries of the holding company. Edison itself justifies the move by defining "nonutility-related" subsidiaries as those "engaged in activities that do not support utility operations and are undertaken wholly at the risk of shareholders and are not subsidized by utility ratepayers" (response to DRA data request A-162; see also Appendix C to this order). Given the policies of this Commission to encourage alternative energy development in our early long-term standard offers, it would stretch one's concept of marketplace risk to believe that Edison's QF affiliates can meet its own test as "nonutility-related."

We must examine the economic relationship in which those QFs stand to the utility ratepayers. It is clear that, through the fixed prices in S.O. No. 2 and interim S.O. No. 4, ratepayers agreed to assume a portion of the risks and rewards of these projects, including those in which Edison is a partner. Following the adoption of these standard offers, ratepayers were no longer indifferent to the price paid to these QFs; our current concern with and involvement in the SB 1970 issues is ample testimony to

that fact. Because of the nature of the standard offer contracts under which their power is sold, Edison's existing QF affiliates are not "activities ... undertaken wholly at the risk of shareholders." They are projects in which the risks and rewards are shared between utility ratepayers and shareholders. The Commission approved such a sharing more for the broader public purpose of encouraging the development of alternative technologies that were perceived as being given short shrift by utilities than for any real diffusion of market risk for resource development.

Given the fact that ratepayers are in effect partners with the developers in these QF projects, I cannot find that Edison's current QF subsidiaries are "nonutility-related". Thus, we should not allow them to become subsidiaries of the holding company, where they would be effectively beyond our regulatory authority. For the reasons discussed below, it is especially important not to make such a change while the future course of electricity generation is so much in doubt under still evolving federal policies.

In California, while providing for diversified and decentralized resources development, we have not in any sense abandoned the economies of scale and scope or the reliability of the vertically-integrated electric utility. To the contrary, in our updated and significantly revised OIR 2 approach to long-term standard offers for QF's, we have vastly strengthened the electric utility's responsibilities for resource planning and development. Our decisions require that QF energy be carefully integrated into the utility systems to assure least-cost electricity generation and distribution. In the face of present excess capacity problems, the heavy incentives of the past for alternative energy development are behind us. QF contracts for new capacity has almost been brought to a standstill. The focus now is on important policy changes that could either strengthen vertically-integrated electric utilities or directly undermine them by abandoning or modifying PURPA in such a

way as to effectively deregulate electricity generation. The latter course would lead to a separation of electricity as a commodity from its distribution, ultimately requiring mandatory retail wheeling by utilities -- a course which SCE senior executives themselves have denounced in national forums as a destructive course to be strictly avoided.

With such uncertainty in the air, even from the perspective of the majority, it would seem more prudent to maintain the status quo with respect to Edison's existing QF projects; they should remain subsidiaries of the regulated utility, at least for the moment. This would maintain the corporate structure under which these QFs were developed and financed. They are functioning very well where they are now, and SCE is not suffering from any heavy hand of regulation over them. Therefore, the Commission should have adopted the following condition:

E-8a Subsidiary companies which consist of qualifying facilities now under contract to sell power to Edison shall remain subsidiaries of the regulated utility. For new electric generation subsidiaries which wish to sell power to Edison, Edison shall file an application for Commission approval if it wishes to place such a subsidiary directly under the holding company, instead of under the regulated company.

The option for new generation projects is especially important. Thus, the Commission should also have left open the question of whether to allow unregulated subsidiaries of the holding company to pursue new generation projects selling power to the affiliated utility, or whether to require such projects to be wholly-owned subsidiaries of the regulated utility. In my view, just as it is prudent to leave existing SCE QFs where they are, it would be imprudent to attempt to answer the location question for new generation without a better idea of how a more competitive market for electric generation will evolve.

We are hopeful that the bidding process which D.87-05-060 established will prevent future problems with QF overcapacity, and will result in true ratepayer indifference to who generates power. However, the bidding procedure has yet to be tested. In addition, the FERC has been considering changes to its PURPA regulations.

Equally important for the future of the electric utilities is the question of opening access to the electric transmission system. As indicated above, the future shape of federal policy in this important area is also unclear. In recent testimony before Congress, the president of this Commission has urged the FERC to approach changes in PURPA and, ultimately, this issue of transmission access cautiously and with careful study. We urged the FERC to explore what the best structure for the electric industry might be, before developing ideas which will de facto define that structure. In short, we have been telling FERC to go slow with market-driven concepts that may irrevocably and adversely change the structure of electric utilities. We should heed our own advice to go slow in shaping the authority we must preserve and exercise constructively under a holding company structure with respect to utility-related activities like electricity generation. Unfortunately, the majority, in their rush to accommodate the diversification interests of utility managers, have plunged blindly ahead, and I fear have fallen prey to a case of regulatory schizophrenia.

Rather than retreating from our regulatory responsibilities, we should be seeking to improve the effectiveness of necessary regulation under these changing circumstances. In order to develop a flexible system of quantifying the cross-flows of benefits and costs and to condition our approval of this application to protect ratepayers, further evidentiary proceedings should have been ordered. The

hearings would develop a system of describing a continuum of utility-affiliate relationships.

Where the affiliate enterprise is closely related to the regulated activities of the utility, it is likely that cross-flows of benefits and costs between the two would be more difficult to control. Technical difficulties, however, in quantifying cross-flows or the value of and loss of economies of scale and scope should not deter this Commission from establishing its cross-flow criteria, or "benchmarks". The advantage that a utility affiliate would have over non-affiliates in dealing with the utility is clear evidence that the affiliation itself confers a benefit on the enterprise. The task is to identify the source of the benefit and to assign a value to it where transfer pricing, auditing and other controls are not adequate.

The "relatedness" proceeding and the subsequent case-by-case application of the benchmark standards would assure the ratepayer-protective role of the CPUC in determining how the economic benefits of scale and scope will be shared between ratepayers and shareholders when unregulated affiliates undertake a part of the utility's traditional service responsibility.

If a particular utility-affiliate relationship is found to generate a cross-flow of costs and benefits, this circumstance should be addressed through the very structure of SCE Holding Company or in the alternative, by the imputation of affiliate payments to the utility's revenue stream. As a condition of approval, SCE Holding Company should advise the Commission when it creates a subsidiary. The Commission would review whether the subsidiary will engage in activities closely related or linked to the regulated operations of the utility. The benchmarks would be used to ascertain whether the cross-flows appear to be inevitable. If so, the Commission would exercise its authority

to determine whether that subsidiary is properly placed under the regulated utility, SCE, or directly under the holding company as an unregulated subsidiary. For example, based on the concerns I have outlined above, we should have required Edison to maintain its QFs as subsidiaries of the regulated utility.

The Commission's authority to impute revenues from the affiliate to the utility, as deemed necessary to make ratepayers indifferent to the existence of the subsidiary, would be direct when the subsidiary is placed under the regulated utility, SCE. There would be no need to employ indirect methods, such as affiliate payments, of reaching the earnings of a holding company affiliate to protect ratepayers. The authority of the Commission over the regulated utility is complete compared to its limited and indirect ability to reach the unregulated holding company and the earnings of its unregulated affiliates.

Specifically, I would have adopted the following policy:

> "On a case-by-case basis, the Commission shall review whether a subsidiary is properly placed under SCE Holding Company or under the regulated utility, Southern California Edison, when the Commission, in such a review, determines that the purpose to the subsidiary is to engage in activities that (a) cannot be carried out without involving the utility's services and personnel in basic ways, (b) require extensive application of transfer pricing mechanisms, and (c) are closely linked to the basic services provided by the regulated utility."
>
> "If, upon consideration of these factors the Commission finds that the subsidiary should have been placed under the regulated utility but is not, the Commission shall investigate the imputation of a percentage of the subsidiary's net revenues, determined on a case-by-case basis, to the revenues of the regulated utility."

company should be operated as a utility subsidiary or as an unregulated affiliate.

These conditions would assure that the Commission could continue to balance the interests of ratepayers and utility management during the transition of a monopoly electricity market into a more competitive one. Unfortunately, they are not adopted by the majority. My colleagues express confidence that between the high road of protecting the regulated company's assets through structural separations and the low road of intermingling the regulated company's interests with those of affiliates, SCE's management will choose the high road. I also encourage the company to take the high road, but I would not pave it with gold.

Donald Vial

Donald Vial, Commissioner

San Francisco, California
January 28, 1988

A.87-05-007
D. 88-01-

G. MITCHELL WILK, Commissioner, Concurring:

We are all aware of the tremendous swings in the availability and prices of all types of energy, including electric power, over the past two decades. As a result, state and national policies have encouraged the broadest diversity of sources of investment and expertise with which to develop new energy supplies and technology. Through policies such as alternative generation and natural gas deregulation at the wellhead, we have involved the private sector on an unregulated basis to help solve problems that regulated industries could not.

Against this background, we have utilities such as Edison with declining investment needs, growing investor capital, and a wealth of expertise in energy. I think it is in the public interest to facilitate utility participation in the unregulated types of activities upon which we have increasingly relied to help solve energy problems.

These changes, however each of us may view their efficacy, will remain inexorable. To ignore them serves the interests of no one, except perhaps those who view regulation as an unchanging institution, and thus have an interest in protecting the status quo. Such a shortsighted position ignores reality while finding comfort in the world as it used to be. We simply cannot turn back the clock.

Second, Edison has already undertaken some diversification, and will undoubtedly pursue more regardless of our decision today. I see a holding company structure, with restrictions and guidelines as I propose we adopt today, as better able to insulate the ratepayer from any adverse impacts from diversification. We have no constitutional right or

authority, as a commission, to tell Edison's shareholders what to do with their money; instead, our talents and skills should be focused on protecting the ratepayer. The clear separation that a holding company offers between regulated and unregulated will help us do our job in these changing times.

I know that there is some controversy about these issues; I know that some would like regulators to exercise as much authority as possible, either because of a basic mistrust of the market system or because they wish to control the profits when diversification happens to pay off. In my view, such arguments are either misleading or simply unfair. It is misleading to suppose that an unregulated sector can thrive if regulators hold their authority over it poised to act at their pleasure. It is unfair to utility stockholders to take their profits from the winning investments while ignoring the losers. And, I think it is inappropriate for us as regulators to expand our authority and responsibility beyond that of our fundamental constitutional charge to protect the ratepayers.

Despite these positive aspects of utility diversification, I know that there can also be a bad side. In the Pacific Bell rate case we voted disallowances to compensate ratepayers for past cross-subsidies. I supported those disallowances, just as I will support further action if any utility abuses its relationships with an affiliate or jeopardizes the best interests of ratepayers. I also know that our staff needs clear and unquestioned access to relevant information to do its job. I have proposed strengthening this decision to clarify the same administrative process we established in the case of San Diego Gas and Electric; if Edison or an affilate wants to challenge a staff request for information, then the burden will fall squarely on Edison to justify its objection quickly and persuasively.

I believe that the numerous safeguards we establish here will do the job of protecting ratepayers while permitting

diversification to go forward. I will also be prepared to modify and strengthen these safeguards if experience demands it.

Let it be clear: this decision neither dilutes nor abdicates this commission's constitutional and statutory obligation on behalf of California ratepayers. Indeed, to the contrary, we clearly improve our ability to identify problems and protect the utility from abuses by separating non-utility diversification from the utility.

G. Mitchell Wilk, Commissioner

January 27, 1988
San Francisco, California

1 st Revised page -

Nos. 47 Thru 53

not included

It is quite clear that the Legislature intended some limitation on the Commission's access to the books and records of the holding company because the exact words used in the bill analysis and underscored in the above quote are contained in Section 314(b). However, the limiting language is couched in very broad terms and parties are placed on notice that we intend to interpret it broadly in fulfilling our regulatory oversight responsibility.

TURN maintains that even if the Commission were to adopt E-1, it would leave the determination of which requests are consistent with the requirements of Section 314 to future litigation, and it fails to explicitly assign Edison the burden of proof when making a claim that a given request is beyond the scope of Section 314. However, under cross-examination, Edison witnesses made it very clear that the holding company would cooperate to the fullest with the Commission while not giving up its right of appeal to the Commission when it thought access was not proper. Edison Witness Pignatelli covers this at Transcript Pages 108, 114, and 119, and Edison's policy witness Bryson at Transcript Pages 142 and 228. In particular, Bryson testified that in the case of disputes, Edison would take the matter before the presiding administrative law judge and if the ALJ "ruled that access should be available, then the company would adhere to that." (TR 142.)

We find that Condition E-1 proposed by Edison should be strengthened with the addition of the following sentence to ensure the Commission has the access to books and records of the enterprise that is necessary for effective regulatory oversight: "Edison is placed on notice that the Commission will interpret Section 314 broadly in fulfilling its regulatory responsibilities as carried out by the Commission, its staff and its authorized agents."

SD-3 SDG&E, SDO Parent Co., Inc., SDO's subsidiaries and the joint ventures of SDO and/or its subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of nonutility activities by SDG&E customers.

E-2 Edison, Edison's holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of nonutility activities by Edison's customers. These procedures and controls are explained in Edison's Corporate Policies and Guidelines for Affiliate Transactions.[12] This document is attached hereto, and by this reference is made part of these conditions. Edison's policies include the application of a five-percent markup on fully loaded labor costs billed to nonutility affiliates for the use of Edison employees. This billing policy, as well as Edison's Corporate Policies and Guidelines for Affiliate Transactions, will be reviewed in subsequent Edison General Rate Cases.

As will be noted, Edison's proposed condition is more complete than the comparable SDG&E condition and also adopts an extensive set of guidelines not included in the SDG&E condition. We find Edison's proposal will protect against cross-subsidization of nonutility activities by the utility.

SD-4 SDO Parent Co., Inc., its subsidiaries and the joint ventures of SDO and/or its subsidiaries shall keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

12 Attached to this decision as Appendix C.

E-3 Edison's holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

Edison's proposed Condition E-3 is identical to SD-4. No parties opposed it or offered an alternative. We will adopt it.

SD-5 The officers and employees of SDO Parent Co., Inc., and its subsidiaries shall be available to appear and testify in Commission proceedings without subpoena.

E-4 The officers and employees of Edison's holding company and its subsidiaries shall be available to appear and testify in Commission proceedings.

Edison's E-4 deletes the provision that witnesses should appear without subpoena. Edison agrees with and commits to the principle that nonutility affiliates' officers and employees should be available to testify before the Commission on all relevant matters. However, Edison believes that requiring such testimony without subpoena is both unnecessary and an extra jurisdictional act and should not be imposed as a condition of holding company formation. DRA agrees with the revision.

TURN argues that requiring attendance without subpoena assures that all necessary officers and employees will be available to testify. Because not all Edison affiliates will be located in California and the Commission's subpoena power does not extend beyond California, (TURN cites Walker v. Boyle (1925) 75 Cal App 152, 242 P. 115), the Commission may lack authority to subpoena certain affiliate employees.

We remind TURN and emphasize to Edison in particular that it is the utility's burden to prove its contentions in any proceeding before the Commission. To fail to produce witnesses as necessary or required on the technicality of non-jurisdiction would be a grave mistake because of the power the Commission has to

invoke penalties. (See for example, D.93367 of Pacific Telephone and Telegraph Company (6 CPUC 2nd 441, 490).) We see no need for the subpoena provision and will adopt E-4 but with the additional clarifying phase, "as necessary or required."

SD-6 SDG&E shall furnish the Commission with:

a. the quarterly and annual financial statements of SDO Parent Co., Inc., including annual consolidated and consolidating balance sheets of SDO and its consolidated subsidiaries;

b. annual statements concerning the nature of intercompany transactions concerning SDG&E and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

c. the balance sheets of the nonconsolidated subsidiaries of SDO; and,

d. all periodic reports filed by SDO with the Securities and Exchange Commission.

e. SDG&E shall submit, as a separate exhibit in its next general rate case, an audit of all transactions between SDG&E and affiliated enterprises, to be performed by an outside auditing firm which shall be selected and supervised by the Commission's Public Staff Division. The need for subsequent audits will be determined in SDG&E's next general rate case.

E-5 Edison shall furnish the Commission with:

a. The quarterly and annual financial statements of its parent holding company, including consolidating workpapers of the holding company and its subsidiaries;

b. Annual statements concerning the nature of intercompany transactions concerning Edison and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

c. The balance sheets and income statements of the nonconsolidated subsidiaries of the holding company;

d. All periodic reports filed by the holding company with the Securities and Exchange Commission; and

e. Edison shall submit, as a separate exhibit in its next general rate case, an audit of all transactions between Edison and its nonutility affiliates, to be performed by an outside auditing firm which shall be selected and supervised by the Commission's Public Staff Division. The need for subsequent audits will be determined in Edison's next general rate case.

E-5 is equivalent to SD-6. None of the parties had comments or suggestions for change. E-5 will be adopted.

SD-7 Within ninety (90) days following the close of its fiscal year, SDO Parent Co., Inc., shall provide the Commission with a detailed statement of (a) the projected capital budgets of SDO and each of its subsidiaries for the current year and each of the next two years including estimated financing requirements and construction plans, and (b) sources of capital to be used in funding said capital budgets for the current year.

Edison opposes this condition, offering no alternative but pointing to the information that would be provided under E-5, 9, 10, 12, and 13 as sufficient to serve the purpose of regulatory oversight. Edison notes that in the SDG&E holding company decision the Commission said SD-7 could be helpful in identifying those instances in which the holding company might be unduly relying on utility dividends to finance its nonutility functions. Edison believes this condition is unnecessary for the protection of ratepayers because the Commission, under the other conditions proposed by Edison, will have the ability to ensure that the equity required to support the utility will not be used to finance

nonutility ventures. For example, E-9 addresses the capital structure of the utility and provides for maintenance of the capital ratios found reasonable in Edison's general rate cases. DRA agrees the provision is not needed.

TURN, however, takes issue with the deletion of SD-7 and other changes proposed in the areas of financing such as SD-16 and 17. TURN believes information on capital budgets is necessary to ensure the financial health of the utility. It maintains that without advance notice but only with after-the-fact data, the Commission is powerless to determine the effect capital changes will have on the utility. Under the holding company scheme, TURN claims equity investment in the utility can only come from the holding company, and therefore the Commission must be aware beforehand of what is being planned concerning capital investments. TURN believes a condition such as SD-16 is absolutely essential to protect ratepayers from injudicious expansion of nonutility activities. TURN also believes that divestiture of subsidiaries could affect the financial health of the utility and therefore should be reviewed by the Commission.

We believe the reports provided for in the conditions Edison proposes will be sufficient information for the Commission to discharge its regulatory obligations. TURN's witness Hancock testified that the nonutility investment under the holding company could as much as triple over the next five years. That would take it to perhaps 5 or 6% of the holding company's revenues. We do not see that as a cause for alarm. Provision of the nonutility proposed budgets to and review of them by the Commission is not necessary to the Commission's function. We do not regulate the nonutility activities and don't wish to get involved with management functions of the holding company such as budgets. The one thing we must make sure of is that the activities of the holding company and its nonutility enterprises do not adversely affect the ratepayers of the utility. Put another way, Edison's

ratepayers should be indifferent to transactions between any and all entities of the holding company enterprise. This standard of "ratepayer indifference" is the one which guides us in these matters. We believe the conditions worked out by Edison and DRA on financial controls and reporting are adequate to support our regulatory function and they will be adopted.

SD-8 SDG&E shall notify the Commission in writing within thirty (30) days prior to any transfer to SDO Parent Co., Inc., or its affiliates of any asset or property exceeding a fair market value of $100,000, whether or not considered by the utility to be necessary or useful in the performance of its public utility obligations. This condition shall not include transfers of funds for investment under a cash management system.

E-7 Edison shall notify the Commission in writing within thirty (30) days prior to any transfer to the holding company or its nonutility affiliates of any utility asset or property exceeding a fair market value of $100,000, whether or not considered by the utility to be necessary or useful in the performance of its public utility obligations. This condition shall not include transfers of funds for investment under a cash management system.

E-7 is equivalent to SD-8. It will be adopted.

SD-9 SDO Parent Co., Inc., shall avoid a diversion of management talent that would adversely affect SDG&E. SDG&E shall provide to the Commission annual reports identifying nonclerical personnel transferred from SDG&E to SDO or SDO's subsidiaries.

E-6 Edison shall avoid a diversion of management talent that would adversely affect the utility. Edison shall also provide to the Commission an annual report identifying nonclerical personnel transferred from Edison to its parent holding company or any of the holding company's nonutility subsidiaries.

E-6 is equivalent to SD-9. It will be adopted.

SD-10 Market, technological or similar data transferred, directly or indirectly, from SDG&E to a nonutility affiliate shall be made available to the public subject to the terms and conditions under which such data was made available to the nonutility affiliate.

E-8 Market, technological, or similar data transferred, directly or indirectly, from Edison to a nonutility affiliate shall be transferred at market value. This condition will ensure that the utility is compensated and that ratepayers are indifferent to the transaction. However, if such data is related to the production of electricity by a Qualifying Facility in which an Edison nonutility affiliate has an ownership interest, then the Commission's procedures for disclosure, as set forth in the Commission's decisions in OIR-2, or its successor proceedings, shall apply.

TURN takes issue with Edison's proposal because it believes market and technological data should not be used solely to benefit affiliates. We read Condition E-8 as not limiting access to information to affiliates. Also, E-8 makes clear that transfers to affiliates must be at market value to protect ratepayers. (See Appendix C, Section II B.2. for the detail of how market value will be determined.) We will adopt E-8.

SD-11 Neither SDO Parent Co., Inc., nor any of its subsidiaries shall contract to sell electric energy to SDG&E for resale by SDG&E.

Edison does not propose adoption of this condition. DRA and TURN believe a similar provision should be adopted.

By D.86-07-004 in the OIR-2 proceeding the Commission determined that if an electric utility showed need for a deferrable resource addition within a specified period, it must acquire such an addition from qualifying facilities through a bidding process. The development of this bidding process was the subject of D.87-05-060 issued in May of this year. By that decision we allow utilities to accept bids from their QF affiliates finding that QF

affiliate participation in the bidding process would benefit ratepayers. DRA is quite candid in its Exhibit 9, Witness Bumgardner, Page 2-7, and in its brief in this proceeding, Page 11, that it would like the Commission to reconsider its findings in D.87-05-060, and find in this proceeding that even with the auction process, there is a potential for self-dealing between the utility and its QF affiliates, particularly within its own service area, at ratepayer expense. Therefore, DRA recommends that a condition be imposed on the reorganization which would prohibit Edison from entering into any new contracts for power with QF affiliates in Edison's service territory. TURN makes similar recommendations. There was a point made during this proceeding in response to a motion by Edison to exclude testimony on this issue, that the record in OIR-2 did not consider the holding company/utility/QF affiliate relationship. The ALJ denied Edison's motion on the grounds that OIR-2 may not have considered such a relationship. However, no evidence was offered to show that it was excluded from consideration.

We reject the recommendations of DRA and TURN because we have addressed this matter in the OIR-2 proceeding where it properly belongs. We have already concluded that the OIR-2 bidding process will not advantage utility affiliates in the choice of winning bidders. While there may also be issues associated with the operational relationships between an Edison-affiliate QF and Edison (i.e., those dealings that would occur after the bidding process chose an Edison-affiliate to supply power to Edison), we choose not to specify broad rules for those relationships at this time. In keeping with all relevant Commission decisions, we will expect Edison to minimize the cost of service for its regulated operations and to deal fairly and evenhandedly with all QFs; we will be prepared to examine any evidence to the contrary if and when it is presented. The other conditions we impose should

preserve the information relevant to such an investigation as well as our staff's ability to examine such information.

SD-12 SDO Parent Co., Inc., shall maintain a balanced capital structure in SDG&E, as determined to be reasonable by this Commission in SDG&E's most recent general rate case decision. SDG&E shall not permit retained earnings to be transferred to SDO where doing so would decrease its net equity ratio below that last adopted in a general rate proceeding.

E-9 Edison shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in Edison's most recent general rate case decision. Edison's equity shall be retained such that the Commission's adopted capital structure will be maintained on average over the period the capital structure is in effect for ratemaking purposes.

Edison's minor changes in this condition clarify and make the condition more realistic. E-9 will be adopted.

SD-13 The dividend policy of SDG&E shall continue to be set by the SDG&E Board of Directors as though SDG&E were a comparable stand-alone utility company.

E-10 The dividend policy of Edison shall continue to be established by Edison's Board of Directors as though Edison were a comparable stand-alone utility company.

SD-14 SDG&E shall not guarantee the notes, debentures, debt obligations or other securities of SDO Parent Co., Inc., or any of SDO's subsidiaries without first obtaining the written consent of this Commission to do so.

E-11 Edison shall not guarantee the notes, debentures, debt obligations, or other securities of its parent holding company or any of its subsidiaries without first obtaining the written consent of this Commission.

SD-15 The capital requirements of the utility, as determined to be necessary to meet its obligation to serve, shall be given first priority by the Board of Directors of SDO Parent Co., Inc., and SDG&E.

E-12 The capital requirements of the utility, as determined to be necessary to meet its obligation to serve, shall be given first priority by the Board of Directors of Edison's parent holding company and Edison.

E-10, 11, and 12 are identical to the SDG&E provisions and will be adopted.

SD-16 Without prior notice to the Commission, SDO Parent Co., Inc., shall not invest greater than fifteen percent (15%) of its total capital assets in nonutility subsidiaries. The Commission may institute an investigation on its own to consider issues raised by the surpassing of the fifteen percent (15%) level.

E-13 On a quarterly basis, Edison shall provide the Commission with a report detailing the utility's proportionate share of the holding company's i) total assets; ii) total operating revenues; iii) operating and maintenance expense; and iv) number of employees.

SD-17 SDO Parent Co., Inc., shall not sell, transfer or divest any of its subsidiary operations without first providing confidential notice to the Commission of the transaction. Said notice shall be provided not later than forty-five (45) days prior to the close of the transaction.

We discussed conditions such as SD-16 and 17 under SD-7 and make the same conclusion we did there. We will adopt Edison's proposed E-13 for SD-16 and no equivalent condition for SD-17.

SD-18 SDO Parent Co., Inc., and SDG&E shall appear as respondents to an investigation, to be commenced by this Commission in which a system of benchmark payments, consistent with the reimbursement of

expenses to ratepayers, intercompany transactions, and cross-subsidy estimates, shall be established. Said respondents shall present their best estimates as to the levels and bases for estimation of affiliate payment "benchmarks" which should be adopted by the Commission.

E-14 Where product rights, patents, copyrights, or similar legal rights are transferred from the utility to the parent holding company or any of its nonutility subsidiaries, a royalty payment may be required to ensure that ratepayers receive appropriate compensation. Such royalty payments shall be developed on a case-by-case basis.

This is the so-called royalty issue. DRA recommends, with TURN's support, that Edison's rates should be set as if Edison had received above-the-line income from its nonutility affiliates equal to 5% of the affiliates' annual gross income. DRA not only recommends this as a condition for approval of the reorganization in this case but also as a ratemaking adjustment in Edison's current general rate case, A.86-12-047. Assuming there is some benefit to affiliates from association with the utility, we don't believe this is the method that should be used for imputing royalty revenue.

The name and reputation of a utility is not an asset to which ratepayers have a claim. Indeed, the Commission has never included good will in the rate base of a utility for ratemaking purposes. It follows that ratepayers have never had to pay through rates a return on the value of good will. Ratepayers have paid nothing for the enhancement of the utility's name and reputation. Those have been built by the management of the utility if they are of any value. Also, those things which build up the name and reputation of a utility such as institutional advertising and charitable contributions have not been included in the cost of service for ratemaking.

DRA has not shown that a royalty payment of 5% of nonutility affiliates' gross income bears a relationship to any

costs or benefits from the affiliates' association with the utility. Any cost to ratepayers by having the affiliates associated with the utility will be accounted for by the conditions we will impose on acceptance by Edison of this decision. DRA's witness Bumgardner listed some 10 intangible "benefits" the affiliates receive by association with Edison, but, as with all things which are intangible, he was unable to put a value on the "benefits." His use of the relationship between franchisers and franchisees as an analogy of the relationship between Edison and its affiliates to justify his 5% recommendation, a figure within the range of the relationships he studied, is flawed because the underlying comparison is improper. By definition, a franchise relationship is unique and distinct from both a utility-parent and utility-affiliate relationship. In the usual relationship the franchiser grants to the franchisee the right to conduct a business identical in nature to the franchiser's business, usually within a specific geographic location. The franchisor typically provides a comprehensive plan on how to organize and operate the business including marketing information, size, appearance, and location of facilities, logos, advertising displays, hiring and training of employees, duties and attire of employees, and detailed information on business operations such as product preparation and sources of supply.

On the other hand, as can be seen in Appendix B, Page 2, each of the proposed nonutility affiliates under the reorganization plan will be conducting a business unique to that affiliate. Each will have its own business scheme. Edison will not be providing any key ingredients prepared from secret formulas, any management services not otherwise reimbursed under the proposed guidelines in Appendix C, any national or local advertising, any comprehensive guides on how to do it, or anything else at a cost to ratepayers that won't be specifically paid for by the nonutility affiliate.

Given the comprehensive transfer pricing policies Edison must adopt if it goes ahead with the holding company reorganization, there should be no significant uncompensated costs incurred by utility ratepayers as a result of Edison's diversification efforts. Under the policies proposed, Edison will be compensated for transfers to affiliates of proprietary and technical intellectual property to which ratepayers have a legitimate claim.

It is claimed that many transferred employees have useful and marketable skills they gained while employed by the utility. This does not justify a fixed royalty payment to the utility. The utility and its ratepayers have no claim on the marketable skills, as distinct from confidential knowledge, of employees who leave a utility, wherever they may go. Had the employees gone to businesses not at all associated with Edison, there would be no payment to the utility for the general skills the employee accrued while working for the utility. In fact, the record shows that the diversification will expand the employment opportunities of personnel thereby increasing Edison's ability to attract and retain high-quality people to the benefit of Edison's ratepayers.

Bumgardner also cites the utility's credit rating as alleged associational benefits which justify DRA's affiliate royalty recommendation.

PU Code Sections 817 and 830 prohibit a utility from issuing debt or equity securities for nonutility purposes, and from guaranteeing the obligations of other corporations, including affiliates and parent corporations, without specific Commission authorization. Edison has also agreed in Condition E-11, that it will not guarantee the obligations of its parent company or its affiliates.

The above-cited restrictions on the use of utility credit ensure that ratepayers will be insulated from the financial nonutility operations and also undercuts the rationale for the

DRA's affiliate royalty recommendation insofar as it is based on alleged benefits to affiliates from the utility's credit rating. If the utility is prohibited from using its credit standing to finance nonutility operations, there simply cannot be any benefit to utility affiliates from the utility's credit worthiness.

Based on the above discussion we will reject the recommendations of DRA and TURN for royalty payments and adopt E-14. We suggest that in the future, DRA concentrate on determining tangible benefits that flow from the utility to its affiliates. The conditions and accompanying guidelines we will adopt provide for ample opportunity to make such determinations, thereby resulting in fair treatment for the utility and protection of ratepayer interests.

Ultimately, it will be management's decision that determines the future path of diversification and affiliate transactions. A high road result will most probably come from management decisions that structurally separate regulated and unregulated operations, protect the regulated company's name, identity, capital, personnel, technology, "know how" and business income and pay a fair price for all interests of value received by the affiliate from the regulated company. The "other road" is full of uncertainties and other dangers caused by confusion of the regulated company's property and interests with the business of the affiliate. We prefer the high road because it is the smooth and sure road into the future.

SD-19 SDO Parent Co., Inc., and SDG&E, appearing as respondents in the investigation instituted in Condition Eighteen, shall also present their best estimates as to the appropriate valuation method for the estimation of royalty payments for the transfer of DFIS.

SD-20 Neither SDO Parent Co., Inc., nor its subsidiaries shall provide interconnection facilities and related electrical equipment to SDG&E, directly or

indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to SDG&E unless the third party may obtain and provide facilities and equipment of like or superior design and quality through competitive bidding. SDO and its subsidiaries may participate in any competitive bidding for such facilities and equipment.

E-15 Neither Edison's holding company nor its subsidiaries shall provide interconnection facilities and related electrical equipment to Edison, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to Edison, unless the third party may obtain and provide facilities and equipment of like or superior design and quality through competitive bidding. The holding company and its nonutility subsidiaries may participate in any competitive bidding for such facilities and equipment.

SD-19 was unique to SDG&E. E-15 is similar to SD-20 and will be adopted.

Findings of Fact

1. Edison is an electric public utility incorporated and organized under the laws of the state of California.

2. Edison requests authority under PU Code Section 854 to implement a plan of reorganization which will result in a holding company structure.

3. The objective of the reorganization plan is to have Edison and its unregulated, nonutility subsidiaries become separate, wholly-owned subsidiaries of the holding company.

4. As a result of the reorganization plan, the utility-related companies owned by the holding company will consist of the current corporation, Southern California Edison Company, and its utility-related subsidiaries.

5. Edison is seeking to reorganize into a holding company structure in order to more clearly separate its utility operations

from its nonutility operations, and to better position itself to respond to the changing business environment in the electric utility industry.

6. Edison's business environment has changed and requires a flexible, responsive business structure.

7. The separation between the utility and nonutility lines of business helps ensure that utility customers will not be affected by nonutility activities and that the Commission's ability to effectively regulate the utility will not be diminished.

8. The proposed reorganization is designed to result in a corporate structure which enhances management's ability to take advantage of nonutility business opportunities should they arise while not diminishing the Commission's ability to effectively regulate utility operations.

9. The proposed reorganization will not affect the Commission's ability to ensure that reliable utility service is maintained.

10. The proposed reorganization will not affect the Commission's ability to ensure that customers bear only the reasonable costs of providing utility service.

11. The Commission's ability to ensure an adequate level of service to utility customers will not be reduced by the holding company structure.

12. Effective regulation of the utility is dependent upon the Commission's ability to obtain and evaluate information concerning the utility.

13. Edison has developed corporate policies and principles which facilitate the Commission's ability to regulate utility operations and separate utility and nonutility activities.

14. DRA and Edison have agreed on a set of conditions which they believe will:

a. Ensure that all costs incurred by the utility which result from activities undertaken by Edison's affiliates are fully recovered from the affiliates;

b. Provide the Commission with access to all recorded and other information necessary to thoroughly analyze Edison's costs and monitor the relationships between Edison and its nonutility affiliates;

c. Ensure that Edison ratepayers are insulated from all effects of nonutility activities;

d. Preserve the regulatory control which the Commission currently has over Edison's activities; and

e. Ensure the financial health of utility operations.

15. Under revised Condition E-1, the Commission will have access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of Public Utilities Code Section 314.

16. Under the proposed conditions, Edison, the holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries will employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission.

17. Systems of accounting, procedures and controls related to cost allocations and transfer pricing are documented in Appendix C, Edison's Corporate Policies and Guidelines for Affiliate Transactions.

18. Under the proposed conditions, transfer pricing policies include the application of a five percent mark-up on fully-loaded labor costs billed to nonutility affiliates for the use of Edison employees.

19. Under the proposed conditions, Edison's holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries will keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

20. Under revised Condition E-4, the officers and employees of Edison's holding company and its subsidiaries will be available to appear and testify in Commission proceedings.

21. Under the proposed conditions, Edison will furnish the Commission with:

a. The quarterly and annual financial statements of its parent holding company, including consolidated work papers of the holding company and its subsidiaries;

b. Annual statements concerning the nature of intercompany transactions concerning Edison and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

c. The balance sheets and income statements of the nonconsolidated subsidiaries of the holding company;

d. All periodic reports filed by the holding company with the Securities and Exchange Commission; and

e. As a separate exhibit in its next general rate case, an audit of all transactions between Edison and its nonutility affiliates, to be performed by an outside auditing firm which shall be selected and supervised by the Commission's Division of Ratepayer Advocates. The need for subsequent audits will be determined in Edison's next general rate case.

22. Edison will avoid a diversion of management talent that would adversely affect the utility. Under the proposed conditions, Edison will provide to the Commission an annual report identifying

nonclerical personnel transferred from Edison to its parent holding company or any of the holding company's nonutility subsidiaries.

23. Under the proposed conditions, Edison will notify the Commission in writing within thirty (30) days prior to any transfer to the holding company or its nonutility affiliates of any utility asset or property exceeding a fair market value of $100,000, whether or not considered by the utility to be necessary or useful in the performance of its public utility obligations. This condition does not include transfers of funds for investment under a cash management system.

24. Under the proposed conditions, market, technological, or similar data transferred, directly or indirectly, from Edison to a nonutility affiliate will be transferred at market value. This condition will ensure that the utility is compensated and that ratepayers are indifferent to the transaction. If such data are related to the production of electricity by a qualified facility ("QF") in which an Edison nonutility affiliate has an ownership interest, the proposed conditions specify that the Commission's procedures for disclosure, as set forth in the Commission's decisions in OIR-2, or its successor proceedings, will apply.

25. Under the holding company structure, Edison will maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in Edison's most recent general rate case decision.

26. Under the holding company structure, Edison's equity will be retained such that the Commission's adopted capital structure will be maintained on average over the period the capital structure is in effect for ratemaking purposes.

27. Under the proposed conditions, the dividend policy of Edison will continue to be established by Edison's Board of Directors as though Edison were a comparable stand-alone utility company.

28. Under the proposed conditions, the capital requirements of the utility, as determined to be necessary to meet its obligation to serve, will be given first priority by the Board of Directors of Edison's parent holding company and Edison.

29. Under the proposed conditions, Edison will provide the Commission with a report on a quarterly basis detailing the utility's proportionate share of the holding company's (a) total assets; (b) total operating revenues; (c) operating and maintenance expense; and (d) number of employees.

30. Where product rights, patents, copyrights, or similar legal rights are transferred from the utility to the parent holding company or any of its nonutility subsidiaries, a royalty payment may be required to ensure that ratepayers receive appropriate compensation. Such royalty payments will be developed on a case-by-case basis.

31. Under the proposed conditions, neither Edison's holding company nor its nonutility subsidiaries will provide interconnection facilities and related electrical equipment to Edison, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to Edison, unless the third party can obtain and provide facilities and equipment of like or superior design and quality through competitive bidding; however, the holding company and its nonutility subsidiaries may participate in any competitive bidding for such facilities and equipment.

32. Royalty or affiliate payments charged to nonutility subsidiaries for alleged intangible benefits from their association with the utility are unfair and discriminatory to Edison and its subsidiary companies.

33. Many intangible benefits alleged by DRA are tangible and will be fully compensated by Edison's proposed transfer pricing mechanisms.

34. Intangible benefits, to the extent they exist at all, have never been reflected in rates and have never imposed any cost to utility customers.

35. DRA's proposed royalty of five percent of gross income is not supported by the record.

36. The conditions we adopt today appropriately and conclusively address those instances where there could be uncompensated benefits to the affiliates arising from their connection with the utility.

37. Ratepayers should be held harmless or indifferent to transactions between any and all entities of the holding company enterprise. It is this standard that guides our decision in these matters.

38. The restrictions and safeguards adopted in OIR-2, do not preclude Edison from purchasing electricity from QF affiliates within its service territory.

39. The proposed reorganization has no affect on the utility's relationship with its QF affiliates. The ownership of any given QF, whether it be by a utility, a holding company, a totally unaffiliated firm, or a combination of the above, is immaterial to the Commission's restrictions on the utility's practices with regard to QFs under the restrictions and safeguards imposed in OIR-2.

40. As a matter of regulatory policy, the Commission does not issue orders on labor-management issues where the subject matter is better left to collective bargaining between the company and the unions representing its employees.

Conclusions of Law

1. The Commission has the authority under PU Code Section 854 to grant Edison's proposed reorganization. That section of the Code provides that the Commission must affirmatively authorize the transfer of ownership or controlling interest in a public utility.

2. Granting the application to reorganize will not have an adverse impact on the public interest, provided it is subject to specific conditions designed to protect the ratepayers.

3. The Commission has access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of Public Utilities Code Section 314.

4. The Commission may require Edison, Edison's holding company, and each of its subsidiaries and joint ventures of the holding company and/or its subsidiaries to employ accounting and other procedures and controls related to cost allocations and transfer pricing that ensure and facilitate full review by the Commission to protect against cross-subsidization of nonutility activities by Edison's customers.

5. The Commission may require Edison's holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries to keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

6. In D.87-05-060, the Commission addressed the issue of allowing QF affiliates to bid on deferrable resource additions and expressly authorized them to do so subject to certain safeguards adopted in that decision.

7. The ownership of any given QF, whether it be by a utility, a holding company, a totally unaffiliated firm or a combination of the above, is immaterial to the Commission's restrictions on utility's practices with regard to QF's under the restrictions and safeguards imposed in D.87-05-060.

8. The conditions proposed by IBEW and UWUA should be rejected.

9. Edison should be granted authority to carry out its proposed reorganization subject to the conditions discussed and adopted in this decision.

10. Authorization to reorganize Edison's corporate structure should be made contingent upon the acceptance by Edison of the conditions adopted herein.

ORDER

IT IS ORDERED that:

1. Southern California Edison Company (Edison) is authorized to effect the reorganization proposed in this application. Such authority is contingent on acceptance by Edison, SCE Holding Company, and Edison Merger Company of the following conditions:

1. Edison shall ensure that the Commission has access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of Public Utilities Code Section 314. Edison is placed on notice that the Commission will interpret Section 314 broadly in fulfilling its regulatory responsibilities as carried out by the Commission, its staff and its authorized agents.

2. Edison, Edison's holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of nonutility activities by Edison's customers. These procedures and controls are explained in Edison's Corporate Policies and Guidelines for Affiliate Transactions. This document is attached hereto, and by this reference is made part of these conditions. Edison's policies include the application of a five-percent markup on fully loaded labor costs billed to nonutility affiliates for the use of Edison employees. This billing policy, as well as Edison's

Corporate Policies and Guidelines for Affiliate Transactions, will be reviewed in subsequent Edison General Rate Cases.

3. Edison's holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall keep their books in a manner consistent with generally accepted accounting principles and, where feasible, consistent with the Uniform System of Accounts.

4. The officers and employees of Edison's holding company and its subsidiaries shall appear and testify in Commission proceedings, as necessary or required.

5. Edison shall furnish the Commission with:

   a. The quarterly and annual financial statements of its parent holding company, including consolidating workpapers of the holding company and its subsidiaries;

   b. Annual statements concerning the nature of intercompany transactions concerning Edison and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

   c. The balance sheets and income statements of the nonconsolidated subsidiaries of the holding company;

   d. All periodic reports filed by the holding company with the Securities and Exchange Commission; and

   e. Edison shall submit, as a separate exhibit in its next general rate case, an audit of all transactions between Edison and its nonutility affiliates, to be performed by an outside auditing firm which shall be selected and supervised by the Commission's Division of Ratepayer Advocates. The need for subsequent audits will be determined in Edison's next general rate case.

6. Edison shall avoid a diversion of management talent that would adversely affect the utility.

Edison shall also provide to the Commission an annual report identifying nonclerical personnel transferred from Edison to its parent holding company or any of the holding company's nonutility subsidiaries.

7. Edison shall notify the Commission in writing within thirty (30) days prior to any transfer to the holding company or its nonutility affiliates of any utility asset or property exceeding a fair market value of $100,000, whether or not considered by the utility to be necessary or useful in the performance of its public utility obligations. This condition shall not include transfers of funds for investment under a cash management system.

8. Market, technological, or similar data transferred, directly or indirectly, from Edison to a nonutility affiliate shall be transferred at market value. This condition will ensure that the utility is compensated and that ratepayers are indifferent to the transaction. However, if such data is related to the production of electricity by a Qualifying Facility in which an Edison nonutility affiliate has an ownership interest, then the Commission's procedures for disclosure, as set forth in the Commission's decisions in OIR-2, or its successor proceedings, shall apply.

9. Edison shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in Edison's most recent general rate case decision. Edison's equity shall be retained such that the Commission's adopted capital structure will be maintained on average over the period the capital structure is in effect for ratemaking purposes.

10. The dividend policy of Edison shall continue to be established by Edison's Board of Directors as though Edison were a comparable stand-alone utility company.

11. Edison shall not guarantee the notes, debentures, debt obligations, or other securities of its parent holding company or any

of its subsidiaries without first obtaining the written consent of this Commission.

12. The capital requirements of the utility, as determined to be necessary to meet its obligation to serve, shall be given first priority by the Board of Directors of Edison's parent holding company and Edison.

13. On a quarterly basis, Edison shall provide the Commission with a report detailing the utility's proportionate share of the holding company's i) total assets; ii) total operating revenues; iii) operating and maintenance expense; and iv) number of employees.

14. Where product rights, patents, copyrights, or similar legal rights are transferred from the utility to the parent holding company or any of its nonutility subsidiaries, a royalty payment may be required to ensure that ratepayers receive appropriate compensation. Such royalty payments shall be developed on a case-by-case basis.

15. Neither Edison's holding company nor its subsidiaries shall provide interconnection facilities and related electrical equipment to Edison, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to Edison, unless the third party may obtain and provide facilities and equipment of like or superior design and quality through competitive bidding. The holding company and its nonutility subsidiaries may participate in any competitive bidding for such facilities and equipment.

2. Edison shall file a written notice with the Commission, served on all parties to this proceeding, of its agreement to the above conditions. Failure to file such a notice within 30 days of the effective date of this decision shall result in the lapse of the authority granted by this decision.

3. The conditions proposed by the International Brotherhood of Electrical Workers and the Utility Workers Union of America are rejected.

This order becomes effective 30 days from today.

Dated _____, at San Francisco, California.

D-88-01-063 A-87-05-007

DECISION NO._____ CASE NO._____ APP. NO._____