A.88-12-035 COM/PME/klw/val

Mailed

MAY 1 4 1991

ORIGINAL

Decision 91-05-028 May 8, 1991

BEFORE THE PUBLIC UTILITES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SCEcorp and its public utility subsidiary SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) and SAN DIEGO GAS & ELECTRIC COMPANY (U 902-M) for Authority to Merge SAN DIEGO GAS & ELECTRIC COMPANY into SOUTHERN CALIFORNIA EDISON COMPANY.	Application 88-12-035 (Filed December 16, 1988; amended April 17, 1989)

(See Appendix A for Appearances.)

TABLE OF CONTENTS

OPINION

Before ECKERT, PRESIDENT and WILK, OHANIAN, FESSLER, and SHUMWAY, COMMISSIONERS:

SUMMARY

We have concluded that the application of Southern California Edison Company and San Diego Gas & Electric Company to merge must be denied. Our decision is based on the evidence presented in this case and on the analysis prescribed by Public Utilities Code § 854, as amended in 1989.[1]

The amended content of § 854 requires the Commission to make three essential findings before approving any merger application. The first two are specified in § 854(b). We are to determine that the proposed merger provides both short- and long-term net benefits to ratepayers, and that it contains a mechanism which ensures that such savings will be passed to ratepayers. Next, we are to conclude that the merger does not adversely affect competition. Finally, § 854(c) requires us to weigh seven specific criteria to determine whether the proposal is in the public interest. In enacting § 854(e) the Legislature has required that the applicants establish each of these elements by a preponderance of the evidence.

To gain our authorization, the proposed merger must meet each of the § 854 requirements. Under that statutory scheme, failure to meet any one is fatal. We have concluded that this application fails to meet any one of them. Our decision not to approve the merger thus has three independent grounds.

First, applicants have not established by a preponderance of the evidence that the merger will provide net benefits to ratepayers in the long term as required by § 854(b)(1). In addition, applicants have not presented a ratemaking proposal that will ensure that ratepayers will receive such long-term benefits as have been forecast.

---

[1] While the case-specific nature of adjudication is familiar to lawyers, we are aware that our decision in this important matter will attract a broader audience. For that reason, we offer the following general observations. We limit our decision to the facts of this case. It is important for all segments of California society to understand that nothing in this opinion should be taken as an indication that the Commission is generally opposed to consolidations of investor-owned utilities, nor do we feel that the 1989 amendments to § 854 preclude a utility from discharging the burden required under that statute. Today's decision simply reflects our conclusion that these applicants failed in their effort.

Second, applicants have failed to prove by a preponderance of the evidence that the merger will not adversely affect competition. To the contrary, we are persuaded that the merger will have adverse effects on competition in the areas of wholesale transmission and bulk power, and in connection with the vertical integration of San Diego Gas & Electric Company and the Mission Group. With the exception of the latter impact, these adverse effects cannot be effectively mitigated. For these reasons, the merger fails to comply with the mandate of § 854(b)(2).

Third, after consideration of the seven criteria enumerated in § 854(c) and the mitigation of the significant adverse consequences, we find ourselves unable to conclude that, on balance, the merger is in the public interest.

I. BACKGROUND

A. General Matters

On December 16, 1988, SCEcorp, Southern California Edison Company (Edison), and San Diego Gas & Electric Company (SDG&E) (hereinafter applicants), filed an application under Public Utilities Code § 854 requesting authorization to merge SDG&E into Edison in accordance with their Agreement and Plan of Reorganization dated November 30, 1988 (the Merger Agreement). (Unless otherwise indicated, all statutory references in this opinion are to the Public Utilities Code.) In addition, Edison requested authorization, pursuant to §§ 830 and 851, to assume SDG&E's liabilities and obligations and to make certain SDG&E properties subject to Edison's mortgage indenture.

1. Terms and Conditions of the Proposed Merger

Under the Merger Agreement, SDG&E's shareholders would receive 1.3 shares of the common stock of SCEcorp, Edison's corporate parent, for each share of SDG&E common stock owned at the time of the merger. As of December 1988, this ratio represented a premium over SDG&E's book value of approximately 29%. Applicants propose to convert each outstanding share of SDG&E preferred or preference stock into an outstanding share of SCEcorp preferred or preference stock with similar provisions, except that higher dividend rates would apply. Applicants propose to account for the merger on a "pooling-of-interests" basis, under which the assets and liabilities of Edison and SDG&E will be carried forward at their recorded book value levels as of the merger's effective date.

2. Implementation of the Proposed Merger

SCEcorp, a holding company which has Edison and certain nonutility companies as direct and indirect subsidiaries, proposes to merge SDG&E with Edison using the merger provisions of the California Corporations Code (Cal. Corp. Code §§ 1100-1111). Edison would be the surviving corporation, and as such, would assume SDG&E's outstanding liabilities and obligations. Post-merger, SCEcorp would continue to own all outstanding common stock of Edison. The current corporate structures of the stand-alone entities and the proposed combined post-merger corporate structure are shown in diagrams 1 and 2, respectively. Under the provisions of the California Corporations Code, the Merger Agreement requires approval by various votes of the shareholders of SCEcorp, Edison, and SDG&E. Shareholders voted to approve the transaction in April 1989.

The merger is conditioned upon approval of this Commission and the Federal Energy Regulatory Commission (FERC). In addition, other regulatory bodies must review various aspects of the transaction.[2]

3. Reasons for the Proposed Merger

Applicants claim that the proposed merger will provide long-term benefits to the public and to both utilities' customers. They anticipate that planning and operational efficiencies, as well as elimination of certain duplicative functions, will result in lower rates than could be achieved separately by either company. Applicants also assert that SDG&E has a need for additional electric capacity which can be met efficiently and economically through the proposed merger, since Edison currently projects that it will have an excess of electric capacity for 8 to 10 years. Applicants also point to resource planning and operational benefits resulting from the integrated operation of the two systems.

---

[2] For example, the Nuclear Regulatory Commission (NRC) must approve amendments to the operating license of San Onofre Nuclear Generating Station (SONGS) Units 1, 2, and 3. The Securities and Exchange Commission, the Federal Trade Commission, the United States Department of Justice (USDOJ), the Internal Revenue Service (IRS), and the California Franchise Tax Board are also reviewing certain aspects of the proposal. (Application, pp. 14-15). In addition, the City of San Diego has conducted proceedings to determine whether it should authorize the transfer of the SDG&E franchise to Edison.

Applicants maintain that consideration by the CPUC and FERC of the broad public interest issues presented by the proposed merger should not be impacted by the activities of these other entities (Application, p. 15).

Diagram #1

CURRENT CORPORATE STRUCTURE

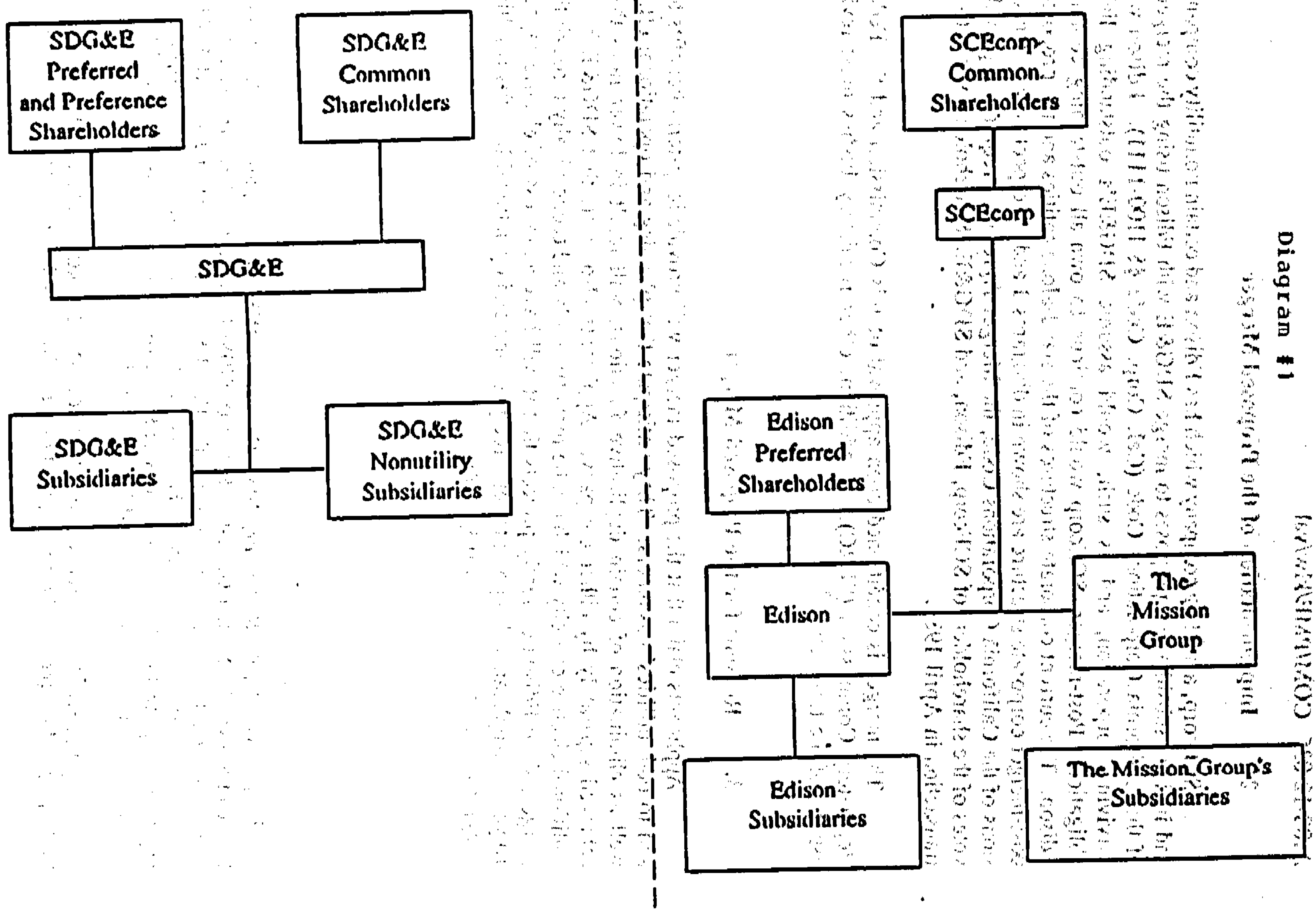
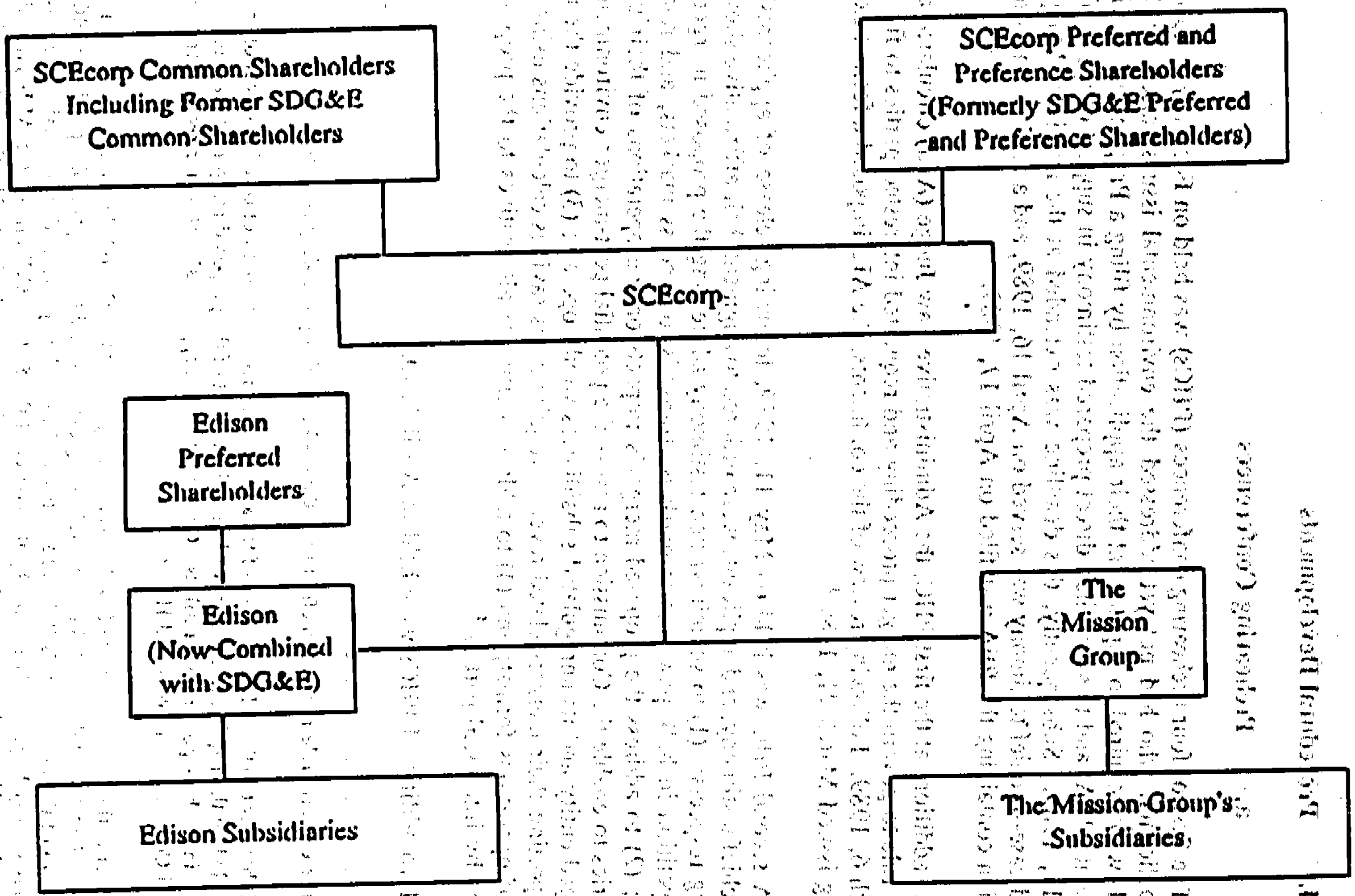


Diagram #2

POST-MERGER CORPORATE STRUCTURE



4. Procedural Developments

a. Prehearing Conferences

The first of four prehearing conferences (PHCs) was held on February 3, 1989. At that time, applicants, who had not yet addressed the environmental issues raised by the merger proposal, were required to supplement their application by filing a Proponents' Environmental Assessment (PEA) and to serve their direct prepared testimony in support of the application by March 17, 1989. Subsequently, this deadline was extended at the applicants' request; their prepared case-in-chief testimony was served on April 16, 1989, and a formal amendment to the application containing the PEA was filed on April 17, 1989.

In addition, at the first PHC, the Administrative Law Judge (ALJ) circulated a proposed ex-parte rule to govern the merger proceeding and requested interested parties to file comments by March 6, 1989. Following review of the comments, the ALJ imposed a formal ex-parte rule by ruling issued March 21, 1989.[3]

A second PHC was held on May 11, 1989, following release of applicants' prepared case-in-chief testimony, and applicants were ordered to augment their affirmative showing in the following respects: (1) to submit written testimony addressing the proposed merger's impacts on competition in bulk power sales markets, transmission access markets, and retail electric markets; (2) to address the proposed merger's impacts on the operations of their unregulated subsidiaries to enable the Commission to assess the potential post-merger environment in which the merged entity and its unregulated subsidiaries would operate; (3) to provide the underlying data supporting their merger-related revenue requirements savings calculations using the FERC results of operations format; and (4) to address particular alternatives to the proposed merger suggested by interested parties.[4]

Two additional PHCs were held in April 1990.[5]

---

3 The ex-parte rule remains in effect until the docket in this proceeding is closed.

4 Subsequent to the PHC, applicants filed a motion for reconsideration of certain aspects of the ALJ's PHC rulings, including the requirement that they address the impact of the proposed merger on transmission access and competition in the bulk power sales markets. On June 9, 1989, applicants' motion for reconsideration was denied by assigned Commissioners Wilk and Hulett.

5 Prior to the commencement of evidentiary hearings, the ALJs also ruled on various motions requesting that official notice be taken of the prefiled testimony, hearing exhibits, and transcripts of the parallel FERC proceeding. While Rule 73 of the Commission's Rules of Practice and Procedure provides that "official notice may be taken of such matters as may be judicially noticed by the courts of the State of California," the ALJs granted the pending motions on a limited basis. Due to the voluminous nature of the material submitted by the parties and the impending

(continued...)

b. **Merger Hearings**

The Commission held 13 public hearings in various locations throughout the service territories of Edison and SDG&E from April 23 to May 16, 1990. In addition, ALJs Carew and Cragg presided over 61 days of evidentiary hearings, held from May 14 to August 4, 1990. Testimony was presented by 116 witnesses, although the parties stipulated to receipt in evidence of the prefiled testimony of certain witnesses without the need for such witnesses to appear personally to testify and undergo cross-examination. However, in reaching a decision on the merits of the proposed merger, all testimony of record has been equally considered, notwithstanding the fact that some witnesses did not appear personally.

There were 61 appearances of record and 21 active parties presenting or cross-examining witnesses.[6]

Opening briefs were filed on September 10, 1990 and reply briefs on September 24, 1990. This proceeding was initially submitted on October 9, 1990, and was subsequently reopened to take additional documentary evidence into the record.

---

[5](...continued) commencement of evidentiary hearings, the ALJs agreed to identify these FERC materials, but opted to defer ruling on their admissibility until the post-briefing period. Parties were instructed to file motions to receive portions of this material with their closing briefs, and were informed that the only portions of this material that will be considered for admission into evidence are those specifically referred to or relied upon in briefs. (ALJ Ruling dated June 5, 1990.) Motions were filed by several parties at the conclusion of the briefing cycle, and these motions were addressed separately by ALJ ruling.

[6] These active parties included the applicants, the Division of Ratepayer Advocates (DRA), the then Attorney General of California, John Van deKamp, the City of San Diego (San Diego), the City of Simi Valley, the City of Vernon, the Environmental Coalition of Ventura County, the Federal Executive Agencies, the International Brotherhood of Electrical Workers (IBEW) Local 47, the Independent Energy Producers (IEP), M-S-R Public Power Agency (M-S-R), the Northern California Power Agency (NCPA), Pacific Gas and Electric Company (PG&E), Rate Watchers, the South Coast Air Quality Management District (SCAQMD), County of San Diego and the San Diego Air Pollution Control District (County and SDAPCD), the Cities of Anaheim, Azusa, Banning, Colton, and Riverside, (the Southern Cities), the San Diego County Superintendent of Schools (Superintendent), Utility Consumers' Action Network (UCAN), and the Ventura County Air Pollution Control District. In addition, the Commission's Advisory and Compliance Division, which was responsible for the preparation of the Environmental Impact Report (EIR), presented testimony of its findings.

c. ALJ's Proposed Decision and Comments Thereon

On February 1, 1991, the ALJs' Proposed Decision (PD) recommending denial of this application was served on all parties pursuant to § 311 and Rule 77.1.

Pursuant to Rules 77.1 et seq., applicants, DRA, San Diego, Attorney General Daniel Lungren, Vernon, Southern Cities, M-S-R, the County and SDAPCD, IBEW, the City of Los Angeles, UCAN, SCAQMD, NCPA, PG&E, and the Superintendent filed opening comments. Applicants, DRA, San Diego, Vernon, Southern Cities, M-S-R, UCAN, and PG&E filed reply comments. To the extent that these comments raise factual, legal, or technical errors in portions of the PD adopted herein, we have corrected such errors. However, to the extent that these comments merely reargue parties' positions, or otherwise raise issues which need not be resolved due to our denial of the application, such matters are not addressed.

d. En Banc Oral Argument

On March 20, 1991, the Commission, sitting en banc, held an oral argument in this proceeding.[7] In order to further elucidate issues raised during the oral argument, the Commission received supplemental briefs addressing the legislative history of Senate Bill (SB) 52, which amended § 854 (67 RT 9498-9499) (ALJ Ruling, dated March 22, 1991, p. 1).

5. The Commission's Decision

The outcome reached in today's decision is the result of a review of the evidentiary record, and of the briefs and arguments presented by the parties. By addressing all disputed issues in a comprehensive matter, the ALJs' PD has provided us with a full array of decisionmaking options and has greatly facilitated the decisionmaking process in this complex proceeding. Our decision to deny the merger stands on three independent bases: the failure of the proposed merger to meet the statutory requisites of § § 854(b)(1), (b)(2) and (c). In contrast, the ALJs' recommended denial was based on a failure related to § 854(b)(2) alone.

---

[7] The following active parties participated: applicants, DRA, San Diego, the Attorney General, UCAN, Southern Cities, Vernon, IBEW Local 47, County and APCD, Environmental Coalition of Ventura County, NCPA, M-S-R, IEP, and Superintendent.

B. Section 854

1. History

Until 1989, mergers and acquisitions involving public utilities doing business in California were governed by Public Utilities Code § § 851, 852, 854, and their predecessors. In 1989, § 854 was amended substantially by SB 52, which added five subsections to the existing statute.[8] The amendments to § 854 display the Legislature's intent to transform § 854 into the primary statute governing mergers involving California's large energy and telephone utilities.

Under the previous statutes, the Commission had broad discretion to determine whether or not a proposed merger or acquisition was in the public interest. The 1989 amendments to § 854 require the Commission to make certain specific findings before a merger or acquisition can be approved. And they mandate a strict burden of proof to be carried by the applicant. The required findings apply to any merger or acquisition involving a utility with gross annual California revenues exceeding $500 million. Edison and SDG&E each have gross revenues of more than $500 million, and the merger comes under the provisions of the amended § 854.

2. Requirements of § 854

Subsections (b), (c), and (d) set forth the Commission's statutory obligations when reviewing a proposed merger.

Section 854(b), added by the 1989 amendments, requires two independent findings. § 854(b)(1) requires the Commission to find that the proposed merger provides net benefits to ratepayers in both the short and long term, and that the proposal includes a ratemaking method to ensure that ratepayers receive the forecasted benefits.

---

[8] Former § 854 has been expanded and incorporated in the new statute as § 854(a), which reads:

> No person or corporation, whether or not organized under the laws of this state, 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. The commission may establish by order or rule the definitions of what constitute acquisition or control activities which are subject to this section. Any such acquisition or control without that prior authorization shall be void and of no effect. No public utility organized and doing business under the laws of this state, and no subsidiary or affiliate of, or corporation holding a controlling interest in a public utility, shall aid or abet any violation of this section.

Under § 854(b)(2), the Commission must find that the proposed merger does not adversely affect competition. The statute also requires the Commission to "request an advisory opinion from the Attorney General regarding whether competition will be adversely affected and what mitigation measures could be adopted to avoid this result."

Section 854(c) requires the Commission to consider seven specific criteria and to find, on balance, that the merger is in the public interest before it can approve the proposal. The criteria are:

(1) Maintain or improve the financial condition of the resulting public utility doing business in the state.

(2) Maintain or improve the quality of service to public utility ratepayers in the state.

3) Maintain or improve the quality of management of the resulting public utility doing business in the state.

(4) Be fair and reasonable to affected public utility employees, including both union and nonunion employees.

(5) Be fair and reasonable to the majority of all affected public utility shareholders.

(6) Be beneficial on an overall basis to state and local economies, and to the communities in the areas served by the resulting public utility.

(7) Preserve the jurisdiction of the Commission and the capacity of the Commission to effectively regulate and audit public utility operations in the state.

In addition, Paragraph (8) seems to require the Commission to "generally provide mitigation conditions to prevent significant adverse consequences which may result" if the Commission approves the merger.

Subsection (c) is ambiguous in one regard, but we now resolve that ambiguity. It is clear that the statute requires the Commission to consider each of the criteria listed in Paragraphs (1) to (7) before finding, on balance, that the merger is in the public interest. What is left unstated is whether the Commission is limited to these seven criteria or whether the Commission may assess additional elements in its balancing of the beneficial and adverse effects of the merger. We believe that it is reasonable to read the statute to require the Commission to consider the criteria listed in Paragraphs (1) to (7) but to permit evaluation of other factors in making its overall determination of whether the merger is in the public interest. So construed, Subsection (c) complements the Commission's previous authority and practice in cases involving the acquisition or control of California utilities.[9]

Subsection (d) requires the Commission to consider options to the proposal to see if comparable benefits can be achieved through other means while avoiding possible adverse consequences of the proposed merger.

3. Burden of Proof

Subsection (e) places the burden on the acquiring entity to prove by a preponderance of the evidence that the requirements of Subsections (b) and (c) are met. Subsection (e) has two separate, but related, elements. First, Subsection (e) assigns the burden of proof to the person or corporation seeking acquisition or control of the utility, or in this case, applicants. Second, Subsection (e) establishes the standard of proof as the preponderance of the evidence standard.

Burden of proof is "the obligation of a party to establish by evidence a requisite degree of belief concerning a fact in the mind of the trier of fact or the court." (Evidence Code § 115). In the context of this case, applicants have the burden of convincing the Commission that the specific requirements of § 854 have been satisfied. Failure of the Commission to be persuaded by the evidence on the required elements of § 854 prevents the Commission from making the findings required under the statute, and compels denial of the merger. When combined with the burden of proof, the requirement of § 854(e) that applicants prove each element of Subsections (b) and (c) by a preponderance of the evidence means that evidence in support of applicants' position, when weighed with that opposed to it, must have the more convincing force and the greater probability of truth. (1 Witkin, California Evidence (3d. Ed. 1986) § 157, and cases cited thereunder.) The standard California jury instruction on preponderance of the evidence is:

> "Preponderance of the evidence" means evidence that has more convincing force than that opposed to it. If the evidence is so evenly balanced that you are unable to say that the evidence on either side of an issue preponderates, your finding on that issue must be against the party who had the burden of proving it. (California Jury Instructions, Civil, (BAJI 7th Ed.), No. 2.60.)

---

[9] We note that the listed criteria of Subsection (c) evolved from Commissioner Wilk's testimony in the legislative hearings that eventually led to SB 52. Commissioner Wilk testified that the Commission would consider many of these criteria in evaluating the proposed merger even in the absence of a specific statutory requirement.

Black's Law Dictionary defines "preponderance" as "[g]reater weight of evidence, or evidence which is more credible and convincing to the mind[; t]hat which best accords with reason and probability."

We have required applicants to meet their burden of proof and have applied the standard of the preponderance of the evidence, as required by § 854(e), in assessing the evidence presented in this proceeding.

II. SECTION 854(b)(1): NET BENEFITS TO RATEPAYERS

Section 854(b)(1) requires that before authorizing a merger or acquisition involving large California electric, gas, or telephone utilities, the Commission must find that the proposal:

> Provide[s] net benefits to ratepayers in both the short-term and long-term, and provide[s] a ratemaking method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted short- and long-term benefits."

The statute requires applicants to prove three elements in connection with Subsection (b)(1). First, applicants must show that the proposed merger will result in net benefits to ratepayers in the short term. Second, applicants must prove that the merger will provide net benefits to ratepayers in the long term. Third, applicants' proposal must provide a ratemaking method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted short- and long-term benefits. As required under § 854(e), applicants have the burden of proving each of these elements by a preponderance of the evidence.

A. Definition of Short and Long Term

We begin our analysis of the statute's requirements with definitions of short term and long term. These periods are not specified in the statute, and the legislative history sheds little light on the legislative intent.

For most of this proceeding, applicants took no specific position on the duration of the short versus the long term. Applicants' proposed guaranteed return of benefits to ratepayers extended for four years, and applicants indicated belief that this satisfied § 854(b)(1)'s requirements for the short term. At the en banc oral argument, applicants represented that "a reasonable interpretation of the statute would be to view something on the order of the ordinary general rate case cycle, three years as short-term, and 10 years, or thereabouts, as long-term." (Malkin, RT 9332.) DRA agreed that it is reasonable to view the short term as three to four years. (Weismehl, RT 9409-9410.)

It is a principle of statutory construction that statutory ambiguities may be resolved by reference to the contemporaneous construction of the administrative agencies charged with implementing the new enactment. Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization (1978) 22 Cal.3d 208, 245. This supports use of our general rate case cycle.

We find that, for purposes of this proceeding, the short term should relate to the current general rate case cycle of three years. Base rates for electric utilities are routinely set from three-year forecasts of costs, and the Commission has experience with forecasts of this length. In this case, the time between the expected approval of the merger and the completion of the merged company's first general rate case was estimated to be four years, and both applicants and DRA suggested that this four-year period would be the appropriate time for consideration of short-term benefits. (See Applicants' Supplemental Brief on SB 52, pp. 19-20; DRA's Supplemental Brief on SB 52, p. 8.) Because of the timing of this proceeding in relation to the expected general rate case for the merged company, we agree that in this case it is reasonable to define the short term as four years.

Defining the long term is more problematical. Obviously, the commencement of the long term is defined by the limits of the short term, the three to four years tied to the general rate case cycle following the expected date of approval of the merger. Although theoretically the long term could extend into the infinite future, we believe the Legislature shared our recognition that the clearest of available crystal balls become translucent and eventually opaque as we look further into the future.

The parties suggest several options for defining the long term. Although applicants did not specifically recommend a definition of the long term, their detailed projections of the merger's costs and benefits through 2000 suggest at least a 10-year duration. Applicants argue that they have demonstrated savings from the merger for well into the next century. (Applicants' Supplemental Brief on SB 52, p. 18, fn. 29.) San Diego suggests a period of 20 to 30 years, corresponding to the useful life of generating plants and other utility projects.[10] Both San Diego and DRA note that a witness at the legislative hearing that led to SB 52 defined the long term as 20 years, the utilities' normal planning horizon. (San Diego's Supplemental Brief on SB 52, pp. 12-13; DRA's Supplemental Brief on SB 52, p. 7, fn. 3.) The legislative history of SB 52 also contains a report from the Assembly Office of Research that analyzed the costs and benefits of the proposed merger through 2007. (San Diego's Supplemental Brief on

[10] San Diego's view is that "long term should be over the period in which the effects of the merger can be expected to be felt. And in usual proceedings of looking at a particular plant or project, the determination of the assessment is over the life expectancy of that project or plant, usually 20 to 30 years. The City respectfully submits that the same period of time must be looked at in order to have an accurate assessment of the impacts of this merger." (Berger, RT 9431.)

SB 52, p. 15, fn. 17; DRA's Supplemental Brief on SB 52, pp. 7-8; Applicants' Supplemental Brief on SB 52, p. 18, fn. 29.)[11]

We recognize that the definition of the long term may vary with the circumstances of each individual case. We decline to define the long term for all future cases. The appropriate definition of the long term for a merger involving telecommunications companies, for example, may differ from the definition for a merger of energy utilities. For purposes of this case, the period of the long term should recognize the normal planning horizons of electric utilities and the nature of the benefits claimed for the merger. In this case, applicants have claimed that the merger produces resource planning benefits, including the deferral of planned generating units whose cost-effectiveness is evaluated over expected useful lives of 25 to 30 years. It is reasonable in this case, because of the nature of the savings claimed for the merger, to require a forecast of costs and benefits of the merger that assures us that the benefits will extend for at least several years into the next century. Applicants' definition of the long term, and thus their evidentiary showing, fail to meet this standard.

B. Long-Term Benefits

Applicants have failed to provide the necessary evidence to sustain their burden to prove by a preponderance of the evidence that there are net benefits associated with the merger after 2000. In many areas, applicants have presented no showing that any benefits result from the merger after 2000. Where applicants have presented evidence, it is often based on a host of assumptions and projections, rather than on a detailed analysis of applicants' forecasts and analyses of developments after 2000. The results incorporated in this evidence have not been tested for their sensitivity to variations in the underlying assumptions, many of which are highly changeable in actuality. Where costs may reasonably be expected to result from the merger after 2000, applicants have, in several instances, omitted to present those costs. Applicants' detailed presentation on the costs and benefits of the merger extended only through 2000. Estimates of the costs and savings after 2000 were much sketchier.

Consonant with the preceding definitions of short and long term, we conclude that applicants have failed to meet their required burden of proving that the merger will result in long-term net benefits.

---

[11] The provisions of Public Resources Code § 25300 et seq. require utilities to submit forecasts of loads and resources for planning horizons of 5, 12, and 20 years. The California Energy Commission (CEC) bases its draft electricity report on five- and 12-year forecasts, and the CEC's Biennial Report uses a 20-year forecast for policy and decision-making purposes. Furthermore, our Biennial Resource Plan Update (BRPU) proceeding uses a 12-year planning horizon to analyze the cost-effectiveness of proposed resource additions. (Decision 90-03-060, p. 132.)

1. **Labor Savings**

Applicants' support for their claim of net benefits after 2000 relied heavily on a straight-line projection of labor savings resulting from reductions in positions that are expected to be completed by the mid-1990s. Applicants' projection extends through 2024. (Fohrer, Exh. 400.) These projections are not based on a detailed analysis of expected employment trends after 2000; rather, they merely extend the forecasted savings of the late 1990s into the future. This undermines the soundness of their projections.

Applicants' projections of labor savings therefore do not take into account at least two effects that could reduce the projected savings. First, applicants do not account for the ability of a growing independent SDG&E to institute the administrative efficiencies that are not economically feasible for a utility the size of the current SDG&E. Therefore, some of the efficiencies SDG&E might realize by merger into Edison may be achieved if SDG&E remains independent and becomes larger. Second, applicants have not accounted for administrative inefficiencies that may result as the merged company becomes even larger. At some point, the merged company will become so large that diseconomies of scale will emerge, although the record in this case does not disclose at what size the diseconomies will begin to take effect. Both of these effects would tend to reduce applicants' projected savings.

2. Resource Deferrals

In the area of resource deferrals, applicants initially cut off the analysis of the costs and benefits of the resource deferrals at the year 2000. By considering the deferral effects only through 2000, applicants counted the capital savings associated with the deferrals as benefits of the merger but ignored the increased capital expenditures and the higher revenue requirements that will result after 2000. DRA showed how this type of analysis could show net benefits through 2000, but the same analysis, when extended to 2005, showed greatly increased production, O&M, and capital costs. (Morse, Exh. 10,400A, pp. I-12C to I-13C.)

Applicants responded with an analysis that measures the costs and benefits associated with the deferral in perpetuity of generating and transmission resources. (Zausner, Exh. 48.) That analysis concluded that the present value in 1990 dollars of additional fuel costs associated with deferrals of generating units is $203.7 million; the present value of the benefits from reduced capital expenditures due to the resource deferrals is $288.8 million. Thus, the analysis concluded that the net overall revenue requirements savings associated with the resource deferrals are $85.1 million in 1990 present value dollars. (Zausner, Exh. 48, pp. 12, 14.)

Applicants' conclusions, however, depend on several assumptions rather than on a detailed analysis of expected events and a consideration of unforeseen circumstances. The analysis assumes that each generating unit added in perpetuity has a useful life of 25 years. The analysis also assumes that replacement plants would be as cost-effective as today's planned units and the replacement plants would be units of similar design with capital costs that increase only for inflation. The analysis further assumes that sites would be available to build these future generating plants. (Zausner, Exh. 48, pp. 9-11.) A discount rate of 11.17% is assumed for the net present value analysis, and fuel is assumed to escalate at a constant 5% per year after 2005. (Zausner, Exh. 48, App. E, p. E-1.) Applicants' analysis is thus not based on an evaluation of what resources would be added at what specific times after 2000, or even on a detailed presentation of one replacement cycle of the plants that are proposed to be deferred. Applicants also failed to test the sensitivity of their analysis to variations in key underlying assumptions. We conclude that applicants have not shown that the proposed resource deferrals will produce net savings in the long term.

3. Payments to QFs

Because applicants urge the Commission not to consider the extent to which the merger increases payments to QFs, applicants make no projection of these increased costs after 2000. DRA estimates that increased merger-related costs in the form of higher payments to QFs will amount to $327 million from 2001 through 2005. (Kinosian, Exh. 10,400A, p. IV-8C.2.) However, applicants' analysis of incremental energy rates (IERs), the basis for payments to most QFs, with and without the merger shows no trend towards convergence through 2000. (Budhraja, Exh. 276, Workpaper Set 6, pp. 0080-0160.) Thus, even applicants' forecasts suggest that the merger-related increases in costs of purchases from QFs will continue into the next century. The best estimate of these increased costs was presented by DRA, and we conclude that the merger will result in increased costs of purchases from QFs of about $327 million from 2001 through 2005.

4. Transmission Service Revenues

Although applicants project increased revenues from sales of firm transmission service freed up by the merger, these revenues will be received for only a limited term. The offer of service to the Northwest extends only from 1991 through 1997, and the service to the Southwest is contingent on the completion of the second Devers-Palo Verde (DVP2) transmission line. If DVP2 is not built, the service to the Southwest will be offered from 1991 to 1997. Even if DVP2 is built, applicants indicate that service to the Southwest would be available for only about 15 years. Thus, there is little assurance that the projected transmission service revenues will extend very far into the period we have defined as the long term.

5. **Costs of Capital**

Applicants present no specific estimates of the merger's effect on the cost of capital after 2000. (See, Fohrer, Exh. 37, pp. 3-4). However, it is apparent that some of the costs included in applicants' analysis from 1991 through 2000 will continue beyond 2000. For example, increased dividends to SDG&E's preferred and preference shareholders will not cease in 2000 but will continue indefinitely at a cost of about $2 million per year. In addition, applicants claim financial savings from applying Edison's lower composite depreciation rate to SDG&E's plant. The change in depreciation rates, however, does not alter the cost or useful life of a particular asset. Although applying a lower depreciation rate will lower revenue requirements in the early part of an asset's useful life, it will increase revenue requirements later in the asset's useful life because a greater portion of the asset's cost will remain in rate base for a longer time. On a net present value basis, the change in depreciation rate should have no significant effect. However, to the extent that applicants claim savings through 2000, we recognize that there will be corresponding increased costs after 2000. (See, Fohrer, RT 5434-5435.)

6. **Environmental Costs**

The merger would also produce environmental impacts, and mitigating these impacts would require increased expenditures. According to the information developed in the EIR and the evidentiary record, the costs of mitigation and monitoring would amount to $107.5 million from 2001 through 2007. (PD, App. E, p. 2.)

7. **Conclusion**

Our definition in this proceeding requires long term to cover the period from 1995 through at least several years after 2000. Applicants' evidence over this entire period was not convincing. We therefore conclude that applicants have not met their statutory burden of proof to show by a preponderance of the evidence that net long-term benefits will result from the merger after 2000. Because we cannot make the finding required by the statute, § 854 requires denial of the merger.

C. Ensuring that Ratepayers Receive Long-Term Benefits

We have concluded that while applicants' proposal appears to guarantee short-term benefits, it does not meet the statutory requirement to provide a ratemaking method that will ensure, to the fullest extent possible, that ratepayers will also receive the forecasted long-term benefits of the merger.

Applicants present a two-part proposal to comply with § 854(b)(1)'s requirement for a "ratemaking method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted short- and long-term benefits." From the date the merger is approved through 1994, applicants propose to guarantee rate reductions as the guaranteed pass through of short-term benefits. Within six months of the effective date of the merger, the merged company will file the first of four annual requests to reduce the otherwise authorized base rate level under the electric revenue adjustment mechanism (ERAM) for SDG&E and Edison. Based on an assumed effective date for the merger of January 1, 1991, applicants contend these reductions will total $398.5 million during the four-year guarantee period. Ratepayers will receive these reductions even if the merged company does not actually achieve the forecasted savings.

The remainder of the rate savings during this period will be passed through to ratepayers by means of the normal adjustments resulting from the Energy Cost Adjustment Clause (ECAC)/Annual Energy Rate (AER) proceeding and the cost of capital proceeding. Additional savings will be achieved from merger-related resource deferrals, which will lower the merged company's revenue requirement. Altogether, applicants calculate that the merger-related savings during the guarantee period will amount to $482 million. They are willing to guarantee this amount, even if the Commission were to find lesser savings than so projected. If the actual merger-related savings during the guarantee period are greater than forecasted by applicants, applicants believe that the merged company should be permitted to retain the excess savings in compensation for the risks that the merger savings may be less than forecasted.

Applicants' proposal contends that savings occurring after 1994 should be passed on to ratepayers through normal ratemaking mechanisms. (Lester, Exh. 10, p. 13.)

Applicants believe that the four years of guaranteed reductions give the merged company a great incentive to develop efficient operations. If the merged company fails to achieve savings in at least the guaranteed amount, shareholders must make up the shortfall, and earnings will erode. These efficiencies are then built into the recorded figures that feed into the first general rate case (GRC) for the merged company, which applicants propose to be conducted in 1994 for a 1995 test year. The GRC provides an opportunity for extensive scrutiny of the merged company's first years of operations. In addition, fuel costs are reviewed under the ECAC mechanism, which includes incentive procedures to encourage efficient operation. If generating and transmission resources are not deferred as forecasted by applicants, appropriate actions may be taken as part of the normal review of new projects by the CEC and the Commission. This takes place in several proceedings, including the BRPU case, proceedings on certificates of public convenience and necessity, major addition adjustment clause cases, and GRCs. (Lester, Exh. 27, pp. 12-15.)

Existing ratemaking mechanisms will *ensure* that long-term benefits of the merger are passed through to ratepayers only under limited circumstances. Because existing rates are set based on principles of cost-based regulation, ratepayers will see the long-term benefits of the merger only if the forecasted savings are actually achieved by the merged company. As applicants apparently recognize, many unforeseeable intervening events can prevent the merged company from realizing the forecasted savings. Applicants' refusal to extend the guaranteed rate reductions beyond 1994 appears to be an implicit recognition that applicants' forecast of benefits becomes less reliable in later years.[12]

Despite the specific language of the statute, applicants have not developed any proposal for tracking merger costs and benefits. We also note that applicants' ratemaking proposals were not altered in response to the passage of SB 52. Applicants apparently made no additional effort to attempt to comply with the explicit requirements of the amended § 854.

Applicants also argue that "requiring the merged company in perpetuity to guarantee a forecast of its savings without regard to the reasonableness of merger-related expenditures when incurred would violate Commission ratemaking precedents." Under such a required guarantee, "all risks associated with merger-related savings would become the responsibility of shareholders. ... Imposition of such a burden regardless of any showing of reasonableness and for an indefinite time would also deprive the merged company of due process in ratemaking, which at a minimum requires that the utility be offered an opportunity to earn a reasonable rate of return." (Applicants' OB, p. V-13.)[13]

Applicants' arguments would have us ignore legislation. First, it is obvious that the Legislature's passage of § 854 (b)(1) would supersede any conflicting former Commission precedents on the same topic. Second, placing the risk associated with realizing forecasted savings on shareholders is, at least in part, the purpose of the statute. An earlier version of SB

---

12 Applicants make several arguments against a proposal by DRA to require the merged company to ensure that ratepayers will in fact receive all the benefits forecasted by applicants. First, applicants argue that "it is simply not possible to devise a cost and benefit tracking scheme which for an indefinite time would assure that ratepayers achieved exactly the projected savings levels forecasted." (Applicants' OB, p. V-12.) However, it would be possible in certain areas to make forecasts of specific items of the projected benefits. As the then Attorney General pointed out, it is quite possible to include the forecasted revenues from sales of firm transmission capacity in the calculation of the merged company's revenue requirement. This approach would lower ERAM rates by a corresponding amount and give the merged company a clear incentive to accomplish the forecasted sales. (Attorney General's OB, p. 117.) Another possible approach is to tie forecasted savings to changes in certain key variables.

13 The implications of applicants' position are troubling. Applicants seem to assert that they have so little confidence in their forecast of the long-term benefits that the Commission could not rely on this forecast to pass on its benefits to ratepayers without risking a violation of the merged company's due process rights. If the forecasted long-term benefits of the merger are so tenuous that they are not susceptible to the type of ratemaking assurance required by § 854(b)(1), it seems unlikely that applicants could meet their burden of proof that such benefits exist.

52 specifically required shareholders to guarantee the forecasted savings. Although that portion of the bill was softened somewhat, the enacted language still reflects the legislative intent to place the burden on the merged company and its shareholders to make sure that forecasted savings are achieved. Applicants' objection is properly directed to the Legislature, and not to our attempt to carry out our statutory responsibilities. Third, applicants' concern that they will be deprived of an opportunity to earn a reasonable rate of return is answered by statutory qualification that the ratemaking method need only ensure "to the fullest extent possible" that ratepayers receive benefits.

Applicants have failed to submit such a ratemaking proposal, and on this basis they have again failed to meet the burden of proof established in Subsection (c) to show that the requirements of Subsection (b) have been met.

D. Short Term Benefits

Due to applicants' failure to satisfy both long-term benefits requirements of § 854 (b)(1), we are compelled to deny the proposed merger, regardless of whether short-term net benefits exist. For this reason, we do not discuss the short-term benefits.

III. SECTION 854(b)(2): EFFECTS OF THE MERGER ON COMPETITION

Section 854(b)(2) requires this Commission to find that the proposal does:

> Not adversely affect competition. In making this finding the commission shall request an advisory opinion from the Attorney General regarding whether competition will be adversely affected and what mitigation measures could be adopted to avoid this result.

The statute requires applicants to prove by a preponderance of the evidence that the merger will not have adverse impacts on competition. If applicants fail to produce such evidence, or if evidence of the existence of merger-related adverse competitive impacts is more convincing, a finding of adverse competitive impacts is required. This triggers a second inquiry regarding what mitigation measures could be adopted to avoid merger-related adverse competitive effects. Applicants also have the burden of proof on mitigation, and they must carry that burden by a preponderance of the evidence (§ 854(e)). However, the statute also places an affirmative obligation on the Commission to request the Attorney General's advice on appropriate mitigation measures. This advice is to be weighed in the balance.

A. Jurisdictional Issues Underlying the CPUC's Assessment of Competitive Impacts

The Commission and FERC have undertaken parallel reviews of the public interest aspects of the proposed merger, including competitive impacts. Both agencies must approve the proposal before it can be consummated.

1. FERC Review

Applicants filed a Joint Application for Authorization and Approval of the Merger at FERC on December 15, 1988 (Docket No. EC89-5-000), pursuant to Section 203 of the Federal Power Act, 16 U.S.C. § 824b (1988). This statute provides that if, after notice and opportunity for hearing, FERC finds that the proposed merger "will be consistent with the public interest, it shall approve the same." (16 U.S.C. § 824b(a) (1988)).

2. The Commission's Review

Early in this proceeding, applicants contended that the proposed merger's impact on transmission access and competition in bulk power sales markets were within the exclusive jurisdiction of FERC. We reject this contention for reasons articulated twenty years ago. Northern California Power Agency v. Public Util. Com. (1971) 5 Cal 3d. 370, declared:

> It is no longer open to serious question that in reaching a decision to grant or deny a certificate of public convenience and necessity, the commission should consider the antitrust implications of the matter before it. The Commission itself has stated: 'There can be no doubt that competition is a relevant factor in weighing the public interest'...
>
> Although the commission is not bound by the dictates of the antitrust laws, it is clear that antitrust concepts are intimately involved in a determination of what action is in the public interest, and therefore the commission is obligated to weigh antitrust policy. [citations omitted.] . . . This is not to suggest, however, that regulatory agencies have jurisdiction to determine violations of antitrust laws. [citations omitted] Nor are the agencies strictly bound by the dictates of these laws, for they can and do approve actions which violate antitrust policies where other economic, social, or political considerations are found to be of overriding importance. In short, the antitrust laws are merely another tool which a regulatory agency employs to a greater or lesser degree to give 'understandable content to the broad statutory concept of the public interest.' [citations omitted]

> It is true that sections 4, 9, 15, and 15a of Title 15 of the United States Code give the federal courts exclusive jurisdiction over antitrust actions brought by the federal government and over certain private suits under the federal antitrust laws. However, those sections clearly do not foreclose the Commission from consideration of antitrust matters. . . . (5 Cal. 3d 377-378.)

A clear line of cases specifies that competition is one of the factors bearing on the exercise of this Commission's discretion, and is one of the factors that must be considered in its decision-making process (see Phonetele, Inc., v. Public Util. Com. (1974) 11 Cal. 3d 125; Industrial Comm. Systems v. Public Util. Com. (1978) 22 Cal. 3d 572; and U.S. Steel Corp. v. Public Util. Com. (1981) 29 Cal. 3d 603). This is true regardless of whether the effect is intrastate as in Industrial Comm. Systems, interstate as alleged in Northern California Power Agency, or foreign as in U.S. Steel.[14]

3. Reconciling the FERC and this Commission's Public Interest Reviews

Since both FERC and this Commission are reviewing the proposed merger's public interest aspects, certain jurisdictional questions have been raised. FERC has jurisdiction under the Federal Power Act over "the transmission of electric energy in interstate commerce" and "the sale of electric energy at wholesale in interstate commerce." (16 USC § 824(b)(1) (1988).) Applicants maintain that FERC's jurisdiction is plenary and that the states may not act in a manner which would conflict with a FERC determination, citing California v. FERC (1990) _____ U.S ____, 110 S. Ct. 2024, 2033-34. Applicants state that FERC has chosen to exercise its authority to determine competitive impacts of the proposed merger on interstate transmission and wholesale electric energy, and that this Commission and other appropriate state entities have been afforded the opportunity to participate fully in the FERC proceedings. Applicants argue that the State of California has jurisdiction to the extent the merger involves facilities used for

---

[14] The Assigned Commissioners also denied applicants' request to limit the evidence on transmission access in bulk sales to that introduced in the parallel FERC proceeding. While recognizing the potential efficiencies to be achieved by reliance on portions of the FERC record, they noted the Commission's authority to take interstate bulk sales and transmission access issues into account in deciding other issues which are within its direct jurisdiction. (Compare Pacific Gas & Elec. v. Energy Resources Comm'n (1983) 461 U.S. 190, in which the U.S. Supreme Court upheld California statutes prohibiting construction of any new nuclear power plant until the State Energy Commission finds that there is adequate storage approved by the authorized federal agency for the permanent storage of spent nuclear fuel.) The Assigned Commissioners noted the possibility that parties appearing at FERC might choose to introduce evidence before the Commission that is different in some respects from that offered in EC89-5-000. (Assigned Commissioners' Ruling dated June 9, 1989, pp. 5-6).

generation and local distribution of electric energy or for transmission of electric energy consumed wholly by the transmitter (16 U.S.C. § 824(b)(1) (1988)). Applicants state that the Commission's § 854(b)(2) authority must be viewed in light of its jurisdiction over generation, local distribution facilities and retail rates (Applicants' OB, p. VI-25).

This Commission's statutory authority to determine whether the proposed merger should be authorized, based upon assessment of competitive impacts and their potential mitigation (§ 854(b)(2)), is meaningfully exercised only if this Commission is free to gauge the full extent of the merger's impacts on California ratepayers. The statute requires that we assess whether the merger will adversely impact competition. If that assessment requires us to take into account certain issues regarding interstate transmission and bulk sales, then that is what we must do. Furthermore, as an administrative agency created by the Constitution, we have no power to refuse to enforce § 854(b)(2) on the basis of federal pre-emption, unless an appellate court has made a determination that enforcement of the statute is prohibited by federal law or federal regulations (Cal. Const. Art. 3, § 3.5). In the absence of such determination, we reject applicants' assessment that FERC's jurisdiction precludes our review of the merger's impacts in these areas. We will assess these impacts to the extent necessary to discharge our obligation to give full force and effect to the statute, and otherwise to protect the interests of California ratepayers.[15]

---

[15] Citing Northern California Power Agency, supra, DRA asserts that the Commission's review of competitive issues does not conflict with the exclusive jurisdiction of the federal courts over causes of action arising under federal antitrust laws. DRA notes that § 854 does not require the Commission to find antitrust violations as a prerequisite to denying or mitigating a proposed merger's anti-competitive impacts. Nor does DRA believe the Commission's review interferes with FERC's jurisdiction, because the Commission is not preempted from assessing the anti-competitive effects of the proposed merger on California ratepayers (DRA's OB, p. 242).

The then Attorney General observes that FERC has not limited the scope of its review to the "transmission of electricity in interstate commerce" and the "sale of electric energy at wholesale in interstate commerce," as applicants imply (Applicants' OB, p. VI 24). FERC intends to review a broader range of issues, including retail issues and affiliate transactions (Southern California Edison Company and San Diego Gas & Electric Company, Docket No. EC89-5-000, 49 FERC ¶ 61,091 (Oct. 27, 1989)) (Attorney General's RB, p. 59). The then Attorney General insists that applicants' suggestion that FERC's findings on matters within its jurisdiction would preclude contrary Commission findings is plainly wrong. In the antitrust arena, states have always been accorded concurrent jurisdiction with federal authorities (ARC America v. California (1988) ___U.S.___109 S.Ct. 1661). The then Attorney General maintains the Commission is free to consider the same issues FERC is considering; reach its own conclusions on those issues; and as mandated by § 854, reject the merger if there are adverse competitive impacts, wherever those effects are found and irrespective of any FERC determination. He regards anything less as an abdication of the Commission's mandate.

B. Attorney General Van de Kamp's Advisory Opinion and Its Impact on This Decision

1. The May 7, 1990 Advisory Opinion of then Attorney General Van de Kamp

On May 7, 1990, Attorney General Van de Kamp delivered an Advisory Opinion to the Commission pursuant to § 854(b)(2). The then Attorney General's analysis of the proposed merger's competitive impacts focused on defined markets in four discrete areas: wholesale transmission; wholesale bulk power; retail or "yardstick" competition; and affiliate impacts.

After identifying adverse competitive effects in each of these areas, the then Attorney General examined each separate market with a view towards mitigation. He discussed those remedies traditionally applied to antitrust injuries and those suggested by the parties. In certain markets such as transmission, he found applicants' proposals of limited value and concluded that neither those commitments nor any adjustment to them constituted effective mitigation (Advisory Opinion, p. 59). The then Attorney General could identify no mitigation measures to avoid the proposed merger's adverse impacts on bulk power markets (Id., p. 60), or on retail competition (Id., p. 61). In the affiliate area, he found that no remedy short of divestiture of unregulated affiliates would suffice.

Based on his conclusion that some, but not all, of the proposed merger's adverse impacts on competition could be avoided by appropriate conditions, the then Attorney General concluded that § 854(b)(2) bars approval (Id., p. 1).

The Advisory Opinion was first solicited by the Commission under amended § 854(b)(2), and it was contested in three respects: the degree of weight to which it is entitled; its evidentiary status; and the then Attorney General's "conflicting" roles in this proceeding.[16]

While urging us to accord no weight to the Advisory Opinion, applicants argue the Commission should accord "great weight" to the US Department of Justice (USDOJ) position on the merger, reflected in USDOJ's Reply Post-Hearing Brief filed in FERC docket EC89-5-

---

[16] We believe these issues were resolved substantially when the ALJs took official notice of the opinion as a "legal opinion based on specified assumptions" and allowed parties to brief how the facts developed in the evidentiary record may or may not be at odds with the assumptions underlying the Advisory Opinion (RT 4166 to 4170).

While applicants argue that the Attorney General is effectively wearing two hats (i.e., party litigant and advisor to the Commission on the merger's anti-competitive impacts), clearly the Legislature was aware of this possibility at the time that it amended the statute (Advisory Opinion, p. 6), and it placed no related restrictions on the Attorney General's participation in this proceeding.

000 on July 20, 1990. On September 24, 1990, applicants filed a Motion for Official Notice of Certain Documents referred to in their Opening and Reply Briefs, including the USDOJ brief. Applicants note that Evidence Code § 452(c) permits judicial notice of "[o]fficial acts of the legislative, executive, and judicial departments of the United States and of any state of the United States." Thus, under Rule 73, the Commission can take official notice of USDOJ's brief, which is a federal executive agency's official filing at FERC. Applicants assert that USDOJ's brief is an objective analysis of the merger's competitive effects, based upon consideration of the FERC merger proceedings, and that USDOJ has substantial expertise concerning competition and federal antitrust laws that may assist this Commission's assessment of these issues.[17]

In a related development, on September 24, 1990, Southern Cities filed a Motion to Strike References in Applicants' Opening Brief to Material Not in the Record in this Proceeding. Among other items, Southern Cities requests that applicants' Opening Brief argument relying on the USDOJ Post-Hearing Brief be stricken because it is not based on the record developed by this Commission.[18]

We now resolve both Motions relative to the status of USDOJ's Post-Hearing Brief. Applicants' motion raises a matter subject to discretionary, not mandatory, official notice under

---

[17] Applicants' Motion is opposed by DRA, Southern Cities and Vernon. DRA opposes the motion as an attempt to insert USDOJ's assertions into the record without benefit of cross-examination and contends the contents of USDOJ's brief are inadmissible hearsay. Southern Cities and Vernon also argue that a brief filed in the context of litigation is not the type of "official" government publication for which official notice is appropriate. Southern Cities cite Love v. Wolf (1964) 38 Cal. Rptr. 183, for the proposition that courts may take official notice of public records, but not the truth of all matters stated therein, since the official character of a document will not make otherwise inadmissible material admissible. (Southern Cities' Opposition, pp. 2-3).

Furthermore, all opposing parties note that the ALJ prevented them from cross-examining applicants' witnesses about the negotiating process which resulted in applicants' agreement with USDOJ (embodied in the Additional Proposed Merger Conditions, Exhibit 730), because (i) no USDOJ witness was present to co-sponsor the agreement and undergo cross-examination as to the merits of its adoption, and (ii) applicants represented that they would not attempt "to place the stamp of the Department of Justice on this proceeding" (RT 4912). Opposing parties argue that applicants are now attempting to do just that by requesting official notice of USDOJ's Post-Hearing Brief.

Applicants reply that their representations to the ALJ were made at a time when USDOJ had not yet explained its position on the merger, and that the Commission should now consider the brief for that reason. Applicants also dismiss DRA's hearsay argument on the basis of the Commission's Rules 64 and 69(b), as well as PU Code § 1701, which address the applicability of the rules of evidence and certification requirements to Commission proceedings.

[18] Applicants formally opposed Southern Cities' Motion as premature in view of their pending Motion for Official Notice.

Evidence Code § 452. Exercising that discretion, we hereby take official notice of the fact that USDOJ, a party in FERC Docket EC89-5-000, filed a Post-Hearing Brief recommending adoption of the Additional Proposed Merger Conditions. The so-called "APMC" settlement was effected after hearings had ended at FERC, so it is not in evidence in that forum, although submitted during briefing (RT 9358-9359). We decline to take official notice of USDOJ's underlying arguments or assumptions for the truth of the matters asserted therein, in the absence of a sponsoring USDOJ witness.[19]

In addressing similar questions about the status of the California Attorney General's statutorily mandated Advisory Opinion, we have taken official notice of the document as a legal opinion based on a specified set of facts, rendered pursuant to § 854; however, we have also stated that parties are free to argue the extent to which the evidentiary record supports, or fails to support, the underlying factual assumptions. In this docket, the California Attorney General has taken an active role in developing the evidentiary record through presentation of expert testimony and cross-examination of witnesses. In contrast, the facts underlying USDOJ's position and assumptions have not been tested. Therefore, we deem it totally inappropriate to give USDOJ's Post-Hearing Brief even greater evidentiary status than we have accorded the California Attorney General's statutorily mandated Advisory Opinion.

For all of these reasons, applicants' request for official notice of the USDOJ Post-Hearing Brief is granted as limited above. Consistent with this result, Southern Cities' Motion to Strike References to USDOJ's Post-Hearing Brief in Applicants' Opening Brief is denied.

---

[19] While DRA's hearsay argument does not preclude us from taking official notice of the existence of the USDOJ's Post-Hearing Brief, taking official notice to the greater extent requested by applicants would mean that we recognize and consider as established any relevant matters of law and/or fact contained in USDOJ's brief, without the necessity of formal proof of such matters by any party (Evid. Code §§ 450-451). This evidentiary treatment is appropriate for matters that cannot reasonably be disputed, but such is not the case with matters bearing on the competitive aspects of this merger. Furthermore, given the history of this particular controversy, any step beyond such limited recognition of USDOJ's brief will prejudice the rights of other parties who have been unable to test the assumptions and factual underpinnings of USDOJ's agreement with applicants. This prejudice outweighs any probative value of USDOJ's underlying assumptions. Finally, taking official notice of these underlying assumptions is at odds with applicants' representations to the ALJ.

2. Attorney General Lungren's Position

After reviewing his predecessor's legal analysis subsequent to the release of the PD, present Attorney General Lungren requested and received authorization to file a Motion for Leave to File a Supplemental Brief, for the purpose of raising matters relating to the statutory construction and application of § 854(b)(2) (ALJ Ruling dated February 21, 1991).[20]

As developed more fully at the March 20 en banc oral argument and in his Supplemental Brief on the Legislative History of Senate Bill 52, Attorney General Lungren asserts that the Commission is obliged to weigh the proposed merger's pro-competitive and anti-competitive impacts in order to ascertain whether it will adversely affect competition. If, after this balancing, the Commission determines that the proposed acquisition will not adversely affect competition, the § 854(b)(2) inquiry ends there. But, if the balancing exercise results in a conclusion that the proposal will adversely affect competition, then as the second step in its competitive analysis, the Commission must face the issue of mitigation.

Attorney General Lungren maintains that the legislative history does not preclude consideration within § 854(b)(2) of factors also considered in §§ 854(b)(1) and (c) when they are relevant to an assessment of competition. Because each of the three § 854 subdivisions serves a different function in the decisionmaking process, Attorney General Lungren argues that such dual consideration will not result in "double counting" of these factors (Attorney General's Supplemental Brief on SB 52, p. 14; RT 9450 - 9455).

Attorney General Lungren also suggests that the Commission has the discretion to assess all of the proposed acquisition's potential adverse competitive effects and apply mitigation to those effects before concluding that there is a "net anti-competitive effect." (RT 9446:9 - 14.) Alternatively, the Commission could also determine whether there is a net anti-competitive effect from those pro- and anti-competitive effects which it balances, and then determine whether or not any mitigating conditions would avoid such net effect (RT 9446:9 - 19).[21]

---

[20] This motion was opposed by UCAN, San Diego, DRA, and Southern Cities, as a late attempt to broaden or reconsider matters already submitted for decision. On February 27, 1991, the ALJs issued a ruling permitting Attorney General Lungren to "file a supplemental brief limited solely to 'the legal standard to be employed under PU Code § 854(b)(2)'", but specifically limiting supplemental arguments to existing facts of record (ALJ Ruling, p. 1). On March 8, 1991, Attorney General Lungren filed his Supplemental Legal Brief.

[21] Attorney General Lungren also asserts that there are specific deficiencies in the May 7, 1990 Advisory Opinion of Attorney General Van de Kamp: (1) failure to apply accepted principles of statutory construction; (2) adoption of a "per se" test against § 854(b) mergers that could lead to disapproval of a merger causing any reduction in competition; (3) adoption and modification of Section 7 of the Clayton Act for analysis without any support in the § 854 legislative history; (4) lack of sound basis for the Advisory Opinion's modification to the (continued...)

Finally, the Supplemental Brief opines that there is often no direct retail competition between contiguous utilities, and that consequently a merger between them would not reduce such competition (Supplemental Brief, p. 16).

Between March 15-18, 1991, formal responses to the Supplemental Brief were filed by applicants, DRA, San Diego, UCAN, Vernon, and Southern Cities. Only applicants argue that the Supplemental Brief undercuts the ultimate conclusion reached in Attorney General Van de Kamp's Advisory Opinion by rejecting the "far too narrow...legal interpretation of Public Utilities Code Section 854(b)(2) offered by the former Attorney General...," thereby providing a basis for modifying the findings of the PD on these points. (Applicants' Response, pp. 2, 10.)

Other responding parties do not necessarily disagree with the propriety of balancing pro-competitive and anti-competitive impacts, but object to a broad balancing test which would allow the Commission to consider, or "mix", certain assertedly "pro-competitive" items, such as quality of service, price effects, and economic, social, and democratic concerns in its § 854(b)(2) assessment.[22]

3. Interpretation of "Adverse Effects on Competition"

The § 854(b)(2) required finding that the proposed merger does "not adversely affect competition," is uncommon to statutory law. The more familiar merger analysis is whether "the effect of such acquisition may be substantially to lessen competition or tend to create a monopoly." (Clayton Act, Section 7) (Advisory Opinion, p. 10). Did the Legislature purposely depart from the Clayton Act's "substantial effect" standard in defining the parameters of our review? Given the uncommon nature of the phrase, we agree with then Attorney General Van

---

[21](...continued)
Section 7 Clayton Act analysis; (5) failure to take into account the pendency of the Edison/SDG&E merger during the 1989 amendments; and (6) misstating that the statute segregates price effects and competitive effects (Supplemental Brief, pp. 15-21).

[22] On March 26, 1991, DRA filed a Motion to Strike Applicants' Response to the Attorney General's Supplemental Brief as inappropriate reargument of facts explicitly barred by the February 21 and 27 ALJ Rulings. On April 5, 1991, applicants filed a formal response denying that they strayed beyond the evidentiary record or otherwise failed to comply with the ALJs' Rulings concerning the proper scope of briefing. On April 10, 1991, Southern Cities filed a Motion to Strike Attachment A to Applicants' Supplemental Brief on SB 52. Attachment A is Applicants' Response, which is the subject of DRA's March 26, 1991 Motion to Strike, and Southern Cities' Motion to Strike raises concerns very similar to those raised by DRA. Applicants have presented no new facts or evidence not already contained in this record, and on that basis, we do not consider their reargument of the facts to be an explicit "relitigation" of the evidence. Therefore, we deny both DRA's Motion to Strike Applicants' Response and Southern Cities' Motion to Strike Attachment A to Applicants' Supplemental Brief on SB 52.

de Kamp that, if the Legislature had any model in mind, it probably lies in our recent decisions on the competitive effects of various proposals (Advisory Opinion, pp. 10-11, and Fn. 6).

a. Must the Effects Be "Substantial"?

In our duty to interpret § 854(b) (2), we have been confronted by a question which has occasioned significant disagreement between the two Attorneys General who have advised the Commission. The disagreement is captured most easily in the context of the following hypothetical. Suppose that the Commission were presented with a proposed merger which impacts competition in a variety of markets some of which are large and important, given the number of affected ratepayers, while others are relatively small and impact a far smaller number of citizens. Suppose further that we were to determine that there are major pro-competitive consequences in the larger market but were also to find the presence of anti-competitive impacts in the smaller market. Are we compelled to reject the merger?

Attorney General Van de Kamp asserts that omission of the word "substantial" from § 854 was presumably deliberate and indicates that if the anti-competitive effect in one market is sufficient to be considered "adverse", the statute precludes approval. We do not understand Attorney General Van de Kamp to read § 854 as barring the approval of a merger which has "insubstantial" or <u>de minimis</u> competitive consequences. It is noted that the term "adversely affect" is keyed to effects "sufficiently weighty" to be characterized as "harmful" (Advisory Opinion, p. 12).

Attorney General Lungren, on the other hand, argues that if the prohibited adverse impact is defined as more than <u>de minimis</u> (sufficiently weighty to be characterized as harmful), but less than "substantial," the effect of the statute is to bar any major acquisitions, "which the Legislature could have, but did not do." (67 RT 9448:24 - 9449:2.) He suggests that the Commission's only choice, in order to avoid "absurd results," is to balance the pro-competitive and anti-competitive effects of a proposed acquisition on a case-by-case basis. This would permit the Commission to assess a huge pro-competitive effect in one market, in conjunction with a lesser anti-competitive effect in another market, and decide, even before considering mitigation, that on the whole, the merger may be pro-competitive. Attorney General Lungren does not regard this as "mixing the markets," but rather as enabling the Commission to place the proper weight in terms of public policy perspectives on the differing competitive features of the proposed acquisition. (RT 9449:3-18.)

While the two Attorneys General take opposing views as to how the Commission should gauge whether a proposed merger will result in adverse impacts on competition, they apparently agree that the Commission is not constrained by the Clayton Act standard, and may disapprove a transaction whose impacts are harmful, but less than "substantial" under the Clayton Act. We so find.

However, the Attorneys General do differ about the methodology the Commission should use to make its § 854(b)(2) determination. Attorney General Van de Kamp advises that a merger causing harmful competitive impacts in one particular market fails the statutory test. Attorney General Lungren maintains that the Commission is free to assess pro- and anti-competitive impacts in all markets prior to making a determination that the acquisition will result in adverse effects on competition. The methodological approach suggested by Attorney General Lungren is somewhat less stringent than that suggested by his predecessor, and would allow the Commission more flexibility to approve a merger whose pro-competitive elements might otherwise be disregarded under application of the more stringent Van de Kamp methodology.

We are mindful of the fact that the evidentiary record developed in this proceeding was keyed to the analysis provided by Attorney General Van de Kamp and that Attorney General Lungren's supplemental argument was presented after the record was closed. We have not allowed any party to present new facts responsive to Attorney General Lungren's briefs and argument. Nonetheless that does not prevent us from taking that analysis, along with the advice of Attorney General Van de Kamp, into account as we review the record before us. This is what we have done in the market-by-market analysis that follows.

The record developed by all parties has relied heavily on the models for measuring competitive impacts developed under the Clayton Act in particular. Because the parties have used these accepted analytical tools and precedents, they will largely guide our review of the proposed merger. However, our review is not constrained by these tools and precedents. The California Legislature has required us to determine whether this merger will adversely affect competition, and has not specified that our determination must rest on a finding that the proposal violates standards set forth in relevant federal antitrust statutes. We infer from this silence that the Legislature did not intend to constrain our already existing authority over the SCE/SDG&E merger, but to emphasize our longstanding obligation to consider, on a case-by-case basis, the competitive impacts of our decisions.

If necessary and appropriate, our decision may also rely on the body of common law which predates the recent amendment to § 854 (Northern California Power Agency, and related cases, cited supra). Therefore, we reject the notion implicit in applicants' argument, that recent amendments to § 854 have narrowed the scope of our review of competitive impacts by limiting our authority to disapprove an acquisition to those instances where we are able to make a finding that it meets the Clayton Act's "substantial lessening of competition" test. Rather, the recent amendment complements longstanding common law standards and makes our decisionmaking obligation more explicit.

b. Does the Statute Reach Incipient Injury to Competition?

The word "affect" in § 854(b)(2) is broad enough to embrace both immediate harm and long-term effects on competition. Thus, even if the merging firms are not now in competition in a particular market, if there is evidence showing that one is a potential competitor of the other, the elimination of the potential competitor constitutes an adverse effect on competition within the parameters of § 854(b)(2) (Advisory Opinion, pp. 13-14; Southern Cities' OB, p. 4; Vernon OB, p. 127; NCPA OB, pp. 5-6; UCAN OB, p. 79; Applicants' OB, p. III-9). Therefore, the Commission may assess incipient injury to competition, pursuant to § 854(b)(2).

c. Must an Impermissible Injury to Competition Constitute an Antitrust Violation?

As stated previously, we need not find all the elements of a violation of Section 7 of the Clayton Act before disapproving the merger. The general language of § 854(b)(2) requires us to review the competitive effects of the merger, and does not focus on a violation of the antitrust laws (Advisory Opinion, p. 14; see also Alabama Power Company v. Nuclear Regulatory Commission (11 Cir. 1982) 692 F. 2d. 1362, 1368, cited at Fn. 9 of Advisory Opinion, p. 14; see also Southern Cities' OB, p. 84; Vernon's OB, p. 126; and NCPA's OB, p. 5).

As applicants note at OB, p. VI-27, we have used federal precedents in the past, and do so in this decision, due to the well-developed body of available federal antitrust authority.[23] However, our decisionmaking authority over this merger, and its broad public interest aspects, is not so limited that it must be premised on whether the acquisition violates federal antitrust statutes.

C. Conceptual Framework for Analyzing Competitive Effects

1. Introduction

In Brown Shoe Co. v. United States, (1962) 370 U.S. 294, 324, 334, the Court recognized both horizontal and vertical aspects of economic combinations. A consolidation of two companies performing similar functions in the production or sale of comparable goods or services at the same level is characterized as "horizontal." Thus a merger between two manufacturers or two retailers of comparable goods or services would be a "horizontal" alignment. By contrast, economic arrangements between companies which conduct operations

23 We observe that California's Cartwright Act contains no merger provision analogous to Section 7 of the Clayton Act (Advisory Opinion at p. 9).

at different levels up and down the distribution chain (e.g., wholesale and retail) are characterized as "vertical."

We have concluded that the proposed merger involves both. Although Edison and SDG&E are each vertically integrated, their proposed merger presents vertical issues related to the merged entity's ownership of key resources and the effect of that ownership on competitors at retail, including the Resale Cities. In addition, the operations of the merger partners at defined levels such as bulk power present horizontal issues. As noted in the Advisory Opinion:

> Each firm is itself vertically integrated. The merger of the two firms' operations at a given level (e.g., bulk power production) must be analyzed horizontally. Additionally, the acquisition must be examined to determine whether SCE is acquiring any bottleneck resources that can be used to disadvantage competitors in other markets. (Advisory Opinion, p. 21.)

2. Defining the Area of Effective Competition: The Relevant Product and Geographic Markets

Market power is the ability to control the price or available quantity of a product in the market place. Traditional merger analysis assumes that an increased concentration of sellers, all else being held equal, implies an increase in market power. Although this conclusion can be overcome by introducing other evidence, such as ease of entry by new suppliers into the market, the analysis of market concentration is the starting point in accepted merger analysis (Gilbert & Cox, Exh. 10,200, p. II-3).

In order to make a determination of market concentration, it is necessary to define the "area of effective competition" by defining both the relevant product market and associated geographic market(s) affected by the merger (Brown Shoe Co., supra, 370 U.S. p. 324). Ancillary to this process is the identification of the firms that compete in the purchase or sale of each of the products for each of the relevant geographic areas (DRA's OB, p. 254). Applicants presented testimony that if the merging companies do not sell the same products in the same geographic areas, they are not pre-merger competitors, and consequently the merger neither changes the structure of competitive markets nor enhances market power (Joskow, Exh. 22, pp. 12-14). Nonetheless, applicants have recognized that accepted merger analysis also focuses on whether the merger partners are potential, as well as actual, competitors (Applicants' OB, p. III-9). This is consistent with our determination that our mandate under § 854(b)(2) includes authority to assess incipient injury to competition.

The product market is a range of products or services that are relatively interchangeable, so that pricing decisions by one firm are influenced by the range of alternative suppliers available to the purchaser. The utility industry is one of the service industries where courts tend to group a "cluster of services" into a single market (Advisory Opinion, p. 17). The relevant geographic market for each product market is defined as the area in which sellers compete and to which buyers can practicably turn for supply.

Within a relevant product or geographic market there may be several relevant submarkets, which by themselves constitute product markets for antitrust purposes (Brown Shoe Co., supra, 370 U.S. p. 325). A relevant submarket is identified by "such practical indicia as industry or public recognition of the submarket as a separate economic entity, the product's peculiar characteristics and uses, unique production facilities, distinct customers, distinct prices, sensitivity to price changes, and specialized vendors." (Id., p. 325.)

The effect of the proposed merger in each defined market is then assessed by examining the market power of each separate firm and of the merged company. A merger which gives the merging firms the power to control prices or to exclude competition is unlawful (United States v. E. I. DuPont De Nemours & Co., (1961) 351 U.S. 777, 791).

3. Horizontal Analyses

a. Traditional Market Analysis Approach

Under the traditional market analysis approach, the market power resulting from the merger of two competitors is usually measured in terms of concentration, or market shares. This is a statistical analysis using the Herfindahl-Herschman Index (HHI), which calculates the sum of the squares of each firms' market share. For example, in a 3-firm market in which the respective shares are 50%, 30%, and 20%, the HHI is calculated by adding .25 (i.e., 50% squared) plus .09, plus .04, for a total of .37, which by convention is multiplied by 10,000, yielding 3700.

USDOJ has indicated in its current version (1984) of the Merger Guidelines, which embodies its policy for reviewing proposed mergers, that a merger resulting in a market with an HHI exceeding 1800, to which the merger in question has contributed at least 50, will ordinarily be challenged as unlawful, as will a merger resulting in a market with an HHI between 1200 and 1800, to which the merger has contributed at least 100. The approach of the fifty state Attorneys General is somewhat more restrictive, accepting a merger adding only half as large an increment to the HHI in markets experiencing concentration over the preceding 3 years. (National Association of Attorneys General, Horizontal Merger Guidelines (1987) reprinted in 52 Antitrust and Trade Reg. Rep. (BNA) No. 1306 (Special Supp.), cited in Advisory Opinion, pp. 18-19.)

While HHI calculations may reach levels indicating very strong evidence of a Section 7 Clayton Act violation, even in the absence of high HHIs, other empirical factors may support a finding of violation. Market share or the level of concentration is only important in the absence of direct evidence of the power to control prices or exclude competition. (Advisory Opinion, p. 19.)[24]

b. Direct Evidence of Harm to Competition

There is also a second approach to the question of whether a merger is anti-competitive. This is the direct approach, where the power to exclude competition is proved directly by actual exclusion, thereby vitiating the need to draw any inference from traditional market share analysis (NCPA's OB, pp. 8-11). Where such direct evidence is presented, it is not necessary to prove any specific market share (citations omitted) (Advisory Opinion, p. 19). Several parties argue that this "direct" approach can be used in this case to examine whether the proposed merger will

---

[24] Applicants caution against over-reliance on concentration ratios, which provide only an analytical starting point. Applicants assert that it is relatively easy in the electric utility industry to calculate shares of generation or transmission capacity owned and controlled by suppliers in the relevant geographic markets because such data are often readily available. But market share values derived mechanically from aggregate figures for the capacity or utilization of generation and transmission assets of utilities in a particular region are likely to be meaningless for evaluating the competitive conditions in any of the product or geographic markets where the merging firms compete (Joskow, Exh. 22, p. 45). According to applicants, vertically integrated utilities are obligated to provide economical and reliable service to their native load customers resulting in commitments vis-a-vis their generation and transmission capacity. Consequently, only that portion of generation and transmission capacity excess to the needs of native load customers and not already dedicated to the bulk power market pursuant to long-term contracts, is available now (or will be available in the future) to compete to make bulk power sales.

Applicants also maintain that in a proper merger evaluation where high market shares or concentration ratios are calculated, the meaning and significance of those numbers can only be assessed after a number of structural and behavioral characteristics are taken into account. (Applicants' OB, p. VI-32.) For example, one might examine the impact of substitution possibilities on high market share or concentration ratios (Applicants' OB, p. VI-36). If high concentration ratios fall to low levels after the market has been expanded in this fashion, one might conclude that the concentration ratios for the narrower market were misleading. Second, high levels of concentration will not always indicate an ability to exercise market power when it is difficult for competitors effectively to coordinate their own output and pricing behavior--where transactions have characteristics in addition to price such as time-of-delivery, volume, delivery point, etc. (Joskow, Exh. 22, pp. 54-55.) Third, the characteristics of buyers in the market affect the ability of sellers to collude. Purchasers of electricity in bulk power markets tend to be unusually well informed about the costs that sellers incur to provide service. In most regions of the country where there are numerous potential suppliers, the threat of competition is therefore likely to constrain the exercise of seller market power over long-term bulk power supplies (Joskow, Exh. 22, pp. 57-58). Finally, the effects of price regulation can substantially limit the ability of a firm to restrict output or raise prices. It is applicants' position that structural and behavioral characteristics such as those noted above should be assessed and used to "test" the results of a traditional market analysis approach, so that undue reliance is not placed on "mechanical" HHI results.

maintain or enhance the merged entity's ability to exercise monopoly power, consistent with Utah Power & Light (1988) 45 F.E.R.C., ¶ 61,288, in which FERC found that UP&L's ability to use its essential transmission facilities to obtain monopoly profits through brokering "demonstrates its market power to extract monopoly profits." (NCPA's OB, p. 9.) These parties emphasize that the direct method is of great advantage in potentially diminishing reliance upon complex economic evidence and statistics, such as HHIs. Since the purpose of Section 7 is "to nip monopoly in the bud," (United States v. E. I. DuPont De Nemours & Co., supra, 351 U.S. pp. 592-93), Congress structured Section 7 to halt mergers that tend to lessen competition in their initial stages, long before they have attained the effects that would indicate violation of the Sherman Act (Brown Shoe Co., supra, 370 U.S. p. 318). Since exercise of monopoly power violates the Sherman Act, a merger's illegality can also be established by proof that there has been an actual exercise of monopoly power which would be even further exacerbated by the merger. Several parties maintain that they have submitted direct proof of the actual use of monopoly power via actual exercise of price control or exclusion of competitors.

c. Resolution

The parties have developed an evidentiary record using two tools for performing the necessary market analysis. The first is concentration ratios (HHIs) and the second is direct evidence. There is no disputing the premise that use of concentration ratios is a starting rather than an ending point in the analysis. As a necessary adjunct to the use of concentration ratios, we will review carefully the direct evidence presented by all parties on the question of whether the proposed merger will have impacts that result in any maintenance or enhancement of the ability to exercise market power.

4. Vertical Analysis

The traditional market analysis approach discussed above addresses only horizontal effects of a proposed merger: those resulting from consolidation of two firms' operations at a single level in the chain of markets from production to ultimate sale. Where firms are vertically integrated and conduct operations at several levels (such as applicants), a merger potentially presents an independent set of problems of foreclosure of competitors' access to suppliers or customers. These problems are assessed not by calculating market shares, but by realistically assessing the potential for market manipulation, resulting in disadvantage to competitors or consumers (Brown Shoe Co. supra, 370 U.S. pp. 328-31).

Vertical mergers present special problems when the merging parties control an essential or "bottleneck" resource which can be used to exclude competitors or otherwise gain advantage in other markets. In the electric utility industry, the transmission grid has often been found to be a bottleneck resource (e.g., Otter Tail Power Co. v. United States, (1973) 410 U.S. 366; Utah Power & Light, supra, 45 F.E.R.C. ¶ 61,095).

Applicants and other parties disagree on the question of whether the merger will cause anti-competitive vertical effects. This is a disagreement both about the methodology for assessing vertical impacts and about the impacts themselves.[25]

While applicants have rigorously criticized other parties' vertical analysis, they have provided no independent assessment of the merger's vertical impacts aside from acknowledging generally the existence of two problems raised by vertical mergers between a downstream buyer of inputs and an upstream input supplier (Applicants' OB, pp. VI-29 to VI-30). Furthermore, applicants' criticism itself is at odds with Brown Shoe Co., supra, which indicates that the assessment of vertical impacts requires an examination of just the sort of historical and economic factors other parties have reviewed (Brown Shoe Co., supra, 370 U.S. pp. 328-329). Thus

[25] For example, applicants assert that it is appropriate to take special heed of pro-competitive or efficiency enhancing effects in assessing the competitive impacts of vertical mergers (Applicants' OB, p. VI-152). Arguing that most vertical mergers are efficiency enhancing and competitively benign, applicants maintain the key antitrust concern with vertical mergers is not "foreclosure" but "the possibility that they may cause barriers to entry or increased concentration in an upstream input market" (Joskow, Exh. 51, p. 48).

To applicants, analysis of vertical impacts is no different from analysis of horizontal impacts, except that one looks at the effects of competition at each horizontal level at which the merging firms operate. Thus, at each horizontal level, one must assess the effects on competition through changes in seller concentration, entry barriers, and other characteristics of the market being analyzed (Joskow, Exh. 51, p. 121).

In contrast, other parties assert that vertical problems are not assessed by calculation of market shares but from a realistic assessment of the potential for market manipulation, to the disadvantage of competitors or consumers:

> Since the diminution of the vigor of competition which may stem from a vertical arrangement results primarily from a foreclosure of a share of the market otherwise open to competitors, an important consideration in determining whether the effect of a vertical arrangement "may be substantially to lessen competition, or to tend to create a monopoly" is the size of the share of the market foreclosed. However, this factor is seldom determinative...
>
> ...in cases ...in which the foreclosure is neither of monopoly nor de minimis proportions, the percentage of the market foreclosed by the vertical arrangement cannot itself be decisive. In such cases, it becomes necessary to undertake an examination of various economic and historical factors in order to determine whether the arrangement under review is of the type Congress sought to proscribe. (Brown Shoe Co., supra, 370 U.S. pp. 328-329.)

Applicants criticize opposing parties' positions as a failure to undertake "any reasoned market analysis." (Applicants' OB, VI-153.) Applicants state that the opposing parties did not properly define horizontal markets, did not identify the buyers and sellers in those markets, and did not consider market shares, concentration ratios, or examine other indicia of competition. Instead, they substituted jargon such as "foreclosure," "leveraging," and "increased market power" for a thoughtful analysis (Applicants' OB, p. VI-153).

applicants have failed to produce evidence in this area. However, we have reviewed the evidence submitted by other parties concerning the vertical impacts of this proposed acquisition as part of our overall § 854(b)(2) assessment, and have otherwise weighed this evidence in the balance.

5. Buyer Versus Seller Market Power

As part of the overall framework for analyzing competitive effects, it is important to note the distinction between the differing roles that a firm may play as both buyer and seller. The typical focus of an antitrust analysis is on the combining firms' ability to manipulate selling price--that is, to raise the price others must pay for the merged company's products. The parties in this proceeding have also focused on a second aspect: Does the merger give the resulting entity unfair power to control purchase prices by eliminating competition between the merging firms in the bidding for up-stream resources? This kind of power is technically referred to as "monopsony power" or "oligopsony power" as contrasted to "monopoly power" or "oligopoly power," although the terms "buyer market power" and "seller market power" are used more commonly by the parties.

D. The Proposed Merger will Have Adverse Impacts on Competition

We will review the proposed merger's competitive impacts first by defining the relevant markets where the merger partners compete. In this instance we define and review five wholesale transmission markets and four wholesale bulk power markets.

Thereafter, we will analyze the proposal's horizontal aspects. For each defined market we will review (i) evidence presented by various parties who performed statistical analyses using HHIs as a measure of market concentration, as well as (ii) other direct evidence bearing on each market's structure, history, and probable future.

Finally, we will assess the proposal's vertical aspects, by a review in each defined market of the merger's impacts on the merged entity's competitors at retail, including the Southern Cities and Vernon (Resale Cities). We will also analyze certain impacts related to the vertical integration of SDG&E with Edison's unregulated affiliates.

1. Impact of the Proposed Merger on Transmission

a. Do the Merger Partners Compete in Offering Transmission Service?

There is a basic difference of opinion between the applicants and other parties as to the impact of the proposed merger on transmission. As discussed previously, applicants posit that a crucial step in any competitive merger analysis is to determine whether two merging entities are actual or potential competitors. Applicants maintain that in order to establish whether transmission service could be affected by this merger, the Commission must determine (1) whether the transmission facilities in question actually reach common origin or destination points (thus making it possible for them to be used to supply competing transmission services to bulk power sellers in the origin area or to buyers in the destination area), and (2) whether transmission facility owners actually make competing transmission service available, or realistically could be expected to do so, despite their native load requirements (Pace, Exh. 50, p. 50). Applicants conclude the merger partners are not, and are unlikely to be, significant competing suppliers of transmission service.[26]

Thus, applicants argue that Edison and SDG&E are not competitors in any market to sell transmission service. Having concluded that the two merger partners do not compete, applicants conclude that the merger can have no competitive impact on any relevant transmission market.

Other parties disagree with applicants' conclusion that there is no competition between the merger partners (San Diego's OB, pp. 195-220), and with applicants' assessment that the

---

[26] Applicants maintain that Edison's and SDG&E's SW transmission facilities do not provide realistic alternatives to potential buyers of firm transmission service in California or elsewhere, because they terminate at different points. Applicants conclude that where transmission facilities do not reach a common destination market, the facilities are not substitutable and a merger that combines these facilities cannot raise seller market power issues (Pace, Exh. 21, pp. 16-18).

Even in those instances where Edison provides transmission north of SONGS, transmission over SWPL and through SONGS is not a significant competitive alternative to service over one of Edison's lines from the SW. Due to system constraints in normal operating conditions, only 261 MW can be scheduled by SDG&E north through Edison's service territory, and this limited capacity must accommodate SDG&E's California Power Pool (CPP) sales and its northbound Pacific Intertie entitlements (Gaebe, Exh. 19, p. 23). As a result, aside from limited and sporadic short-term firm and interruptible capability, applicants assert there is no long-term firm transmission capability available for sale to third parties north of SONGS. Also, both SDG&E and Edison use the bulk of their SW transmission entitlements to serve their native load, and lines so committed are not properly viewed as available in the competitive market (Pace, Exh. 21, pp. 11-12; Joskow, Exh. 22, pp. 46-47).

merger will have no competitive impact on transmission markets (DRA's OB, p. 250).[27]

We reject applicants' argument that they do not presently compete significantly in providing transmission service, and that the proposed merger will not impact competition in relevant transmission markets. The argument has two bases: (1) the transmission facilities in question do not reach common customers and/or common producers; and (2) native load requirements and technical system limitations constrain the amount of long-term transmission capacity available for sale (Pace, Exh. 50, p. 50; Pace, Exh. 21, pp. 11-12, 16-18; Gaebe, Exh. 19, p. 23; Joskow, Exh. 22, pp. 46-47).

The problem with applicants' argument is that Dr. Pace's "origin/destination market" analysis ignores the existence of competition between Edison and SDG&E in supplying interruptible and short-term firm transmission service, including wheeling and the transmission component of sales of delivered bulk power (San Diego's OB, pp. 195-220). The record indicates that SDG&E's aggressive marketing of interruptible and short-term firm transmission services has included sales as large as 500 MW to PG&E and 200 MW to the Pacific Northwest (PNW) (Owen, Exh. 20,800, FERC Exhs. 1070, ¶ 45,155). The trend of these sales is upward, except for 1989, the year following announcement of the merger proposal (San Diego's OB, p. 198).

Applicants' analysis also overlooks the significance of SDG&E's control over transmission capacity to the Southwest (SW) and at the point interconnecting Edison and PG&E service territories, as well as its future ability to provide transmission services using these facilities. DRA, for one, recommends taking a longer term view of such competitive potentialities (Noll, Exh. 10,210, p. II-3). PG&E indicates it is not unusual for SDG&E to broker amounts in excess of 261 MW to PG&E, notwithstanding north of SONGS constraints (PG&E's RB, p. 7). Furthermore, San Diego's expert testified that there is no reason to believe that PG&E's need for short-term firm transmission service (such as that provided by SDG&E at certain times north from its territory) will end.

There is also evidence that SDG&E's capacity may increase in the future, thus allowing it to become a bigger player as a supplier of short-term firm and interruptible transmission

---

[27] For example, countering the argument that the 261 MW limit removes SDG&E as a competitor for sales of transmission service, PG&E claims that SDG&E has engaged in brokered energy transactions to California in excess of the north of SONGS constraints, and that it is not unusual for SDG&E to broker amounts in excess of 261 MW to PG&E (Gray, Exh. 45,155; PG&E's RB, p. 7). DRA also chastises applicants for refusing to acknowledge either the significance of SDG&E's ownership and control of significant transmission capacity to the SW (and some capacity to the interconnection point between Edison and PG&E service territories), or SDG&E's sales of power over these facilities. These factors make SDG&E a potential competitor to Edison in providing transmission services, such as wheeling, in the future; in overlooking them, applicants overlook the impact that the proposed merger will have in eliminating SDG&E as an important potential competitor in providing such services. (Noll, Exh. 10,210, p. II-3; DRA's RB, pp. 149-151.)

service. For example, in 1996 SDG&E's commitment to wheel power between Comision Federal de Electricidad (CFE) and Edison will expire, potentially freeing up an additional 70 MW of firm capacity, which would also increase opportunities for nonfirm or short-term firm transactions. Moreover, if DPV2 and COTP are built, SDG&E will have the option of acquiring additional transmission capacity to and from the SW and PNW to serve these needs (Owen, Exh. 20,800, FERC Exh. 710, pp. 156-157; San Diego's OB, p. 208).

Applicants' focus on native load constraints obscures the fact that SDG&E controls substantial capacity during many hours of the year, which is excess to the needs of native load customers or long-term transmission needs. As San Diego notes, it is irrelevant for purposes of this competitive analysis that such transmission is not the mainstay or primary focus of SDG&E's utility business (Page, Exh. 58, pp. 10-11). It is only relevant that interruptible and short-term firm trading/transmission is a market in which SDG&E is an active supplier (San Diego OB, p. 205).

Based on the above, we conclude that SDG&E is an active participant in the market supplying interruptible and short-term firm transmission and its competitive role in that market vis-a-vis Edison is likely to expand in the future, absent the merger.

b. Defined Product/Geographic Markets

Applicants argue that transmission is not a separate product market, and that the only product that matters is delivered power, which combines capacity, energy, and its delivery (Pace, Exh. 21, pp. 14-29; Joskow, Exh. 22, pp. 27-43). However this position runs counter to the usual antitrust analysis of wholesale electricity markets.

The weight of the evidence supports a finding that transmission services are routinely offered for sale separately from power (Gilbert & Cox, Exh. 10,200, p. II-6; Taylor, Exh. 44,421, pp. 6-7). Treating transmission as a separate product market is consistent with longstanding court and administrative agency determinations (Otter Tail Power Co. v. United States (1973) 410 U.S. 366; Utah Power & Light (1988) 45 F.E.R.C. ¶ 61,095). Consistent with these established authorities, we have examined transmission as a separate product market that excludes local generation (cf. Owen, Exh. 20,800, FERC Exh. 710, pp. 119-121).

While intervenors have assessed many different geographic transmission markets, including service area markets and interregional transmission markets, they have all analyzed transmission between (1) California and the SW and (2) California and the PNW, as two separate geographic markets, due to the fact that there are very limited connections between the PNW and SW (Gilbert & Cox, Exh. 10,300, p. II-16). These two markets also have very different characteristics, which support viewing them separately. For example, the PNW offers different bulk power components, which are not available in the same quantities, at the same time, or at the same cost anywhere else in the WSCC bulk power market (Taylor, Exh. 44,400, p. 105). These unique PNW characteristics require that we view transmission between (1) California and the PNW and (2) California and the SW as separate geographic markets. We focus first on concentration ratios and relevant direct evidence of merger-related impacts in these two geographic markets.

Subsequently, we review the evidence presented vis-a-vis three other geographic markets: two interregional transmission markets (transmission between the PNW and SW; transmission to California from the PNW and SW combined) and the network transmission market. Thus, our review encompasses five specific transmission markets, and the proposed merger's impacts upon them.

c. Horizontal Analysis

(1) Transmission Between California and the SW

a) Concentration Levels in Transmission Between California and the SW

Set forth below are the HHI calculations presented by three intervenors relative to the proposed merger's impact on the transmission market between California and the SW:

TABLE I
HHI Calculations For Transmission: California/SW

Year	Party	Pre-Merger	Post-Merger	Change
1991	Attorney General (Exh. 30,000, p. 90, Table 1)	2300	2978	678
1989 - 2000	City of San Diego (Exh. 20,800, Sch. 6)	2778-3015	3464-3737	635-754
1991	Southern Cities (Exh. 44,400, p. 131)	3042	3476	434

Applicants' principal technical criticism leveled against the HHI calculations of intervenors is that they include committed capacity, thereby providing an unrealistic picture of the markets under review. San Diego responds that its failure to deduct committed capacity from total transmission entitlements does not undercut its basic analysis, due to the fact that the market share proportion of uncommitted capacity would be about the same for each firm in the market. San Diego's argument appears to be vindicated, in that Attorney General's expert

Marcus (in response to applicants' criticism) netted out the proportion of physically available capacity used to transmit firm resources, and calculated an HHI merger-related change of 678, well within the 635-734 range calculated by San Diego's expert, who did not make a similar adjustment.

However, the key fact is that all three intervenors (Attorney General, San Diego, and Southern Cities) have calculated merger-associated HHI changes which greatly exceed the threshold cited in the Merger Guidelines as evidence of concern that a particular acquisition will unlawfully increase concentration in a particular market. As noted previously, the calculated merger-related HHI changes are 678 (Attorney General), 635-754 (San Diego), and 434 (Southern Cities), based on post-merger HHIs of 2978, 3464-3737, and 3476, respectively. Under the Merger Guidelines, a merger resulting in a market with an HHI exceeding 1800, to which the merger has contributed at least 50, will ordinarily be challenged as unlawful. Thus, it is appropriate to review other direct evidence of the merged entity's ability to control the market for transmission between California and the SW, to ascertain whether this evidence supports the unfavorable indications demonstrated by intervenors' HHI calculations.

(b) Direct Evidence of the Power to Control Prices or Exclude Competition in Transmission Between California and the SW

The evidence presented primarily goes to the probable future of the transmission market between California and the SW. The evidence supports a finding that SDG&E has acted as "middleman" or "broker" in this transmission market, and that it has actually served a significant and growing role, which applicants' "average per megawatt hour over an entire year" analysis or similar MWh measurements do not duly recognize. Such measures minimize the significance of SDG&E's transactions, and we believe it is more valuable, for purposes of analyzing SDG&E's significance, to view the issue from the perspective of the purchasers in this market. (Attorney General's OB, p. 140; Applicant's RB, p. VI-8, Fn. 5.)[28]

Several intervenors have pointed to SDG&E's active present role (see generally, intervenor citations to Mays, Exh. 30,002), and to its likely future active involvement in this market. For example, they note that the 1996 termination of Edison's CFE contract will free 70 MW of SDG&E's firm transmission capacity for other uses in this transmission market (Southern Cities' OB, p. 107).

---

[28] For example, SDG&E has served 12% of M-S-R's entire 1989 requirements in this "middleman" capacity, a fact M-S-R considered important enough to highlight in its testimony (Harvego, Exh. 53,526, p. 10; Attorney General's OB, p. 140).

Therefore, we conclude that the direct evidence presented by intervenors is consistent with the unfavorable competitive inferences to be drawn from the HHI calculations.

(2) Transmission Between California and the PNW

a) Concentration Levels in Transmission Between California and the PNW

Set forth below are the HHI calculations presented by two intervenors relative to the proposed merger's impact on the transmission market between California and the PNW:

TABLE II
California/PNW

Year	Party	Pre-Merger	Post-Merger	Change
1989 - 2000	City of San Diego (Exh. 20,800, Sch. 1-4)	1819-2163	2034-2415	207-252
1991	Southern Cities (Exh. 44,400, p. 115)	3091	3290	199

The concentration ratios calculated by San Diego and Southern Cities result in merger-related increases in the HHI ranging from 199 (Southern Cities' Taylor) to 207-252 (San Diego's Owen). These figures are indicative of increased concentration in the market for transmission between the PNW and California, and exceed the threshold specified in the Merger Guidelines. Therefore, we analyze other direct evidence bearing on the structure, history, and probable future of this transmission market, in order to ascertain whether these statistical results are credible.

b) Direct Evidence of the Power to Control Prices or Exclude Competition in Transmission Between California and the PNW

We have previously rejected applicants' arguments that the merger partners do not compete in the short-term firm and interruptible transmission market, and need not address them again here. However, we now explicitly extend our review to assess direct evidence of the nature of the competition between the merger partners in the California/PNW short-term firm and interruptible transmission market.

As in the case of the California/SW transmission market, we reject the use of a MWh/hour benchmark for assessing the significance of SDG&E's activities as "middleman" in the California/PNW transmission market. As stated in previous sections of this decision, SDG&E has made significant sales to PG&E notwithstanding the north of SONGS constraints. Southern Cities notes that if SDG&E had been permitted to make these sales to Southern Cities (assuming no delivery point restrictions), its volume of sales to the Resale Cities would have increased tenfold.

Southern Cities have also noted the beneficial price restraining impacts of SDG&E's competitive presence. They cite the example of the Anaheim/Riverside replacement capacity experience, where SDG&E offered the cities a price significantly lower than the price Edison would be entitled to collect under the Integrated Operation Agreement (IOA), followed by Edison's offer of a price competitive with the lower figure. Applicants have provided no credible counter-evidence proving that Edison was prevented from charging these cities a $1.57 per kW/day ceiling price by anything other than SDG&E's more competitive alternative (Southern Cities' RB, p. 78).

The merger will result in the loss of SDG&E as a competitive alternative whose influence is growing. It will also end SDG&E's participation as an effective counterweight to Edison's participation in the transmission study groups that are critical to determining transmission line ratings, as discussed in more detail in the analysis of vertical impacts, infra. (Mays RT 5066-76; Attorney General OB, p. 142.)

Therefore, we conclude that the direct evidence presented by intervenors is consistent with the unfavorable competitive inferences to be drawn from the HHI calculations.

(3) Interregional Transmission Markets

a) Concentration Levels in Other Defined Interregional Transmission Markets

Set forth below are the market concentration calculations performed by intervenors and DRA in connection with the interregional market defined as "Transmission to California from the PNW and SW Combined."

TABLE III
Combined NW & SW to California or S. California

Year	Party	Pre-Merger	Post-Merger	Change
1989 - 2000	City of San Diego (Exh. 20,800, Sch.7)	2052-2282	2495-2792	446-509
1991	Southern Cities (Exh. 44,400, p. 138)	2905	3300	395
Time period unspecified	DRA (Exh. 10,200, p. III-18) (seller market power)	3020	4200	1180
1985, 1986, 1987	DRA (Alternative) (Exh. 10,201, pp. I-5 to I-7)	721-1038	910-1252	173-214

The concentration ratios calculated by San Diego, Southern Cities, and DRA for the "combined PNW and SW into California transmission market" indicate merger-related increases in the HHI ranging from 395 (Southern Cities) to 1180 (DRA). DRA's alternative calculations, adjusted to reflect elimination of barriers to transactions between SW and PNW, reveal much smaller increases (173 - 214) than those DRA calculated earlier, but those increases still exceed the threshold of concern identified in the Merger Guidelines. The calculations presented by San Diego for "transmission between the PNW and SW" are also within the range noted above (HHI increase: 540). All of these results, which are consistent with those derived in connection with two previously examined (and closely related) interregional transmission markets ("Transmission Between California and the SW" and "Transmission Between California and the PNW"), are evidence that the merger will increase concentration in these markets.

Therefore, we analyze other direct evidence bearing on the structure, history, and probable future of these other transmission markets, in order to test the credibility of these statistical results.

b) **Direct Evidence of the Power to Control Prices or Exclude Competition in Other Defined Interregional Transmission Markets**

The direct evidence of barriers to entry, presented by Southern Cities' expert Dr. Taylor as an adjunct to his HHI calculations, discloses that additional planned transmission projects are too speculative or too far in the future to diminish the merged company's market share in import transmission markets, or to meet the Merger Guidelines' two-year ease of entry standard. (Taylor, Exh. 44,400, pp. 118-121; 131, 135). If entry into a market is so easy that existing competitors could not succeed in raising prices for any significant period of time, USDOJ is unlikely to challenge mergers in that market. The more difficult entry into the market is, the more likely USDOJ is to challenge the merger. A two-year time period is generally used (Taylor, Exh. 44,405, pp. 27-28; Merger Guidelines, § 3.3).

Furthermore, disappearance of SDG&E as a separate entity may increase the merged company's market share in transmission between California and the PNW. The testimony of applicants' witness Hertel also underscores the merged company's control of the few remaining transmission corridors available for construction of high voltage transmission paths into Southern California. This evidence, discussed in more detail in our review of vertical impacts, infra, shows the merged utility's present and future control of transmission in the markets under review. Furthermore, this evidence is probative in the analysis of all four import transmission markets we have assessed, not just the two considered in our analysis of "Other Defined Interregional Transmission Markets."

Based upon loss of SDG&E as a competitive alternative to Edison in the markets for (1) transmission to California from the PNW and SW combined, and (2) transmission between the PNW and SW, and the evidence of substantial existing barriers to entry, we conclude that the direct evidence is consistent with the unfavorable results of the market share analyses.

(4) The Network Transmission Market

San Diego has defined a market called "transmission across Edison's territory." SDG&E currently has transmission rights across Edison's territory in connection with its Pacific Intertie entitlements and its CPP participation. In the absence of a merger, these entitlements might constrain the exercise of market power over transmission across the Edison territory (Owen, Exh. 20,800, p. 176, FERC Exh. 710).

Southern Cities' Dr. Taylor has also defined a network transmission market, or service area network transmission market, consisting of Edison's and SDG&E's combined service area network transmission facilities (Taylor, Exh. 44,400, pp. 87-88). Dr. Taylor testified that the merged company would have the power in this market to foreclose Resale Cities from purchasing bulk power from any seller other than itself. It would have the ability to deny service area transmission altogether or to discriminate against Resale Cities and charge them higher prices than it charges other utilities with whom it does not compete at retail.

No concentration ratios have been calculated for the defined network transmission markets. However, even applicants' expert acknowledged that the service area transmission network constitutes a natural monopoly (Joskow, Exh. 716, FERC TR 7512-7513, FERC TR 7212, 7274), and as a practical matter, barriers to entry in the service area transmission market are insurmountable (Taylor, Exh. 44,400, pp. 88-89).

We reject applicants' argument that the proposed merger does not alter the structure of Edison's service area transmission network.[29]

Notwithstanding the historical figures for the post-1987 sales by SDG&E to Anaheim and Riverside, the reasons why post-1987 sales were not higher have not been addressed by the parties. In the absence of evidence on this point, we decline to make the inference applicants suggest, because to do so would be flatly inconsistent with other evidence of record indicating that the Resale Cities wish to greatly expand their purchases from SDG&E. The Resale Cities believe they would increase such purchases, absent present delivery point restrictions, because they could effectively compete with other prospective purchasers, such as PG&E, in view of the limits on SDG&E's mark-up on its CPP sales to PG&E (Southern Cities' RB, p. 79, fn. 26).

Therefore, we conclude that the proposed merger, which will result in the elimination of Anaheim and Riverside's independent firm transmission path to SDG&E, will prevent Resale Cities from developing a more extensive buyer/seller relationship with SDG&E; therefore it will have adverse competitive impacts on these cities.

d. Vertical Analysis

(1) Transmission Access Issues

Analysis of the transmission access policies of the merger partners, most particularly Edison, is crucial to assessing the vertical impacts of the proposed acquisition. Analyzing these policies is one way of assessing the merger's impact on buyers and sellers who will compete with the merged entity in the relevant transmission markets. The evidence presented by the parties in this proceeding spans past, present, and future events. Reviewing the relevant transmission access policies from these perspectives in time allows us to ascertain whether they shed light on the proposed merger's impacts.

---

[29] In this regard, applicants deny that elimination of Anaheim's and Riverside's firm transmission path to SDG&E at SONGS is an adverse impact of the merger. They assert that SDG&E has sold only de minimis amounts of transmission service to Anaheim at SONGS since 1987. Thus, applicants implicitly disparage the claim that the Resale Cities are adversely affected by the lack of delivery points within Edison's service territory, because the only two cities who do have an available firm transmission path to SDG&E have not used it heavily since 1987 (Applicants' RB, p. VI-38 to VI-39).

a) Do Historical Events Shed Light on the Proposed Merger's Impacts?

The disputes between Edison and the Resale Cities are long-standing in nature. Our task is not to decide, as characterized by parties, whether Edison is a "recidivist antitrust violator" or whether the Resale Cities are "greedy opportunists" in their attempts to minimize costs to their electric utility customers. Such debates can easily distract us from assessing the proposed merger's impacts.

The essential question is whether historical disputes between Edison and the Resale Cities can tell us anything about the vertical impacts of this merger. The then Attorney General and other intervenors argue that the historical track record is relevant because Edison will be the surviving firm if the merger is approved, and it can be expected to continue its past transmission access practices as the stronger merged company (Attorney General's RB, p. 70). If this is correct, it would be unwise to ignore such evidence.

However, applicants argue that this Commission is limited to a prospective analysis (SCM Corp. v. Xerox Corp. (2d Cir. 645 F. 2d 1195, 1210, cert. denied (1982) 455 U.S. 1016) (Applicants' RB, pp. VI-31 to VI-32). According to SCM Corp., "Section 7 principally was designed to curtail the anti-competitive consequences of corporate acquisitions in their 'incipiency.' Brown Shoe Co. v. United States, 370 U.S. 294, 317, 82 S.Ct. 1502, 1519, 8 L.Ed. 2d. 510 (1962). Thus, the analysis ordinarily employed in determining the lawfulness of a corporate acquisition under § 7 is prospective in nature." (Id. p. 1210.)

We find nothing in SCM Corp. however, that would preclude the exercise of our discretion under § 854(b)(2) to assess any and all evidence, including historical evidence, relevant to the post-merger transmission markets. All the SCM Corp. opinion states is that the analysis ordinarily employed is prospective; it does not specify a hard and fast rule in that regard. Furthermore, SCM Corp.'s language is keyed to a § 7 Clayton Act analysis, and we have determined previously that our review of the proposed merger under § 854(b)(2) may be guided by the authorities underlying a § 7 Clayton Act analysis, but is not so restricted. In conclusion, we exercise our discretion to review the competitive impacts of the proposed merger, and we are not restricted by SCM Corp. to a prospective analysis. Thus, we may consider historical events, as they shed light on the likely post-merger environment, including transmission access policies.

b) The Vernon Judgment

Closely related to these issues is applicants' Motion for Official Notice of Certain Documents, including the "Judgment and Findings of Fact and Conclusions of Law in Support of Order Granting Edison's Motion for Summary Judgment on Plaintiff's Foreclosure Claim" in

City of Vernon v. Southern California Edison Co., Case No. CV 83-8137 MRD, before the United States District Court, Central District of California (the "Vernon Judgment").[30]

On October 2, 1990, Vernon filed a formal answer to applicants' motion, stating there is no dispute that the Vernon Judgment is a ruling citable by the parties in this docket, but as Vernon argued in its brief, the judgment has no probative value in determining the issues before this Commission. Vernon has moved for reconsideration of the District Court Judge's rulings, largely on the basis of materials developed in this docket which were not before the District Court Judge when she made her decision (Vernon Answer, p. 2). For these reasons, Vernon does not object to the Commission taking official notice of the Vernon Judgment just as it may examine any citable District Court or agency order. However, Vernon argues the Vernon Judgment is entitled to no weight on the merits of the issues before this Commission.[31]

Applicants' motion for official notice of the Vernon Judgment is granted. However, the weight to which the Vernon Judgment is entitled in this docket is a matter within the Commission's discretion. Vernon is correct that the record developed in this proceeding is the one upon which this Commission will rely in deciding the facts at issue. Even applicants confine their characterization of the similarity between the record developed here and the record of the District Court to the following description: "After hearing most of the same complaints about Edison's past conduct that Vernon raised in this proceeding, the Court granted summary judgment in favor of Edison on all of Vernon's damage claims in the action, ***" (Applicants' RB, p. VI-34) (emphasis added). This underscores the point made by Vernon, that we must carefully confine our review to the evidence developed here, because the nature and extent of the two records differ, and the issues and parties before this Commission are not identical to those in Case No. CV 83-8137 MRD.[32]

---

[30] Applicants filed this motion on September 24, 1990, asserting that Evidence Code § 452(d) provides that judicial notice may be taken of the "[r]ecords of (1) any Court of this State or (2) any Court of Record of the United States or of any State of the United States." Applicants argue the Commission may take official notice of the Vernon Judgment because it is part of the record of the United States District Court for the Central District of California in Case CV 83-8137 MRP, and is relevant to antitrust concerns at issue in this proceeding, arising from Vernon's access to Edison's transmission lines and non-Edison sources of power. Applicants' request for official notice is keyed to the arguments made in their Reply Brief, pp. VI-34 to VI-36, and VI-79. (Motion, p. 5.)

[31] Applicants formally replied to Vernon, citing arguments made in their reply brief at VI-34 to VI-36. Furthermore, applicants argue that Vernon's suggestion that its motion for reconsideration of the judgment diminishes the force of the Vernon Judgment is wrong as a matter of law (Fed. Rule Civ. Proc. 60(b)).

[32] For example, Edison cites the Vernon Judgment for the proposition "[t]hat Edison's practice of placing its customers' needs ahead of the needs of others—including the Resale Cities—is not anticompetitive ***." (Applicants' RB, p. VI-34.) Of course the issue is not whether Edison's asserted practice of placing its customers' needs ahead of the Resale Cities' needs is anti-competitive. The issue is whether Edison has avoided making existing amounts of transmission capacity in excess of native load needs available to competing buyers and sellers on a pro- (continued...)

Applicants have not asserted the District Court findings have res judicata effect in this docket. Since there is no identity of parties and issues, any such assertion would fail in any event.

c) Historical Examples

We now review the historical examples addressed by the parties.[33]

First, the evidence of Edison's abuse of Interruptible Transmission Service (ITS) curtailment, provided by Edison's former Energy Control Center Senior Operations Supervisor McCann, is not rebutted effectively by applicants. Applicants' argument, that Resale Cities benefit as Edison customers whenever Edison curtails in order to take cost-effective firm or economy energy, misses the point. Even if true, this justification ignores the economic harm to Resale Cities, as retail competitors of Edison, caused by the abuse of ITS curtailment procedures (McCann, Exh. 44,100, pp. 24-30). It is precisely this type of competitive harm, rooted in the competition between Edison and the Resale Cities to obtain least cost resources to meet their retail customers' needs, which must be assessed in the review of this merger's vertical impacts.

In the "Riverside Energy Issue,"[34] Edison allowed occurrence of a situation which precluded effectively Riverside's sales of excess energy to Azusa, Banning, and Colton, merely because the excess imports could not be accommodated under applicable Edison rate schedules (Kendall, Exh. 54, p. 36). Since no contractual arrangements existed to deal with this excess capacity, Edison in effect took the energy for free (Greenwalt, Exh. 44,200, pp. 18-19). Yet, parties who were in equal bargaining positions would have quickly resolved this contractual impediment so that Riverside could be paid for the energy it brought into the system which unquestionably benefitted the entire system to some extent (Vernon's RB, p. 21).

In connection with the refusal to provide SDG&E with additional delivery points, we express no judgment as to whether Edison's actions were justified by system constraints, but

---

32(...continued) competitive basis.

Edison also argues in its Reply Brief (p. VI-35) that the District Court found that it has "provided Vernon with significant transmission service...for outside resources, and as a result...[m]ost of Vernon's power needs are being met by outside resources 'wheeled' to Vernon by Edison." (Findings of Fact, pp. 27-28). The record developed in A.88-12-035 may or may not support such a finding, but this Commission is not precluded from independently reviewing the evidence before it to reach its own determination on this issue.

33 These are more completely described in the Proposed Decision, pp. 713-725.

34 See the Proposed Decision (pp. 715-717).

note that this refusal has effectively constrained SDG&E from engaging in wholesale power transactions with the municipal utilities (Russell, Exh. 40,000, p. 57).

In connection with claimed line-loading problems which arguably prevented Nevada Power from selling power to Vernon (Attorney General's Opinion, p. 30), the effect of Edison's actions was to shift a portion of the loop flow burden to NPC while also precluding Vernon's purchase from NPC.

Edison's refusal to permit Anaheim to integrate Cholla as a capacity resource for approximately five years was disadvantageous to Anaheim, although the withdrawal of the APS offer mooted this dispute (Advisory Opinion, p. 30; PD, pp. 720-721).

In connection with Edison's refusal to schedule nonfirm transmission more than an hour in advance, it appears that Edison has the ability to supply nonfirm transmission to the Resale Cities on a prescheduled basis and that there is no operational impediment in issue. Edison would retain the ability to interrupt prescheduled ITS to the same extent and on the same terms as interruptible transmission provided on an hour-by-hour basis. The problem is a refusal to provide for prescheduling by contract or otherwise. Without the ability to preschedule, the Resale Cities cannot compete meaningfully with Edison for nonfirm purchases.

Edison's refusal to respond, between 1985 and 1989, to AEPCO's request that Edison provide AEPCO with transmission service exceeding 10 MW to its customer, the Anza Electric Cooperative, is uncontroverted.

The real question is whether Edison has merely played "hard ball" with the Resale Cities in the interests of its native load customers, or whether at times it has crossed this line and has used its transmission dominance to undercut the cities' efforts to lower costs to their retail customers. Based on the historical evidence, it is reasonable to conclude the latter. In sum, these historical examples demonstrate that Edison has used its strategic control over transmission to the competitive disadvantage of other utilities, who are buyers and sellers in the relevant interregional transmission markets and in the network transmission market. The then Attorney General is correct that it is reasonable to infer that the merged utility, dominated by Edison, will continue Edison's past transmission access policies, unless effective mitigation measures are imposed.

d) Southern Cities' Equitable Argument

There is one additional historical issue to be addressed. This is an equitable argument raised by Southern Cities, who have shouldered a proportionate share of the Pacific Intertie costs, as well as the costs of Edison's transmission facilities in general, through their wholesale and fully-allocated transmission rates (Taylor, Exh. 44,400, pp. 102-103). Applicants have not disputed the fact that Southern Cities have borne a proportionate share of these costs. The evidence on this historical point is uncontroverted.

e) Does the Present Shed Light on Merger Impacts?

First we examine the Resale Cities' present situation. Applicants' assertion that the Resale Cities have the "best of both worlds" due to their unique part-customer/part-fellow utility relationship with Edison, is disputed by the Resale Cities. Applicants have asserted that Resale Cities met 87% of total peak load with non-Edison resources using firm transmission entitlements (based on a combination of in-state and out-of-state). Resale Cities note correctly this "87% of peak load" figure is misleading because Edison provides the Resale Cities' import transmission equal to only about 12% of their peak load, and only a small percentage of total import transmission from the PNW and the SW, despite the fact that Resale Cities helped to build the Pacific Intertie.

Furthermore, while it appears the New Business Relationship (NBR) embodied in the 1990 IOAs (Kendall Exh. 54, pp. 20-21) is an improvement over the previous situation, it still falls short in some crucial areas. For example, the IOAs provide Resale Cities no assurance that Edison will provide the service area transmission or import transmission required to effect integration. The 1990 IOAs will not prevent Edison from overcharging for replacement capacity (Southern Cities' OB, p. 152). We conclude from the above that the 1990 IOAs are not a panacea for past problems, and that some fundamental transmission access problems between Edison and Resale Cities remain unresolved.

A second issue bearing upon present circumstances is the already heavily concentrated state of transmission markets, as noted by DRA and the then Attorney General. The latter's expert testified that the majority of available capacity from the SW during 1993 to 2000 is controlled by Edison. He asserts that this control, combined with Edison's transmission access policies, has effectively forced other utilities to attempt to build new transmission lines not otherwise needed. The testimony that Edison engineered the LADWP swap to remove LADWP as a participant in the Mead-Adelanto project, in order to prevent or hamper construction of that line (Mays, RT 5126-30), is undisputed. This is also disturbing because Mead-Adelanto is one of the planned lines upon which Edison relies in countering adverse testimony concerning its transmission access policies.

Another vertical impact of the merger is PG&E's loss of certain advantageous SW energy transactions. PG&E asserts that under § 854 (c)(2), the Commission must review and consider adverse impacts on all California ratepayers, not just the merger partner's ratepayers, and that the loss in question would have adverse economic impacts on PG&E ratepayers.

We agree with PG&E's legal argument. The statute refers to the maintenance or improvement of "the quality of service to public utility ratepayers in the state." Therefore, the literal terms of the statute require us to take an expansive view, and consider the proposed merger's impacts on California ratepayers as a whole, as we assess the overall public interest under § 854(c).

Moving from that determination to the practical issues before us, it is undisputed in this record that the merger will impact adversely transactions between PG&E and SW energy suppliers. Using its essentially independent path from the SW to PG&E under the provisions of the CPP, SDG&E has brokered power across Edison's system to PG&E in offpeak hours at a contractually fixed 2-mill markup. This competitive alternative will be lost due to the merger. The loss is not confined to offpeak hours, since sales have also occured in shoulder hours and some onpeak hours. The weight of the evidence supports a finding that SDG&E has afforded unique opportunities to PG&E, which will be lost if the merger is approved, to the economic detriment of PG&E's ratepayers.[35]

Another present vertical impact is the loss of SDG&E's participation in transmission study groups. It is undisputed that SDG&E represents a significant counterweight to Edison's dominance of these planning groups, and that the groups themselves play a crucial role in rating the capacity of existing and new transmission lines. Such ratings are fundamental to assessing available transmission capacity, and are thus a key underpinning of statewide transmission access policies. With the merger, SDG&E will be eliminated from these transmission planning groups, leaving the merged utility in a totally dominant situation. The record shows this may have adverse impacts for the future competitive development of the transmission markets under review (Mays, RT 5074).

f) Does the Future Shed Light on Merger Impacts?

The then Attorney General notes that there does not exist today a complete long-term transmission path between SDG&E and any of the utilities Edison encircles, and that applicants are correct that this represents a substantial defense. However, this defense ignores the realities of the current market and the potential for a more open market in the future. It would be erroneous to assess the merger's impacts under § 854(b)(2) solely on the basis of the existing configuration of the relevant transmission grids. Such an assessment would be inconsistent with the determination we have made throughout this decision concerning SDG&E's potential competitive significance. We recognize that the transmission system is dynamic, and the

[35] While applicants have proposed some mitigation measures, their effectiveness is in dispute.

potential for expansion cannot be disregarded. To the extent the merger forecloses such possibilities, it will impair competition by constraining the competitive roles of other utilities.

These transmission markets should be examined as if no improper contractual limitations were in place. Vernon is correct that such limitations should not be used as a shield by the merged utility to resist the imposition of pro-competitive transmission access policies or conditions. Indeed, applicants acknowledge the need for such pro-competitive policies in their affirmative showing, via undertakings in their transmission service commitments and in connection with construction of Incremental Facility Additions (IFAs).

Finally, as we look to the future, it is apparent that new transmission lines currently under study will not remove existing constraints. Many of these lines will not be constructed in sufficient time (1992) to meet the ease of entry criteria set forth in the Merger Guidelines. Edison is making no effort to construct DPV2 prior to 1997, and several other lines are either on hold or in the study phase (Mead-Phoenix, Mead-Adelanto, and Utah-Nevada). In the case of the latter lines, LADWP's role is crucial to the participation of the Resale Cities and LADWP's absence may adversely affect the viability of these projects from the Resale Cities perspective. Even assuming the COTP project is completed on schedule, the evidence indicates it may not be a good substitute for the Pacific Intertie with its depreciated original cost, and transmission dependent utilities argue they will not benefit from the COTP project unless access from Tesla to Edison's network is specifically ensured (Koehn, Exh. 40,300, p. 56).

g) In Summary

Our review of the record developed on past, present, and future events bearing upon the vertical impacts of the proposed merger indicates that the proposed merger will adversely impact competition between the merged utility and the Resale Cities in the defined transmission markets, and will have adverse impacts on PG&E's California ratepayers as well.

(2) Essential Facility Doctrine

The essential facility doctrine, or "bottleneck principle," states that where facilities cannot practicably be duplicated by would-be competitors, those in possession of them must allow them to be shared on fair terms (See, L. A. Sullivan, Antitrust 131 (1977)). Foreclosure of a scarce resource is an illegal restraint of trade, a principle of antitrust law derived from United States v. Terminal R. R. Ass'n (1912) 224 U.S. 383, 409, as reaffirmed in Otter Tail Power Co. v. United States (1973) 410 U.S. 366, 377-78.

The four elements necessary to establish liability under the essential facility doctrine are: (1) control of the essential facility by a monopolist; (2) a competitor's inability practically or reasonably to duplicate the essential facility; (3) the denial of the use of the facility to a competitor; and (4) the feasibility of providing the facility (Hecht v. Pro-Football, Inc. (D.C. Cir. 1977) 570 F.2d. 982, 992-93, cert. denied, (1978) 436 U.S. 956; Otter Tail Power Co., supra, 410 U.S. 366; MCI Communications v. American Tel. & Tel. Co. (7th Cir. 1983) 708 F.2d. 1081, 1132-1133).[36]

There is a great debate over the applicability of this doctrine to our review of the proposed merger.[37] We resolve the debate by limiting our use of the doctrine. We use it only to test the results of our earlier vertical analysis, and not as an independent justification for disapproving the proposed merger. Using the essential facility doctrine as an adjunct to other evidence of record is the most constructive approach, and is consistent with our prior determination of the extent of our discretion to assess the proposed merger competitive impacts under § 854 (b) (2).

We now focus on the four elements of the doctrine, not to determine whether each element is satisfied, but to determine whether the evidence submitted in connection with each element is consistent with our existing findings on the proposed merger's vertical impacts.

The parties have not placed in issue Element No. 1, the merged utility's control of an essential facility, and this fact is consistent with our previous findings.

---

[36] In applying his 4-part framework for market analysis pursuant to the Merger Guidelines, and as an adjunct to his analysis, Southern Cities' Dr. Taylor considered whether any relevent markets are essential facilities. He determined that the 3 relevant transmission markets (service area and 2 import markets) qualify. (Taylor, Exh. 44,400, pp.39-40, 89, 102; Southern Cities' RB, p. 105.)

Vernon also used the essential facility doctrine consonant with its belief that the Commission should consider monopolization precedents under Section 2 of the Sherman Act. Vernon has presented this analysis in the context of its discussion of transmission access issues, which are a part of the vertical analysis of the merger.

[37] Southern Cities and Vernon have used the essential facility doctrine in different ways. Southern Cities'expert used the doctrine as an adjunct to his market concentration analysis. Vernon, with its focus on § 2 Sherman Act monopolization issues, used the doctrine to support its assertion that control of an essential facility is dispositive of the issue of market power (Vernon's OB, p. 140). Therefore, if we were to find that all of the elements of the essential facility doctrine were met in this instance, under Vernon's interpretation, we could not approve the merger. On the other hand, applicants argue that the doctrine is inapplicable here, because it has not been used in § 7 Clayton Act proceedings. In the alternative, they argue the doctrine is not helpful to a determination of whether the merger will create market power.

Of the three positions outlined above, we find Southern Cities' approach the most reasonable. As determined previously, neither § 2 of the Sherman Act (upon which Vernon relies) nor § 7 of the Clayton Act (upon which applicants rely) is dispositive of our analysis under § 854 (b)(2).

Element No. 2, the inability to practically or reasonably duplicate an essential facility, is in issue. First, there is a dispute over what the duplication standard is. In the case of Pacific Intertie, this is whether the inability to duplicate the intertie at a cost comparable to depreciated original cost, constitutes the inability to duplicate. We agree with PG&E's argument that if duplication is economically feasible (an issue of fact), a facility does not fall within the essential facility doctrine. The difficulty is over what constitutes "economic feasibility." We do not have a sufficient evidentiary record to determine whether or not duplication of the Pacific Intertie is economically feasible. The task is easier, however, when assessing lines to the SW, given the geographic impediments associated with the Cajon and San Gorgonio Passes. Likewise, physical constraints noted by intervenors in connection with the L.A. Basin and service area facilities support the notion that these lines are non-duplicable. Therefore, we conclude that the evidence submitted in connection with Element No. 2 is consistent with our previous finding that the proposed merger will adversely affect competition between applicants and Resale Cities in the network transmission market defined by Dr. Taylor. Furthermore, we conclude that the evidence submitted in connection with Element No. 2 is consistent with our findings that the proposed merger will have adverse impacts on competition between the merged utility and the Resale Cities in the defined California/SW transmission market. We are unable to make a similar finding of consistency in connection with our previous determination regarding the proposed merger's effects on the defined California/PNW transmission market.

Element No. 3, the denial of access, is consistent with our previous findings that the proposed merger will have adverse impacts on competition between the merged utility and the Resale Cities due to the latter's limited access to import transmission facilities in the defined transmission markets. (Taylor, Exh. 44,112; Owen, Exh. 20,800; FERC Exh. 749, pp. 14-15).

Element No. 4, feasibility of access, raises issues discussed previously in connection with native load customer demands. We do not contemplate a requirement that applicants share an essential facility if such sharing would be infeasible or otherwise would inhibit their ability to serve customers adequately. It is true that pro-competitive access to transmission lines must be tempered by native load requirements. However, the record is undisputed that, notwithstanding the demands and needs of native load customers and the obligation to serve, the merger partners have historically provided transmission access to others for purposes not related to native load needs. Network facilities are built to serve Edison's entire service area load, including the load of the Resale Cities. And, import transmission lines are built with a view to the needs of total load area requirements, including those of the Resale Cities. These determinations are consistent with previous findings on the merger's competitive impacts in the defined transmission markets.

In summary, we conclude that the record evidence is consistent with Elements 1, 3, and 4, and partially consistent with Element 2. However, we do not go beyond this determination of consistency, to make explicit findings that the transmission facilities in question are essential, as that doctrine is applied in § 2 Sherman Act proceedings. We have merely used the essential facility doctrine as a framework to test determinations made in prior sections of this decision on transmission-related issues.

(3) Other Vertical Impacts

Non-horizontal mergers may be used by monopoly public utilities subject to rate regulation as a tool for circumventing that regulation (Section 4.23 of the Merger Guidelines (Taylor, Exh. 44,405, pp. 49-50)). The clearest example is the acquisition by a regulated utility of a supplier of its fixed or variable inputs. Post merger, the utility would be selling to itself, and it might be able to inflate arbitrarily the prices of internal transactions. Regulators may have great difficulty policing these practices, particularly if there is no independent market for the product (or service) purchased from the affiliate. Several parties have addressed the so-called "evasion of regulation" issue as a vertical impact of the merger, especially in the area of affiliate transactions.[38] These issues are discussed in greater detail in the portion of this decision which analyzes affiliate issues.

e. Summary of the Merger's Horizontal/Vertical Impacts on Transmission Markets

In our review of the proposed merger's competitive impacts on wholesale transmission markets, we have treated transmission and bulk power as separate markets. We have also determined that Edison and SDG&E compete in providing transmission service, and that SDG&E has assumed a growing role in the defined interruptible and short-term firm transmission markets.

We have identified five transmission markets: transmission between California and the SW; transmission between California and the PNW; transmission between the PNW and the SW; transmission to California from the PNW and SW combined; and network transmission.

In the horizontal analysis of the merger, we have determined that each of these five transmission markets will become more concentrated due to the merger, and that this is an adverse competitive impact.

In the vertical analysis of the merger, we have determined that the merger will have adverse impacts on competition between the merged utility and the Resale Cities in the defined transmission markets, and that it will have adverse economic impacts on PG&E's ratepayers as well (§ 854(c)(2)).

---

[38] For example, San Diego has presented an analysis rooted in the "evasion of regulation" theory, tied to recent amendments to § 854 which requires the Commission to consider possible adverse impacts on its ability to regulate § 854(c)(7), as part of its overall public interest review of the proposed merger.

2. Impact of the Proposed Merger on Bulk Power Markets

a. Defined Product/Geographic Markets

There is a basic disagreement between applicants and the other parties concerning the interrelationship of bulk power markets and transmission, as reflected in their market definitions. Applicants' approach focuses on delivered bulk power. Applicants identify the Western Systems Coordinating Council (WSCC) (which covers the Western United States, portions of British Columbia and Alberta, and Baja, as shown in Kent, Exh. 90) as the relevant geographic area because they believe, especially in the category of short-term firm or economy energy purchases, that virtually all utilities within that area transact business with each other (Kent, Exh. 23, pp. 43-44; Fogarty, Exh. 18, p. 11). Thus, applicants' approach contemplates no transmission barriers to such transactions. In contrast, other parties note that transmission is crucial, since without it bulk power cannot be delivered.

Recognizing the impact of the transmission access problems described previously in this decision, we separate the SW and PNW regions and treat them as separate submarkets. It is undisputed that the costs of transporting electricity from the PNW to Southern California and from the SW to Southern California differ greatly (Gilbert & Cox, Exh. 10,200, p. II-15). And there is limited capacity to transmit electricity between the two regions except through Southern California (Id., p. III-14, Table III.4). We also recognize the fact that firm energy and economy energy have very different characteristics. Firm energy is usually costlier to supply than economy energy because it involves a commitment to provide capacity over an extended time period. It also has greater supply reliability. Economy energy, in contrast, has more pricing latitude. Its lower bound is determined by the seller's incremental generation cost, and its upper bound is determined by the buyer's opportunity cost of other supplies. In 1985 and 1988, the average price paid for firm energy exceeded the average price for economy energy in both the SW and PNW regions.

Based on these factors, for purposes of reviewing the impacts of this merger on bulk power markets, we adopt DRA's approach[39] and focus on four bulk power markets: PNW firm

---

[39] DRA's approach is closely related to that of the then Attorney General. The Southern Cities and Vernon assert that the relevant markets are the WSCC bulk power market and the merged company control area bulk power market, and that as a result of the merger, the former market will shrink to the latter. These cities are in a unique position as both Edison's wholesale customers and its retail competitors. They have focused on transmission access which is necessary and crucial to their acquisition of the various components of bulk power throughout the WSCC region. Thus, their arguments address the interrelatedness of transmission and bulk power. Resale Cities' views on the merger's impact on transmission access have been thoroughly discussed, supra. Their merger-related bulk power analysis is discussed separately from that of other parties who have addressed the issue of buyer market power in the SW and PNW, and is addressed more fully in our assessment of the proposed merger's vertical (continued...)

power, SW firm power, PNW economy transactions, and SW economy transactions. This is consistent with our treatment of transmission access issues, supra, and recognizes the impact of transmission access problems in furthering the physical separation of the bulk power markets under review.

b. Horizontal Analysis

(1) Concentration Levels and Other Evidence Regarding the PNW and SW Firm Bulk Power Markets

It is apparent that the proposed merger will not have adverse competitive impacts of either a seller market power or buyer market power nature on the PNW firm bulk power markets.[40]

We also conclude that this merger creates no seller market power concerns in the SW firm bulk power markets.[41]

Controversy exists over the question of buyer market power in SW firm bulk power markets. DRA's concentration ratios in that area exceed the threshold specified in the Merger Guidelines by significant amounts in 1985, 1987, and 1988 (the increase in the index is 569 for 1985, 518 for 1987, and 1014 for 1988, as shown in Exhibit 10,200, Table II-14), causing DRA to express "moderate concern". Unlike the then Attorney General, who believes DRA has

---

39(...continued)

impacts. The unique relationship between applicants and the Resale Cities raises classic issues of the merged entity's ability to foreclose its competitors from access to bulk power markets.

40 DRA's concentration ratios on seller market power in this market show no increase in the HHI index in the years examined (1985, 1987, and 1988) (Gilbert & Cox, Exh. 10,200, Table II-20). This result is corroborated by applicants' direct evidence that SDG&E and Edison do not compete in the sale of long- or medium-term power (Pace, Exh. 21, p. 75). DRA's market concentration ratios on buyer market power indicate increases in the HHI index for 1985, 1987, and 1988 well below the threshold contained in the Merger Guidelines (Gilbert & Cox, Exh. 10,200, Table II-18). Applicants have presented direct evidence corroborating these results. They indicate that there is no competition between the merger partners as buyers in the PNW long-term bulk power markets; that Edison will not be in the market for new long-term bulk power supplies for several years; that there will be many other competing buyers in this market late in the decade; and that the supply of new generating capacity is likely to be quite elastic, with nonutility suppliers furnishing a significant portion of new capacity requirements.

41 DRA's concentration ratios show an increase in the HHI index well within the Merger Guidelines' threshold for 1985, 1987, and 1988 (Gilbert & Cox, Exh. 10,200, Table II-16), and these results are consistent with applicants' direct testimony (Pace, Exh. 21, p. 74).

dismissed these concerns too lightly, DRA believes the results are tempered by the high elasticity of firm supply in this market (PD, p. 786). Such elasticity effectively means that changes in price do affect the amount of energy available for sale in these markets. As a result, sellers would be in a position to protect themselves from any attempt by the merged entity to exercise buyer market power. Therefore, we conclude that there is only moderate concern that the merger may adversely impact competition in the SW firm bulk power markets.

(2) Concentration Levels and Other Evidence Regarding the PNW and SW Short-Term Bulk Power Markets

a) Seller Market Power Issues

The evidence submitted by applicants and DRA indicates the role of SDG&E and Edison in the PNW nonfirm bulk power market is minor and sporadic. Applicants analyzed short-term firm and economy energy bulk power sales, and determined that the merger partners are predominantly buyers, not sellers, of economy energy.[42] DRA's analysis indicates that in all three years the pre-merger HHIs are between the DOJ "moderate" Guidelines of 1000 and 1800 (Gilbert & Cox, Exh. 10,200, Table II-12).[43]

The then Attorney General agrees that the merger partners' sales volumes in this market are insufficient to have any impact on competition. Consequently, no evidence has been presented that would tend to prove that the proposed merger will adversely impact competition in the PNW nonfirm bulk power market via the exercise of seller market power.

[42] Based upon Western Systems Power Pool (WSPP) sales for May/June 1988, Pace estimated that the merger partners together accounted for only 4% of all such sales (Pace, Exh. 21, p. 76). As an indication of the small future role the merged company can be expected to play, applicants account for only 6% of all utility-owned non-oil and gas generation within the WSCC. PG&E is the largest purchaser of energy from applicants, and the combined companies cannot exercise market power over PG&E's energy purchases (Pace, Exh. 21, p. 77). PG&E purchases the overwhelming bulk of its economy energy from suppliers in the NW and Canada. PG&E's future purchases of economy energy from the merged company through CPP will be pursuant to the same FERC-approved rate schedules that apply today (Id., p. 77).

[43] Seller market power is indicated, but this relates primarily to BPA and BC-hydro. These two utilities account for a very large percentage of the total sales in the market. The impact of a dry year is indicated in the 1988 figures where the relative concentration in the market declined significantly. Both these major utilities are hydro-based, and had less energy available for sale. The role of Edison and SDG&E as sellers in this market is minor and sporadic. The two companies have little individual market power and a merger between the two in any of the years examined would not have changed the HHI to any appreciable extent. Hence, DRA finds that seller market power issues are of no concern in the market for NW nonfirm bulk power. (Gilbert & Cos, Exh. 10,200, p. II-50).

The issue of seller market power in the SW nonfirm bulk power market is not so clear-cut. It is true, as applicants suggest, that the merger partners are predominantly buyers, not sellers, of economy energy, when viewed in the context of the WSCC's total economy energy sales for the period reviewed by their expert (Pace, Exh. 21, pp. 76-77). DRA's concentration ratios are consistent with that conclusion (Gilbert & Cox, Exh. 10,200, Table II-7). However, this evidence does not tell the entire story in the SW.[44] Before concluding on the basis of this evidence that the merger does not enable the merged entity to exercise seller market power in this short-term market, we must examine other direct evidence bearing on the future. Specifically, there is the question of how the merger will impact the short-term bulk power markets that have developed since 1987 when FERC approved the WSPP, which has since become the largest power pool in the nation. The evidence indicates that SDG&E has played an active and growing role in these markets in the SW, and the impacts of its loss therein should be reviewed.

The scope of our statutory authority to review the proposed merger's competitive impacts under § 854(b)(2) encompasses the area of incipient injury to competition. Thus, we must examine the direct evidence presented by the parties in connection with SDG&E's growing and potential role in these emerging bulk power markets before we draw any definitive conclusion, based on DRA's calculated HHIs or on applicants' historical sales figures, about the merger's seller market power impacts on the SW nonfirm bulk power market. These issues are addressed in subsection (3) of this horizontal analysis entitled "Emerging Short-Term Bulk Power Markets."

b) The Standards for Assessing Buyer Market Power Issues

Turning from seller market power issues to the issue of buyer market power in nonfirm bulk power markets, we encounter a great debate. DRA and the then Attorney General assert that the proposed merger will facilitate the exercise of buyer market power by the merged entity in the SW nonfirm bulk power markets, a proposition challenged vigorously by applicants. And, in connection with the PNW nonfirm bulk power markets, DRA expresses some concern about the potential for exercise of buyer market power. This finding is attacked both by the then Attorney General, who sees a more serious problem here, and the applicants, who believe there is no buyer market power problem in this market.

We focus first on the concept of buyer market power. As noted in earlier sections of this decision, buyer market power (also known as monopsony power or oligopsony power) is the

[44] See p. 812 of the Proposed Decision.

ability of the merged entity to reduce the price it pays for purchased energy/capacity below competitive levels. By reducing its purchases, the merged entity allegedly could reduce the price it pays, and thereby cause a price reduction for all purchases by all buyers in the defined market. If the merged utility is able to exercise buyer market power, it will be able to redistribute wealth from utilities who sell this power to itself, and that redistribution may have adverse efficiency consequences if it results in a reduction in output (Joskow, Exh. 22, pp. 5-6; Gilbert & Cox, Exh. 10,200, pp. II-20 to II-24).

The fact that ratepayers may ultimately benefit from this redistribution of wealth if the price of SW nonfirm bulk power is depressed is not a justification for ignoring the competitive injury to the SW short-term bulk power markets associated with the exercise of buyer market power. Ratepayers may be short-term winners, but will be long-term losers if there are adverse long-term efficiency consequences of the merged company's exercise of buyer market power in this market. Therefore, it would be shortsighted to ignore or minimize the consequences of the exercise of buyer market power just because it may favorably impact California ratepayers in the near term.

The parties have extensively debated the issue of whether the standards for reviewing buyer market power are more lax than the standards for reviewing seller market power. After analyzing these arguments we conclude that they are not. And, even if they were, our broader § 854(b)(2) authority would permit us to refrain from using a more lax standard if the direct evidence of buyer market power persuaded us that the merger would result in adverse competitive effects.

Applicants assert that relevant case law authorities are against judicial interference, and therefore the merger should not be defeated on buyer market power grounds absent a very strong evidentiary showing. Both DRA and Vernon have supplied case law references countering the view that antitrust law does not apply to existence and exercise of buyer market power.[45] Clearly the USDOJ Merger Guidelines recognize buyer market power, given the statement that: "The exercise of market power by buyers has wealth, transfer, and resource misallocation effects analogous to those associated with the exercise of market power by sellers." (Taylor, Exh. 44,405, p. 3).

---

[45] Kartell v. Blue Shield of Massachusetts (1st Cir. 1984) 749 F. 2d 922, 923, cert. denied (1985) 478 U.S. 1029, cited by applicants, does not require that we find otherwise, because Kartell addressed violations of the Sherman Act. As noted previously, our review of the merger's competitive impacts is not constrained to the Sherman or Clayton Acts. We could refuse to approve the merger based on a finding of adverse competitive impacts not rising to the level of a violation of federal antitrust statutes.

However, applicants argue that USDOJ itself applies different standards to the review of buyer market power issues.[46] This assessment is, in applicants' view, underscored by the application of the safe harbor doctrine used by USDOJ in evaluating buyer market power issues. USDOJ considers buyer market shares of less than 35% to provide a "safe harbor" in certain joint purchasing arrangements and assumes that no problem exists and no further analysis is required if this level is not met. Based upon these factors, applicants' expert recommended a 50% threshold for the market share of the largest buyer and a 3000 threshold value for the buyer HHI (Joskow, Exh. 22, p. 80).

There are several problems with applicants' approach. First, the use of applicants' higher HHI thresholds is not explicitly sanctioned in the USDOJ Merger Guidelines, or anywhere else.

Second, even if it is true that USDOJ enforcement of antitrust statutes has been weak recently, that is not an excuse for this Commission to ignore buyer market power competitive impacts under § 854(b)(2).

Third, we cannot agree with applicants that USDOJ's acceptance of this merger based on its participation at FERC reinforces the notion that USDOJ has less rigorous standards for reviewing buyer market power problems. The record is unclear as to the extent of USDOJ's involvement in the FERC proceeding (where the agreement between applicants and USDOJ is not even in evidence) and the record is silent as to the negotiating process that culminated in applicants' agreement with USDOJ. Applicants could have made a USDOJ representative available for cross-examination to support the agreement reached with USDOJ, but opted not to do so. Applicants presented only their side of this agreement, and represented to this Commission that they were not attempting thereby "to place any special imprimatur of the Department of Justice on this proceeding" (RT 4908-4910). Therefore, the considerations that underlie USDOJ's agreement to the Additional Proposed Merger Conditions (APMC) have not been subjected to cross-examination in this forum, or even at FERC, where the agreement is not in evidence. The record at FERC which presumably underlies USDOJ's FERC position was markedly different from this one. For example, DRA's detailed analysis of buyer market power (detailed more fully in the PD at pp. 809-822) is not in the FERC record, and it is pure speculation to draw any conclusions regarding USDOJ's reaction to the record developed in this docket, where USDOJ was not a party. The problem with applicants' focus on USDOJ's agreement to the APMC is that it is premised upon USDOJ's FERC participation. USDOJ has taken no position on the merger based upon the evidence before us, and USDOJ's FERC position does not justify this Commission's disregard of merger-related buyer market power impacts developed in its own evidentiary record.

---

[46] For example, applicants state that virtually all recent cases involve markets with HHIs exceeding 2000, and often approaching 4000 to 6000 with HHI increases exceeding 200, based upon the Briggs Article (Exh. 784). Further confirming evidence is the March 1988 Federal Reserve Board order approving a bank acquisition (Exh. 785).

Furthermore, even if we were to accept the proposition that USDOJ has a weaker enforcement standard vis-a-vis buyer market power, USDOJ's safe harbor doctrine does not support applicants' position. The four conditions which must be met for applying the safe harbor doctrine are not met here (Gilbert, Exh. 10,210, pp. I-39 to I-41).

In view of the above, we conclude it is inappropriate for this Commission to apply a more lax standard in reviewing buyer market power than it has applied to seller market power issues in its overall § 854(b)(2) review.

c) **Buyer Market Power: Concentration Ratios**

In assessing buyer market power issues both DRA and applicants have calculated concentration ratios for the nonfirm bulk power markets. In connection with the SW nonfirm bulk power markets, applicants have studied 1985, 1986, and 1987, and have derived post-merger HHIs in those years of 1660, 1410, and 1245, with associated HHI changes due to the merger of 369, 426, and 349. DRA has performed calculations for 1985, 1987, and 1988, deriving a post-merger index of 1736, 1139, and 1741 in those years, and corresponding merger-related increases in the HHI of 352, 366, and 704. Given these levels, there is concern that the merged entity will have the ability to exercise buyer market power in the SW non-firm bulk power markets, and it is appropriate to review other direct evidence to test these statistical results.

For PNW nonfirm bulk power markets, applicants have calculated post-merger HHIs for 1985, 1986, and 1987, of 1502, 849, and 1261 and concomitant merger-related HHI changes of 194, 83, and 101. DRA has also performed calculations for 1985, 1987, and 1988, showing post-merger indices of 1495, 1587, and 1542, and merger-related increases in HHI indices of 162, 94, and 4. Based upon these results, applicants have asserted there is no buyer market power concern, because their HHIs are below the safe harbor measure and Professor Joskow's recommended HHIs. In contrast, DRA expresses some potential concern about buyer market power based on its calculations. The then Attorney General criticizes DRA for not taking a stronger position, and cites testimony of an SDG&E employee, called as an adverse witness pursuant to Evidence Code § 776, that Edison has actually exerted buyer market power in the PNW nonfirm bulk power market (Mays, RT 5091). The then Attorney General believes that DRA's HHIs, which are aggregated on an annual basis, mask certain seasonal effects, and that they should rightfully be higher by some unspecified amount.[47]

[47] DRA supported its concentration calculations by using applicants' SERAM model to determine that the supply of nonfirm energy is inelastic. DRA also examined the merged utility's demand for power and determined that it was relatively flat, thus leading to the conclusion that exercise of buyer market power will significantly reduce demand. Thus, DRA did not rely exclusively upon HHIs in formulating its opinion on the buyer market power is-

(continued...)

We have rejected applicants' safe harbor argument and the argument that a more lax HHI standard should be used. We find, based upon DRA's calculations, that there is indeed some potential concern that the proposed merger will increase the merged utility's buyer market power in the PNW nonfirm bulk power markets. This is a conservative outcome given the existence of uncontradicted evidence that Edison has actually exercised buyer market power in this market.

d) Buyer Market Power: Structural and Behavioral Factors

We now analyze whether the results reflected in the analyses of the PNW and SW nonfirm bulk power markets are supported by structural or behavioral factors.

The first factor analyzed, barriers to entry, is a function of transmission availability. Applicants acknowledge the appropriateness of considering available transmission concentrations in the buyer market power analysis for economy energy. The evidence demonstrates such available capacity will be increasingly concentrated over the next decade due to the merger (D. Marcus, Exh. 30,000, Table 1; Attorney General's RB, p. 73), thus supporting the notion that the merger will facilitate the exercise of buyer market power.

Applicants argue that there will be more than sufficient transmission available to thwart any effort to exercise monopsony power, citing the availability of ITS and the merged entity's offer of 250 MW of firm transmission capacity to the SW and 150 MW to the PNW. However, the evidence that these two "pro-competitive factors" undercut the results implicit in the market share calculations is unsupported. As several parties note, ITS is not a good substitute for firm transmission, and purchasers will be reluctant to enter this market without firm access to long-term transmission capacity. Furthermore, ITS is subject to curtailment, and the Southern Cities underscore the fact that such curtailment occurs at the sole discretion of the merged utility, and in the past, has been a sore point in Edison's dealings with the Resale Cities. In connection with the 400 MW, there is no record evidence that this amount is sufficient to mitigate the buyer market power effects the merger (1) will create in the SW market and (2) will likely create in the PNW market.

We also find misplaced applicants' argument that the 250 MW to the SW exceeds the 30 to 50 MW reduction estimated by the Cournot Oligopsony Model, the computer simulation

---

[47](...continued)

sue. Furthermore, DRA used the Cournot Model to confirm and support its buyer market power findings. This model has been much maligned by applicants, but no party has presented a similar model. Since it is only proffered by DRA as confirmation of DRA's other results, which are supported by analysis of other structural and behavioral factors, reliance on the model is not crucial to the outcome.

model used to show that the merger will result in a significant transfer of income from SW suppliers and a loss of economic supplies that is significant relative to projected cost savings. (Gilbert, Exh. 10,210, pp. I-41 to I-42). According to its sponsor, DRA, this model is not a basis for determining the amount of transmission access to be made available to mitigate the merger's impacts. Furthermore, the adequacy of the 250 MW to the SW and the 150 MW to the PNW as mitigation measures is questionable, as more thoroughly discussed subsequently. Suffice it to say that the 400 MW, while a pro-competitive factor to be considered in the balance, does not in and of itself undercut the results of the statistical calculations.

Nor do the other transmission projects which are planned for the future alleviate entry barriers. No conclusion can be drawn regarding the Mead-Phoenix Project or other planned projects such as the Inland Pacific and Mead-Adelanto lines. It is uncertain when these possible lines will be built, and they clearly will not be constructed within the two years specified in the Merger Guidelines to constitute effective mitigation to entry barriers (Merger Guidelines, § 3.3). In addition, assuming DPV2 is built later in the 1990s, its effectiveness in mitigating entry barriers is questionable since the applicants will own or control most of its capacity.

Other factors such as opportunities for collusion and the impact of price regulation, as discussed by applicants, were considered only in a very general sense. While it might be difficult for firms to maintain collusive arrangements in this market, and while price regulation imposes some restrictions in the form of regulatory scrutiny, the impacts of these two factors as constraints on the exercise of buyer market power are unclear based on the evidence of record.

In conclusion, we find that the results of DRA's and applicants' market concentration calculations relative to buyer market power in PNW and SW nonfirm bulk power markets are supported by DRA's analysis of structural and behavioral factors. Therefore, the proposed merger will adversely impact competition in the SW nonfirm bulk power market by enabling the merged entity to exercise buyer market power. Furthermore, the proposed merger may adversely affect competition in the PNW nonfirm bulk power markets by enabling the merged utility to exercise buyer market power in that market.

(3) Emerging Short-Term Bulk Power Markets

Special concerns have been raised by various parties concerning SDG&E's pro-competitive trading activities. Because of the interrelatedness of transmission and bulk power, many of the arguments raised in this area have been addressed earlier in our discussion of merger-related transmission impacts. They are revisited here only to the extent necessary to shed light on what parties have termed the "emerging short-term bulk power market."

In 1987 FERC approved an experimental pooling agreement known as the Western Systems Power Pool (WSPP), which has now become the nation's largest power pool. SDG&E has made economy energy purchases and sales as well as transmission service arrangements under the WSPP since its inception, resulting in lower operating costs (Gaebe, CPUC Exh. 710, FERC Exh. 1203, p. II-12). Viewing itself as an aggressive "energy management company," SDG&E has come to view the WSPP as a marketplace for transactions which can both lower its ratepayers' costs and improve shareholders' profits (Mays, Exh. 30,002, p. 46). As it has gained more experience, SDG&E has assumed the role of "middleman" in making economic arrangements between utilities under the WSPP (Id., p. 63). Other utilities, particularly municipal utilities with limited transmission access such as M-S-R and Turlock Irrigation District (TID), have begun to look to SDG&E as a broker for power purchases and sales under the WSPP, a role which SDG&E has willingly filled (Id., pp. 62-65). One result of SDG&E's participation in this growing market has been the dramatic growth in its sales since 1986 (Gaebe, CPUC FERC Exh. 710, FERC Exh. 181 (GPG-1); Mays, Exh. 30,002, pp. 80-81).

Our analysis of the merger's impacts on the emerging SW short-term bulk power markets is different from that undertaken previously. There are no concentration ratios calculated for this market. Rather, the focus is on direct evidence of SDG&E's growing role as energy broker, and on the fact that the merger will end SDG&E's involvement in this emerging marketplace in its nascent stages.

While applicants criticize intervenors who have raised this issue for confusing transmission and bulk power issues, we disagree that intervenors are confused. It is necessary to focus on the interrelatedness of transmission and bulk power issues in order to understand the dynamics of this emerging market.

The evidence indicates that SDG&E plays a unique role in brokering or trading bulk power using both its entitlements and arranging sales for such entities as M-S-R on a delivered basis. This means that it arranges for the source of generation and for the transmission all the way to a point where M-S-R can take delivery. There is no evidence that any other utility in this state has undertaken such a brokering or trading role, and the evidence is that SDG&E has undertaken this role due to its unique energy management focus. In addition, SDG&E has been particularly inventive in using the transmission grid to facilitate its brokering and trading activities.

PG&E and M-S-R, parties to some of these brokering transactions, regard them as significant, even if applicants do not.[48]

[48] In one case, PG&E notes that applicants have misconstrued the import of the fact that in a recent 12-month period there were no sales between PG&E and SDG&E. As PG&E notes, the reason for this was the outage of the Palo Verde units.

Finally, the arguments that the emerging bulk power market has passed its heyday are unconvincing. Oil and gas prices may well increase, but the relative relationship between them and purchased power prices tends to remain the same. This indicates that a utility like SDG&E will have the ability to participate in the bulk power market as a seller at times and should not be dismissed as a future competitor (Mays, RT 5079-5080). Furthermore, while SDG&E's trading partners may become independent in the future and less reliant on SDG&E, other utilities will continue to rely upon SDG&E's staff and resources, and will continue their relationship with broker SDG&E. (Mays, RT 5083.)

In sum, reaching no specific conclusion that the merger will have adverse seller market power effects in the SW nonfirm bulk power markets, we conclude the proposed merger will result in the loss of SDG&E as a key participant in the emerging SW short-term (or nonfirm) bulk power markets, and that this loss is adverse.

c. Vertical Analysis

(1) Applicants Assert the Proposed Merger Has No Anti-competitive Vertical Impacts

Applicants' position is that this merger does not cause any anti-competitive vertical impacts (see, generally, Applicants' OB, pp. VI-151 to VI-155). We have previously noted their failure to produce evidence in that regard, as required by the statute (§ 854(e)). However, intervenors have analyzed several vertical impacts, presenting issues of foreclosure of competitors' access to suppliers or customers. Applicants' responses to these arguments are weighed in our balancing of competitive impacts.[49]

In our earlier discussion of vertical impacts in the transmission area, we determined that the proposed merger will increase the merged utility's control over network transmission and various interregional transmission markets, and that its vertical aspects vis-a-vis Edison and the Resale Cities impact competition adversely.

These findings are consistent with the analysis of vertical impacts in the bulk power markets due to the interrelatedness of transmission and bulk power. The merged utility will be in a dominant position, capable of forcing the Resale Cities to purchase power from the merged entity and also of distorting pricing in the bulk power markets where the Resale Cities are purchasers. The effect of this on the Resale Cities is to increase their costs and impair their ability to compete at retail with the merged entity in serving the Resale Cities' customers. Vernon has detailed the manner in which Edison has assertedly leveraged its control over

[49] These arguments are more fully set forth in the PD (pp. 845-856).

transmission to dictate the type and timing of generation resources obtainable by the Resale Cities.[50] We express no opinion as to the accuracy of Vernon's charges, but note that the charges are consistent with previous findings that Edison has abused its dominance over transmission, supra. Edison will be the dominant merger partner post merger, so that it is at least as likely as not that these practices will continue.

While applicants argue that the merger has absolutely no impact on Edison's control area, we find that it does, as most specifically illustrated by the impact of Anaheim's and Riverside's loss of their firm transmission path to SDG&E. The Anaheim/Riverside replacement capacity example illustrates the beneficial impact SDG&E has had as a competitive force for these cities. With the loss of their independent path to SDG&E at SONGS, Anaheim and Riverside must deal with the merged entity and will have no other options. Furthermore, any future opportunity Resale Cities have to gain delivery points from SDG&E, and thereby gain access to alternative bulk power sources through SDG&E, is foreclosed by the merger. Thus, the merger's vertical aspects do have an impact on the control area bulk power markets.

While applicants assert that the Southern Cities have largely ignored SDG&E as a potential joint-venture partner, they provide no cite to evidence supporting this contention (Applicants' RB, p. VI-14). However, notwithstanding the evidence supplied by the Southern Cities indicating that SDG&E is planning the Blythe Project as a joint effort with a number of municipal utilities, there is no conclusive evidence to indicate that the project will not be completed at some point following the merger, with the participation of the Resale Cities. Furthermore, it is speculative to find that the Resale Cities will be unable to fill the void left by SDG&E in future joint venture transmission/generation projects. Thus, we cannot find that the merger will have adverse impacts in this area.

Edison's posture regarding delivery points is that SDG&E did not pursue the matter further (Kendall, Exh. 54, p. 50). However, a more accurate characterization of the dispute is that SDG&E was unsuccessful for a variety of reasons in obtaining additional delivery points from Edison. Whether SDG&E in the future, in the absence of the merger, would be able to obtain such delivery points, is unknown for certain, but the merger will put an end to this inquiry.

In sum, we regard the principal vertical impact of the merger on the Resale Cities to be the loss of Anaheim and Riverside's access to SDG&E as an alternative bulk power supplier through the firm transmission path at SONGS, and the foreclosure of future opportunities to gain delivery points from SDG&E, a non-Edison bulk power supplier with a track record of innovative energy marketing strategic and bulk power packaging activities. This is an adverse

---

[50] This is more fully discussed in the Proposed Decision (pp. 849-853).

impact on competition, which necessitates further inquiry regarding effective mitigation (§ 854(b)(2)).

d. Summary of Merger's Horizontal/Vertical Impacts on Bulk Power Markets

We have identified four bulk power markets: PNW firm bulk power; SW firm bulk power; PNW economy (or nonfirm) bulk power and SW economy (or nonfirm) bulk power.

In the horizontal analysis, depicted in the table that follows, we have determined that the merger does not adversely impact competition through exercise of either buyer or seller market power in the PNW firm bulk power market. The merger causes no seller market power problem in the SW firm market, but there is "moderate concern" that it will adversely affect competition in that market via exercise of buyer market power.

Turning from the firm to the economy bulk power markets, we have found that the merger causes no seller market power problem in the PNW economy (or nonfirm) bulk power market, but that there is a potential that it will adversely affect competition in that market via exercise of buyer market power. In the SW economy (or nonfirm) bulk power market we have made no specific finding that the merger will increase seller market power, but we do regard the loss of SDG&E as a key participant in the emerging SW nonfirm bulk power market to be an adverse seller-side merger impact. Also, we have determined that the merger will adversely affect competition in the SW economy (nonfirm) bulk power market via exercise of buyer market power.

TABLE IV
Bulk Power Markets: Summary of Horizontal Analysis

Market	Buyer Market Power	Seller Market Power
PNW Firm	No	No
SW Firm	No	Yes, Moderate Concerns
PNW Firm	No	Yes, Potential Concerns
SW Economy	No, But Loss of SDG&E in Emerging Bulk Power Markets	Yes

In the vertical analysis, we have determined that due to its control over network transmission and the defined interregional transmission markets, the merged utility will be in a dominant position, capable of forcing the Resale Cities to purchase power from it and of distorting pricing in the bulk power markets where Resale Cities are purchasers. This is an adverse impact on competition. We have also found adverse competitive impacts in the control area bulk power market via foreclosure of Resale Cities' future opportunities to gain delivery points from SDG&E, and thereby to gain alternative bulk power sources.

3. Other Vertical Impacts of the Merger Associated With Affiliate Relationships

a. Background

Both merger partners currently produce, distribute, and sell electricity and consequently are already vertically integrated. If approved, the merger will accomplish a new type of vertical integration, bringing SDG&E within the SCEcorp holding company structure, and effectively integrating its regulated electric utility operations with the unregulated SCEcorp subsidiary Mission Group and its lower tier unregulated affiliates.

(1) Applicants' Current Corporate Structures

Pursuant to Commission authorization in D.88-01-063 (the "holding company decision"), applicant holding company (SCEcorp) is not itself a regulated public utility, but owns both utility-related and nonutility subsidiaries.

On the holding company's nonutility side, Mission Group owns 100% of Mission Energy Company (Mission Energy), which operates and develops major cogeneration and other energy projects throughout the country (Bryson, Exh. 36, p. 2). Under the regulations implementing the Public Utility Regulatory Policies Act (PURPA), a utility's interest in a QF is limited to no more than 50% of the equity interest in the facility; therefore Mission Energy owns a 50% or less interest in specific QF projects. As of October 1989, Mission Energy owned interests in 39 projects totaling 3,656 MW (Kinosian, Exh. 734, and Kinosian, Exh. 10,300, p. II-4). During 1991, Mission Energy QFs will account for 39% of the merged company's total QF purchases, and Edison's payments to Mission Energy will reach $1 billion by 1997 (Morse and Kinosian, Exh. 10,300, pp. I-4, I-5, IV-3, and IV-4). In addition to Mission Energy Company, there are three other nonutility affiliates: Mission First Financial Company, Mission Land Company, and Mission Power Engineering Company.

Mission Power Engineering Company (Mission Engineering) provides engineering, construction and consulting services in the energy field. Its projects include electric generating units, transmission lines, and substations (Bryson, Exh. 36, p. 4; Bryson, Exh. 10,732, p. 27). Its operating revenues for 1989 were $209 million (Bryson, Exh. 10,732, p. 27).

Mission First Financial (Mission Financial) provides energy-related venture capital and invests in leveraged leasing transactions, project financing, and high quality securities. It has also developed a customized cash management program to provide attractive yields on funds held pending longer term investments. (Bryson, Exh. 36, pp. 3-4.)

Mission Land Company (Mission Land) is a real estate development firm which builds industrial business parks and engages in land acquisition, construction, management, and sales. It concentrates on parks containing light manufacturing and industrial warehouse and distribution buildings, located primarily in Southern California. (Bryson, Exh. 36, p. 3.)

In contrast to its merger partner Edison, SDG&E is not part of a holding company structure. It directly owns Pacific Diversified Capital Company (PDCC) which, at the time of this application, owned four nonutility subsidiaries: Mock Resources, Wahlco, Phase I Development, and Integrated Information Systems. On July 13, 1990, counsel informed the ALJs and all parties by letter with enclosed press release that, on June 29, 1990, SDG&E's subsidiary PDCC disposed of its 51% interest in Mock Resources, Inc., an oil and gas marketer. Integrated Information Systems is a computerized mapping software and consulting company. Phase I Development, Inc. is involved in real estate development, and Wahlco, Inc. in air pollution control systems. PDCC grew very little between 1987 and 1988 (Bumgardner, Exh. 10,300, pp. II-9 to II-11). If the merger is effected, Edison will own PDCC and its interests in its subsidiaries (Bryson, Exh. 36, p. 4). Applicants have not yet formulated a definitive plan for the integration of the PDCC subsidiaries into SCEcorp but believe it is likely that eventually these subsidiaries will be transferred to and operated under the Mission Group and that PDCC will be dissolved. (Bryson, Exh. 36, p. 5.) Applicants have not focused on whether these prospective actions require further regulatory approval from this Commission, assuming the merger is approved (Bryson, RT 3793-3794).

(2) The Merger's Impact on Applicants' Current Corporate Structures

The melding of SDG&E into the holding company structure and the prospective integration of PDCC's subsidiaries into the Mission Group will trigger significant regulatory impacts. At the present time PDCC and its subsidiaries are subsidiaries of a regulated SDG&E. As such their operations are subject to direct ratemaking control as part of the Commission's standard regulatory review of SDG&E's operations.[51]

---

[51] For example, under the current structure, the Commission determines cost of capital for SDG&E as a whole, including subsidiaries. This enables the Commission to actively mitigate any adverse impacts of the subsidiaries' activities on the regulated utility, since the Commission's ratemaking process may take account of the profitability and risks posed by such activities.

Furthermore, when the activities of a closely-held subsidiary are utility-related, the Commission can and does impute some or all of the revenues of the subsidiary to the revenue requirement of ratepayers. This is an appropriate means of assuring that revenues derived from the utility's monopoly advantage inure to the benefit of ratepayers on whose behalf the monopoly franchise was granted. An example is the relationship between Pacific Bell and its PacBell Directory, which publishes white and yellow page directories on the utility's behalf. Revenues from the sales of yellow page advertisements are imputed to ratepayers.

If SDG&E subsidiaries were to expand into utility-related enterprises, SDG&E's current corporate structure would allow the Commission to impute revenues to the regulated utility if it deemed such action necessary for any reason, including the need to respond to potential self-dealing or monopoly advantage. However, under the proposed merger, SDG&E's subsidiaries would not be directly related to the merged utility; thus the Commission may be precluded from employing such a remedy, and forced to search for other means to protect ratepayers.

More significant, however, is the prospective integration of the regulated SDG&E with the unregulated Mission Group subsidiaries, including unregulated power supplier Mission Energy. For the first time, the holding company corporate structure, with its regulated and unregulated components, will be imposed upon SDG&E and its ratepayers.

Since the holding company structure (1) provides the Commission with a different type of control over parent/subsidiary interactions than it currently possesses in its regulation of stand-alone SDG&E, and (2) exposes SDG&E ratepayers to the impacts of SCEcorp's existing unregulated affiliate transactions, the Commission is required to review its current SCEcorp holding company protections to ensure they are adequate to the task of protecting ratepayers from increased costs which may accompany the corporate melding described above.

(3) Protections Embodied in D.88-01-063

In its decision authorizing Edison to reorganize and create a holding company structure, this Commission imposed the following conditions (D.88-01-063, Ordering Paragraph 1):

1. Edison must ensure Commission access to the books and records of the holding company, its affiliates, and joint ventures (§ 314). The Commission will interpret § 314 broadly, and Commission/staff requests for books and records are presumptively valid, material and relevant.

2. SCEcorp, its subsidiaries and joint ventures must employ accounting and other cost allocation procedures and controls and transfer pricing to ensure and facilitate full Commission review and protect against cross-subsidization *(see Edison's Corporate Policies and Guidelines for Affiliate*

Transactions). Edison's policies include a 5% markup on fully loaded labor costs billed to nonutility affiliates for use of Edison employees.

3. SCEcorp, its subsidiaries and joint ventures must keep books consistent with generally accepted accounting principles, and consistent with the Uniform System of Accounts.

4. Officers and employees of SCEcorp and subsidiaries must appear and testify in Commission proceedings as necessary or required.

5. Edison must provide the Commission with:

    a. Quarterly and annual financial statements of SCEcorp, including consolidated workpapers;

    b. Annual statements re intercompany transactions, and description of cost allocations and transfer pricing underlying same;

    c. Balance sheets and income statements of nonconsolidated subsidiaries;

    d. All periodic reports filed by SCEcorp with the SEC; and

    e. An audit performed by an outside auditing firm selected and supervised by DRA, to be submitted in Edison's next general rate case, where the Commission will determine the need for subsequent audits as well.

6. Edison must avoid diversion of management talent and provide the Commission an annual report identifying certain transfers.

7. Edison must notify the Commission in writing 30 days prior to any transfer to SCEcorp or to its nonutility affiliates of any utility asset or property exceeding a fair market value of $100,000.

8. Market, technological, or similar data transferred, directly or indirectly from Edison to a nonutility affiliate must be transferred at market value.

9. Edison must maintain a balanced capital structure consistent with that determined to be reasonable in Edison's most recent general rate case decision.

10. Edison's Board of Directors must continue to establish Edison's dividend policy as if Edison were a comparable stand-alone utility company.

11. Edison must not guarantee the notes, debentures, debt obligations or other securities of SCEcorp or its subsidiaries without prior written Commission consent.

12. SCEcorp's and Edison's Board of Directors must give first priority to the utility's capital requirements, as determined necessary to meet its obligation to serve.

13. Edison must provide a quarterly report to the Commission detailing the utility's proportional share of SCEcorp's total assets, total operating revenues, O&M expense, and number of employees.

14. The Commission may require a royalty payment whenever product rights, patents, copyrights or similar legal rights are transferred from the utility to SCEcorp or to any nonutility subsidiary.

15. SCEcorp and its subsidiaries may not provide interconnection facilities and related electrical equipment to Edison, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in connection with sale of energy to Edison, unless the third party has the right to acquire such facilities and equipment through competitive bids. SCEcorp and nonutility subsidiaries may participate in any such competitive bidding.

These are the post-merger protections which will apply unless the Commission chooses to augment them as a condition of merger approval.

(4) The Scope of the Commission's Review of Affiliate Relationships in this Proceeding

One of the more obvious impacts of the proposed merger is the vertical integration of a regulated electric utility with an unregulated energy supplier. The Commission is required to assess the merger's vertical competitive impacts, as well as its horizontal competitive impacts, pursuant to § 854(b)(2). In addition, the Commission must assess the impacts of this vertical integration on ratepayer cost of service pursuant to its regulatory authority under §§ 707 and 854. Finally, the Commission must assess the impacts of this vertical integration on its own jurisdiction and capacity to effectively regulate and audit public utility operations within this state (§ 854(c)(7)).

Therefore, we review these vertical merger impacts to (i) determine which, if any, are adverse within the parameters of § 854, (ii) analyze, as necessary, conditions proposed and designed to mitigate any adverse impacts, and (iii) determine whether, and/or under what circumstances, the proposed merger is in the public interest and may be approved.

(5) Applicants' Affirmative Showing

Pursuant to § 854(e) applicants have the burden of proving by a preponderance of the evidence that the SDG&E/Mission Group vertical integration will not have adverse unmitigable impacts on competition, cost of service, and the Commission's jurisdiction and capacity to effectively regulate and audit the merged entity.

Because the application was deficient in this regard, applicants were directed to augment their case-in-chief.[52]

In response to this directive, in June 1989, applicants submitted the "Supplemental Testimony of John E. Bryson on the Impact on Business Plans of Unregulated Subsidiaries" (Exh. 36), and the 1989 business plans of Mission Energy, Mission Land, Mission Financial, and Mission Engineering. (Exhs. 726, 727, 728, and 729).

Applicants contended that the merger does not affect their unregulated subsidiaries, although SCEcorp ultimately may integrate SDG&E's nonutility subsidiaries into Mission Group (Bryson, Exh. 36, pp. 1-2). Exhibit 36 consists of 5 pages. The only other affiliate-related testimony applicants presented was in rebuttal to DRA and intervenors (Jurewitz, Exh. 33; Joskow, Exh. 34; Jurewitz, Exh. 60; and Joskow, Exh. 51).

Applicants assert that the business plans of Edison's unregulated affiliates reveal no intention to expand any operations in the current SDG&E service territory (Exh. 726 to 729), as confirmed by their testimony that the merger has no impact on the affiliates' business plans (Bryson, Exh. 36; Applicants' OB, VII-1). However, they propose the following safeguards in the event of merger approval "to assure not only that the interests of ratepayers are protected but that there is no appearance of impropriety." (Bryson, Exh. 26, p. 16):

---

[52] "Applicants must address the impacts of the merger on the operations of their unregulated subsidiaries in order that the Commission may assess the potential post-merger environment in which the merged entity and its unregulated subsidiaries will operate. In connection with this requirement, applicants must make available to the parties current business plans of the existing unregulated subsidiaries, and to the extent those existing business plans do not address changed circumstances (i.e., the impacts of the merger), applicants must also provide that information as part of their affirmative showing (2 PHC TR 95-96)." (May 26, 1989 ALJs' Ruling, p. 3.)

> The merged company will not enter into any contract to purchase electric energy and/or capacity from a qualifying facility in which SCEcorp or any subsidiary or affiliate thereof is a beneficial owner, except (1) with the prior approval of the Commission or (2) pursuant to a competitive bidding or other standard procedure established by the Commission. (Bryson, Exh. 26, p. 17; see also the Additional Proposed Merger Conditions presented by applicants and the U.S. DOJ in FERC Docket EC 89-5-000, Exh. 730, pp. 16-17.)

Applicants are adamant that they have met their burden of proof. Applicants indicate that their initial direct testimony did not address the merger's effect on unregulated subsidiaries and affiliates because there was no effect to discuss. In their brief supplemental showing, they concluded again that the merger would not affect the nonutility subsidiaries' strategies or activities in any way (Bryson, Exh. 36, p. 2).[53]

Furthermore, applicants assert the amended § 854 does not require consideration of the merger's impact on unregulated businesses, but rather mandates weighing the merger's effect on "the jurisdiction of the Commission and the capacity of the Commission to effectively regulate and audit public utility operations in the state" as part of the overall public interest determination (§ 854(c)(7)). (Applicants' OB, p. VII-6, fn. 4.)[54]

We believe that applicants' view is overly conservative. Applicants were required to supplement their case-in-chief to enable the Commission to assess the potential post-merger environment in which the merged entity and its unregulated subsidiaries would operate. The ALJs' ruling was not restricted to impacts on the Commission's ability to regulate the merged entity, or to an explanation of how the merger affects applicants' business plans (contrary to Applicants' OB, p. VII-6), but required a broader assessment of the "potential post-merger environment." In response, applicants essentially repeated the "no impact" posture taken in their deficient initial showing.

Applicants argue that the only affiliate-related § 854 issue is the Commission's jurisdiction and capacity to regulate in the post-merger environment (§ 854(c)(7)). (Applicants'

---

[53] Applicants aver that SCEcorp managers did not consider the potential business opportunities of the unregulated affiliates in deciding whether to pursue the merger (Bryson, Exh. 26, p. 13; Bryson, RT 1182; Exh. 10,704; Fohrer, RT 1722-23), and that nothing has changed since then (Bryson, Exh. 36, pp. 1-2; Bryson, RT 1182).

[54] Applicants charge that DRA and intervenors wish only to relitigate D.88-01-063. Furthermore, applicants deny that DRA's proposed conditions are justified by the merger. Rather, applicants view DRA's affiliate-related concerns as industrywide issues, more appropriately addressed in a generic proceeding (Applicants' OB, pp. VII-4 to VII-5).

OB, p. VII-6.) This is but one of the issues the Commission must review. The other major related issue is one which applicants have chosen to meet via their "no impact" testimony: will the vertical merger between SDG&E's electric utility operations and SCEcorp's unregulated supplier (Mission Group) facilitate the evasion of Commission regulation that would otherwise limit the exercise of market power in distribution? (Owen, Exh. 20,800, FERC Exh. 710, p. 22.) (See also Merger Guidelines § 4.23.) While this is an issue the Commission is required to assess under § 854(b)(2) as it gauges the merger's competitive effects, it is one on which applicants have presented only rebuttal testimony (Joskow, Exh. 51, pp. 120-133).

Because it ignores the obvious vertical integration issues posed by the merger, we do not find applicants' "no impact" posture credible. This finding is underscored by the fact that applicants have proposed a QF contract preapproval condition that would be unnecessary in the absence of real-world affiliate-related merger impacts. Therefore, applicants' own proposal contradicts and undercuts the thrust of their affirmative showing.

Nor do we accept applicants' narrow § 854(c)(7) assessment. Obviously, we will review those regulatory impacts in this proceeding, but not in the vacuum applicants urge. The structural changes the merger would effect require that we analyze regulatory impacts in conjunction with the vertical impacts of the merger which applicants have dismissed as nonexistent.

In sum, applicants have failed to meet their burden of proof that the merger will have no adverse impact on the operations of their unregulated subsidiaries. This is a failure to sustain the requisite burden of proof under § 854(e).

However, in order to assess the merger's negative impacts in this area, we review evidence presented by other parties on this subject. In reviewing this evidence, we are left with two tasks: (1) to identify the effects of the merger on unregulated affiliates and their relationship to the regulated utilities, and (2) to determine the conditions which would have to be placed on approval of the merger to eliminate unacceptable effects.

b. Merger-Related Impacts

Vertical integration of SDG&E's distribution facilities and SCEcorp's unregulated Mission Group subsidiaries is an effect of the merger, which will, in and of itself, have four significant impacts, all "adverse". First, it will increase opportunities for self-dealing. Second, it will increase ratepayer costs. Third, it will have adverse competitive impacts on nonaffiliated QFs. Fourth, it will increase the demand on regulatory resources now devoted to the review of affiliate transactions, due to the placement of many of SDG&E's activities in the less regulated holding company structure. This raises the issue of whether the merger is in the public interest (§ 854(c)(7).

(1) **Increased Self-Dealing Opportunities**

The merger will increase opportunities for self-dealing, particularly with Mission Energy, both in Edison's current service territory and in the new merged entity's larger service territory, thereby potentially exposing a new set of ratepayers to adverse rate impacts. We believe post-merger self-dealing opportunities will increase for five principal reasons.

First, the Commission has found that Edison, which will be the surviving entity following the merger, has engaged in past affiliate self-dealing (D.90-09-088). We would be less concerned if SDG&E were the post-merger dominant firm, since its subsidiaries are directly subject to ratemaking control. And, significantly, neither SDG&E's current "energy management" philosophy and practices (Mays, Exh. 30,002, pp. 43-44) nor its historical lack of QF self-dealing are compatible with post-merger self-dealing. However, in this area, it is clear that SCEcorp's corporate structure, policies and practices, not SDG&E's, would guide the merged entity. And we find, based on applicants' affirmative case, that SCEcorp plans no fundamental change in its dealings with affiliates post merger (Bryson, Exh. 36, pp. 1-2). Indeed, the only change applicants propose, the minimalist contract preapproval recommendation, is not premised on any fundamental alteration of Edison's dealings with its Mission Energy QF affiliate. Therefore, unless that proposal is effective in mitigating adverse identified impacts, a premise which is discussed infra, the Edison/Mission Energy self-dealing activities may continue and increase post merger, impacting an entirely new set of ratepayers in an expanded geographic service territory.

Second, it is undisputed that the merged entity will have access to more cash post merger, due to SDG&E's cash flow, and other financial factors. This will facilitate the likely expansion of Mission Energy's and the other unregulated affiliates' operations, and open the door to further self-dealing (Bumgardner, Exh. 10,300, p. II-24).

Third, the record demonstrates that the merged entity's demand in future years will be higher than Edison's alone. Therefore, existing excess capacity will be absorbed faster and more QFs will be able to sell to the merged utility sooner than would be the case without the merger. This will expand opportunities for all QFs, including Mission Energy, in a post-merger environment dominated by the merger partner which has engaged in past self-dealing abuses. (D.90-09-088, Conclusions of Law 28 and 29.) We note that the past self-dealing pre-dates our holding company decision. The discovery of these abuses is also an example of how our regulatory system can uncover and remedy such unlawful activities. But expanded markets and service areas will increase our staff's responsibilities and tax our resources to uncover future self-dealing, especially in light of Edison's intransigence in obeying the information access requirements set forth in the holding company decision. The expanded opportunities are not confined to Mission Energy, but may extend to other Mission Group affiliates, such as Mission Engineering and Renewable Energy Capital Company, who will be positioned to enter into construction and/or business arrangements with Mission Energy and nonaffiliated QFs seeking to meet the merged utility's increased energy needs. This means that possible post-merger self-dealing may take both direct and indirect forms. (Clay, Exh. 40,460, pp. 9-11; Bumgardner, Exh. 10,300, pp. II-20 to II-21.)

Fourth, the acquisition by the merged entity of SDG&E's gas system opens up additional self-dealing avenues following the merger. DRA's witness, whom applicants chose not to cross-examine, identified several post-merger incentives available to the merged entity, which are currently unavailable to stand-alone Edison. These include dealings with unregulated gas procurement subsidiaries,[55] manipulation of queue position to favor an affiliate, selling excess transmission capacity entitlements to an affiliate at terms unfavorable to ratepayers, and transfer of sensitive market information (Dobson, Exh. 10,310, p. III-13 to III-23).

Finally, the merger will provide SCEcorp and its subsidiaries with transmission control and access to additional areas such as Mexico and the IID, thereby opening these areas to expansion by these affiliates on terms more favorable than those presently available (Kinosian, Exh. 10,300, p. IV-28).

(2) **Increased Ratepayer Cost**

A second impact of vertical integration relates to increased payments to existing Mission Energy projects flowing from the merged entity's increased marginal cost (Kinosian, Exh. 10,400A, p. IV-8c.2). Since these increased payments provide an additional profit incentive to the merged entity, it may sign additional purchased power agreements with its Mission Energy affiliate or otherwise favor Mission Energy in the post-merger environment of increased energy sales opportunities. If that occurs, ratepayers may well end up paying higher prices for capacity and energy due to these increased transactions with Mission Energy (Kinosian, Exh. 10,300, p. IV-22) unless existing protections are adequate to protect against the effect of the increased self-dealing in contract execution and contract administration post merger.

(3) **Adverse Competitive Impacts**

Third, there may be adverse competitive impacts flowing from the merger, again principally related to the melding of SDG&E's needs and Mission Energy's capacity to fill them. As discussed in connection with the increased self-dealing opportunities it creates, the merger

[55] Notwithstanding Mock Resources is no longer owned by SDG&E's subsidiary PDCC, the generic problem remains, because nothing prevents the merged entity's future affiliation with an unregulated gas procurement enterprise under the holding company structure.

sets in motion a series of events that facilitates Mission Energy's expansion within and outside the merged entity's service territory, both to meet the merged entity's increasing needs and to take advantage of additional development opportunities in areas not subject to the rigorous air quality standards applicable in SCAQMD, such as the IID and Mexico (Kinosian, Exh. 10,310, p. III-10). These out-of-service territory development opportunities, coupled with the increased transmission access and control the merger provides SCEcorp, may alter the competitive picture in QF markets not currently open to Mission Energy or not currently controlled by the merged entity (Kinosian, Exh. 10,300, pp. IV-28 to IV-30). Having new out-of-service territory development opportunities might enhance competition, standing alone. However, while ease of transmission access creates this opportunity, the control of access places the merged entity in a dominant position.

This control is referenced in the historical record of transmission access problems experienced by nonaffiliated QFs. Given SCEcorp's merger-enhanced profit incentives, nonaffiliated QFs may likely experience additional difficulties obtaining access to transmission on fair and nondiscriminatory terms in a post-merger environment of expanded Mission Energy opportunities absent Commission action. (DRA's OB, pp. 336-337.) Such problems may be experienced by nonaffiliated QFs located in the expanded post-merger service territory, and by those attempting to move their power in the geographic markets in which the merged entity controls transmission access.

Finally, if the merged entity acts on its inherent incentives to sign contracts with affiliated QFs in preference to nonaffiliated QFs, as it draws down its current surplus capacity, nonaffiliated QFs who would otherwise be ready to meet future energy needs may be disadvantaged (Kinosian, Exh. 10,300, p. IV-18). In addition, nonaffiliated QFs lose SDG&E as an alternative purchaser post merger. While additional purchasers may be available as applicants contend (Applicants' OB, p. VII-17), Edison controls the transmission facilities nonaffiliated QFs need to complete these purchase transactions (Kinosian, Exh. 10,310, p. III-24), and is positioned to impede them if it is so inclined in the best interests of its Mission Energy affiliate.

(4) **Evasion of Regulation**

The fourth merger impact, again associated with vertical integration, is the evasion of regulation issue noted in Section 4.23 of the Merger Guidelines. By expanding the geographic scope and extent of potential self-dealing, the opportunities of Mission Energy and the scope of SCEcorp's unregulated activities, the merger may increase the demands on Commission resources now devoted to affiliate issues. Indeed, if Edison's past violations of the regulatory compacts set forth in our holding company decision are any indication of what will transpire in the future, it will be increasingly difficult to ensure that inappropriate costs are not passed on to ratepayers. Thus while our holding company decision is a valuable protection for ratepayers, Edison has attempted to use it to shield its activities rather than open the Commission's access to expeditious and thorough review. Such contentiousness produces increased burdens on the Commission in fulfilling its watchdog role under the decision. But we are committed to standing guard against affiliate transactions. This impact is discussed in more detail in connection with mitigation, infra.

(5) **Balancing Combined Competitive Impacts**

Having reviewed the defined wholesale transmission and bulk power markets, as well as the vertical integration aspects of the affiliate issues implicated by the proposed merger, we have determined that the acquisition will have the following adverse competitive impacts:

> TRANSMISSION: When viewed from both the horizontal and vertical perspectives, the proposed merger will have adverse impacts in the following five defined transmission markets: (1) transmission between California and the SW; (2) transmission between California and the PNW; (3) transmission between the PNW and the SW; (4) transmission to California from the PNW and SW combined; and (5) network transmission. Horizontal impacts are reflected in the increased concentration in these markets post merger, while vertical impacts are keyed to the proposed acquisition's effects on competition between the merged entity and the Resale Cities in these same markets.
>
> BULK POWER: When viewed from the horizontal perspective, the proposed merger will have adverse impacts in three bulk power markets: (1) the SW firm bulk power market, where there is moderate concern that the merger will enable the merged entity to exercise buyer market power; (2) the PNW economy (or nonfirm) bulk power market, where there is a potential that the merger will enable the merged entity to exercise buyer market power; and (3) the SW economy (or nonfirm) bulk power market, where the merger will enable the merged entity to exercise buyer market power and will also result in adverse seller-side impacts due to the loss of SDG&E as a key participant in an emerging market.
>
> When viewed from the vertical perspective, the proposed merger will have adverse impacts in the defined bulk power markets where Resale Cities are purchasers, due to the merged entity's control over the network and interregional transmission markets discussed above. A separate impact of the merger in the control area bulk power market is its foreclosure of Resale Cities' future opportunities to gain delivery points from SDG&E, and thereby gain alternative bulk power sources.

VERTICAL INTEGRATION: MERGER-RELATED IMPACTS ON AFFILIATED OPERATIONS: There are four adverse impacts of the merger-effected vertical integration of SDG&E's distribution facilities and SCEcorp's unregulated Mission Group subsidiaries: (1) increased opportunities for self-dealing; (2) increased ratepayer cost; (3) adverse competitive impacts on unaffiliated QFs; and (4) evasion of regulation.

The PD made separate findings of "adverse effects on competition" for each of the three broad categories outlined above, and for a fourth category: retail competition.[56] It indicated that the proposed merger could not be approved unless each of these adverse competitive impacts could be avoided through mitigation measures. This meant that a failure of mitigation in any one of these categories was sufficient to support denial of the application. Indeed the PD recommended denial of the application on that basis. This outcome is consistent with the Van de Kamp Advisory Opinion.

Under Attorney General Lungren's analysis, we also have the discretion to consider the merger's combined competitive impacts and to determine, based on an assessment of such aggregate effects, whether there will be net adverse effects on competition which militate against approval under § 854(b)(2). As part of this exercise, we balance the adverse impacts on transmission, bulk power, and affiliate relationships against the pro-competitive impacts of the merger in these areas, as Attorney General Lungren suggests.

However, in this balancing task we will not explicitly consider within § 854(b)(2) other factors considered in § 854(b)(1) or (c) which may be arguably relevant to an assessment of competition. The statute does not explicitly indicate that factors considered under § 854(b)(1) or (c) may be balanced against the findings made under § 854(b)(2). Since the evidentiary record in this particular proceeding was developed in a manner consistent with a separate consideration of the § 854(b)(1), (b)(2), and (c) factors, we believe it is prudent to adhere more closely to this analysis.

Only applicants assert that the proposed merger has pro-competitive elements. Specifically, these are benefits associated with applicants' Transmission Service Commitments, their undertakings in connection with Incremental Facilities Additions (IFAs), and their claim that the merger will make available 400 MW of firm transmission service (250 MW to the SW and 150 MW to the PNW pursuant to the APMC). These matters bear directly on the issue of transmission. However, as discussed more fully in our mitigation analysis, applicants' specific undertakings in these areas are inadequate because they fail to address horizontal-side transmission market impacts, and would do nothing to alleviate post-merger concentration in the transmission and bulk power markets identified above. And, as further stated in our mitigation

[56] In this decision we assess issues previously addressed as retail competition instead as rivalry under § 854 (c)(2) & (6).

analysis, the Transmission Service Commitments, the IFA proposal, and the APMC are woefully inadequate in dealing with the merger's identified adverse vertical impacts (see also, PD, pp. 996-1002 for more detailed analysis of these infirmities). These inadequacies totally undercut applicants' assertion that this merger is pro-competitive. However even if we give applicants the "benefit of the doubt" and consider these elements as "pro-competitive" in the balance of adverse/pro-competitive merger elements, their obvious shortcomings (which also make them ineffective mitigation measures) lead us to the inevitable conclusion that the balance of pro- and anti-competitive merger impacts is unfavorable to applicants.

Furthermore, whether viewed separately via a market-by-market assessment of impacts consistent with the PD's approach, or aggregated and balanced as Attorney General Lungren advises, there is no doubt that the proposed merger will impact competition adversely. Its identified impacts are not merely de minimis or confined to one market. The effects which the opposing parties have demonstrated will result from this acquisition are significant and harmful, and pervade multiple product/geographic markets for transmission and bulk power.

In many of these areas, including the affiliates and transmission areas, applicants failed to produce evidence of the merger's impacts. As discussed above, and more fully in our mitigation analysis, we find more convincing the evidence produced by other parties to counter applicants' pro-competitive claims. Given applicants' failures, the task of weighing the evidence of the merger's pro- and anti-competitive impacts is more clear-cut than it otherwise would be, and our assessment is that when all three categories are reviewed, the net impacts of the proposed merger on transmission, bulk power, and affiliates issues must lead to a finding that the proposed merger will adversely affect competition under § 854(b)(2). Thus, whether viewed under the approach taken in the PD, consistent with Attorney General Van de Kamp's Advisory Opinion, or under the "balancing" approach suggested by Attorney General Lungren, this proposed acquisition will adversely affect competition under § 854(b)(2). We now assess whether these impacts can be avoided through mitigation.

4. Mitigation

Several parties have addressed mitigation issues, and their positions vary widely.

For example, Attorney General Van de Kamp has determined that the proposed merger does not meet the requirements of § 854(b)(2), either as proposed or as potentially conditioned (Advisory Opinion, p. 62). At the other end of the spectrum, applicants argue that the proposed merger will provide other utilities greater transmission access than they presently enjoy, and consequently transmission access conditions are inappropriate and unnecessary (Applicants' OB, p. VI-158). Nonetheless, applicants' case-in-chief includes specific transmission access proposals.

Other parties have proposed various transmission access conditions designed to mitigate perceived anti-competitive impacts, assuming the Commission will opt to approve the proposed merger if it determines such anti-competitive problems can be mitigated. Set forth below are the proposals of DRA, Resale Cities, IEP, NCPA, M-S-R, and PG&E.

The legal standard for reviewing proposed mitigation of the merger's adverse impacts on competition pursuant to § 854(b)(2) is avoidance of adverse impacts. Anything short of avoidance is statutorily insufficient and will preclude authorization of the proposed merger.

E. Adverse Impacts on Wholesale Transmission and Bulk Power Markets Cannot be Avoided through Mitigation

1. Applicants' Proposals

Applicants' transmission-related conditions fall into two categories: the Transmission Service Commitments (Fogarty, Exh. 722), and the proposal, augmented by the APMC, to auction 400 MW of transmission service (250 MW to the SW and 150 MW to the PNW).

a. The Transmission Service Commitments

The Transmission Service Commitments build upon Edison's existing NRC commitments. Under the terms of the Amended 1982 licenses issued by the NRC for SONGS 2 and 3, Edison has committed to include in its transmission planning for facilities within its service territory sufficient capacity to meet the transmission service needs of other utilities (Fogarty, Exh. 18, p. 7). If the merger is approved, Edison has offered to extend its NRC commitment to the combined Edison/SDG&E system, and to expand it in two basic respects. First, Edison will expand the NRC commitment to the transmission of power produced by a QF in the merged company's service territory to outside utilities. Second, Edison will construct IFAs where needed to provide transmission service requested by other utilities.

IFAs are defined to include new facilities, upgrades of existing or planned facilities, or the acceleration of planned facilities. IFAs would be made to expand the merged company's interconnections with adjacent utilities as well as to expand transmission capacity within the merged company's service territory (Id., p. 23). IFAs will become part of the merged company's transmission system, and must not interfere with the merged company's use of facilities to meet its service obligations to native load customers and contractual commitments to others. Furthermore, the merged company must be compensated appropriately for the transmission services to be provided.

These proposals are inadequate for several reasons. Fundamentally, the proposed merger will cause anti-competitive problems on both the vertical and horizontal sides. Applicants' proposals do not address horizontal-side impacts at all, and would do nothing to alleviate post-merger concentration in the wholesale markets under review.

Turning to vertical-side impacts, the definition of service area transmission contained in the NRC commitment is inadequate to address Resale Cities' needs to purchase bulk power from non-Edison sources, in order to vitiate identified adverse vertical side impacts of the merger. Specifically, the definition excludes certain key facilities located entirely within the merged entity's service territory (including Lugo Substation, the three 500 kV lines from Lugo to the Miraloma and Serrano Substations, the two lines from Lugo to the Vincent Substation, and the entire 230 kV system of SDG&E), which are necessary to permit Resale Cities to access alternative wholesale bulk power markets.

Also, as IEP points out, the NRC commitment, as expanded to the post-merger environment, would require that utilities purchasing from QFs, and not QFs themselves, request transmission service, and this may have an adverse "chicken and egg" problem on the ease with which QFs are able to participate in these markets. For example, some utilities require executed power sales contracts before they consider wheeling requests, while other utilities require the QF to obtain wheeling rights before executing a power order contract (Marcus, Ex. 44,900, pp. 13-14). As presently framed, applicants' proposal does not recognize this problem, and thus would not be as effective in assuring transmission access to QFs as it should be to constitute effective mitigation in the post-merger environment.

The merged entity's IFA-related interpretation of "full compensation" to mean incremental cost, which is a change from Edison's longstanding commitment to provide transmission within its service territory on a rolled-in cost basis, also casts doubt on the efficacy of the IFA proposal as mitigation. Applicants' interpretation would place Resale Cities in a worse situation than at present in cost terms, instead of improving their situation through effective mitigation measures. IEP also notes that the open-ended cost responsibility for incremental upgrades may adversely affect the ability of QFs to finance projects. While cost is not the determinative factor in assessing the efficacy of mitigation, it is one measure of assessing whether a particular mitigation proposal will work, and thereby avoid adverse consequences.

Applicants' present IFA proposal gives the merged entity entirely too much discretion to determine whether or not a particular transmission request should be fulfilled under the NRC commitment (as "load-related") or whether the request should be treated as an IFA request because it is "resource related." This open-ended discretion may simply exacerbate existing problems by causing disputes which delay completion of IFA projects. Furthermore, as Vernon notes, the IFA scheme may not promote the most efficient configuration of the transmission system, and will result in some cases in the requesting utility being forced to bear the cost of transmission capacity held idle for the merged entity's future use. This concern is closely related to Resale Cities' criticism that the merged entity is not obligated to provide ownership options under the IFA commitment, and that any facilities constructed pursuant thereto will revert ultimately to the merged entity. Applicants have not indicated why the ownership option could not be provided under their IFA proposal, or some variation thereof. In sum, the Transmission Service Commitments, including the IFA proposal, place entirely too much discretion in the hands of the merged company. That fact, coupled with the limitations noted above, make it inadequate as a mitigation measure.

b. The Additional Proposed Merger Conditions (APMC)

Pursuant to the APMC, which is the most current version of applicants' merger-related transmission access proposal, the merged entity will provide 250 MW of transmission service between Palo Verde Switchyard and Devers Substation as well as service between Devers Substation and one or more of three points: an L.A. Basin network point; the Sylmar Converter Station; and/or the Midway Substation. Service between Devers Substation and the Midway Substation will only be firm in the northward direction. Participants in the auction must buy this transmission capacity on a bundled basis, meaning that they must buy the link from Palo Verde to Devers Switchyard, as well as a second link from Devers to Sylmar, Midway, or the L.A. Basin. Service to the SW will continue until May 31, 2005 contingent on DPV2 being built and placed into service by May 31, 1997. If this does not occur, the 250 MW transmission service will terminate in May 1997.

Under the APMC proposal, the merged entity will also provide 150 MW of firm transmission service to the PNW through the Sylmar Converter Station to the Nevada-Oregon Border. Participants in the auction can buy this transmission capacity on an unbundled basis. Service is to be provided on a firm bidirectional basis until January 1, 1998, and then south to north only until 2001.

There are several reasons why applicants' APMC proposal will not avoid the proposed merger's adverse impacts on competition in the wholesale transmission and bulk power markets under review. First, the duration of the transmission service to be offered is inadequate. Service from the SW will continue for a maximum period of 14 years, or may cease at the end of 1997 if DPV2 is not built. Bidirectional transmission service to the PNW is certain only until 1998, and from 1998 to 2001, transmission service is unidirectional only (south to north).

Second, the APMC proposal contemplates two separate and uncoordinated auctions. This means that a utility must succeed in two auctions to get service linking the PNW and SW, and only a maximum of 150 MW is available to link the two separate regions. Thus, the connection linking these two regions has a maximum duration period of 7 years (1998). Furthermore, there is no nexus between 150 MW and the competitive problems identified in these markets. Yet adoption of applicants' proposal would require a finding that the availability of 150 MW for

7 years constitutes effective mitigation of the merger's long-term separation of two regional markets (SW & PNW) that may otherwise eventually be unified through removal of existing barriers to transmission accessibility. The APMC, a one-time event during which two separate uncoordinated auctions will be held to dispose of 400 MW, clearly does not address the long-term problems identified in these markets, where mitigation could only be accomplished by the availability of reasonably priced long-term transmission service. Case-by-case contracting, such as that underlying the APMC proposal, is an inadequate vehicle for opening up these transmission markets on a nondiscriminatory basis in the long-term. In short, both the duration and quantity of the APMC are inadequate.

Third, there is no way to oversee the APMC mechanism; implementation has been left to the merged entity, which will be responsible for resolving ambiguities outside any formal dispute resolution forum. This criticism, of course, assumes that any forum could effectively resolve disputes related to short-term transmission service provided under the APMC. Effective resolution is a real question given that decisions regarding short-term service must be made quickly and often on-the-spot to avoid lost opportunities.

Fourth, the APMC proposal is restricted to "entities," a definition which excludes QFs and IPPs. Although the proposal includes a provision for resale or assignment of transmission, this remedy is probably impractical due to the required bundling of the service which may not make it attractive for resale. Furthermore, the merged company is not restricted from buying this service under an assignment arrangement, so there is no guarantee that all auctioned service will eventually be used as mitigation.

Finally, there are troublesome questions about the reasonableness of the APMC's price mechanism. The "90% to 120% of base rate" calculation is premised on a very rough range, which some parties criticize as arbitrary. No examples have been provided by the applicants to demonstrate how the mechanism would work in actual practice. DRA is concerned that the ceiling price is too low, and that the proposal will likely result in excess demand. Other parties believe the ceiling price is too high. Bidders will pay different prices for the same service versus a uniform price. Transmission is not necessarily awarded to the highest bidder on each segment, since the entire bid is evaluated as a whole. Also, ranking the bids on a net present value basis may discriminate against those who need transmission more in later years, as DRA notes.

For all of these reasons, applicants' proposals fall short of avoiding the anti-competitive aspects of the proposed merger.

2. DRA's Transmission Proposal

DRA's transmission proposal is the most far-reaching of any presented in this docket, and the only one which takes account of both short-term and long-term merger impacts. DRA's proposal considers the needs of buyers and sellers in these markets for 25 to 40 years in the future, as well as in the short term. Its proposed mandatory auction is an attempt to fashion a reasonable arrangement for buyers to obtain firm transmission capacity, while balancing the bargaining positions of buyers and sellers in transmission markets where the merged company has substantial market power. It also gives buyers more access to the SW post merger, thereby addressing DRA's buyer market concerns in the SW bulk power markets. The proposal is the only one which attempts to further the unification of the regional PNW and SW markets through increased transmission access. It is also the only proposal which contemplates that service would be made available for periods corresponding to the life of the generating resources that will utilize the transmission capacity. Thus, the proposal is adequate in terms of the duration of transmission service to be offered.

DRA's single price auction contemplates that unbundled point-to-point service would be made available under a procedure that would be repeated periodically. The amount of wheeling services to be provided under this proposal would be determined by the demand for same at a price sufficient to cover long-run incremental costs. The mechanics of the procedure would be overseen by regulators. Therefore, DRA contemplates that regulators would be involved in determining the amount of transmission service to be auctioned in response to the competitive problems identified in this decision. This is a marked improvement over the arbitrary assignment of a fixed MW amount (400 MW) by applicants.

Turning to the issue of price, DRA contemplates that Edison would identify a bidding price range with a ceiling price equal to or larger than the embedded cost of the point-to-point service, plus the cost of any identifiable present or future incremental facility additions required to provide the service. Edison would determine the floor price as less than the sum of the embedded cost of the point-to-point service and the cost of any identifiable present or future incremental facility additions required to provide service, but no lower than the short-run incremental cost of transmission service. DRA believes that ratepayers are protected by the use of incremental cost pricing in the development of the price floor. However, the use of marginal cost pricing is disputed by those parties who believe they would be adversely affected by the departure from embedded cost, and/or that their unique position justifies preferential treatment. Thus, DRA's use of marginal cost is controversial, and would require additional refinement in a contested regulatory proceeding.

DRA's proposal also is comprehensive in its attempt to address situations where demand exceeds supply in both the short and long run, an issue applicants' proposal does not acknowledge. Where demand exceeds supply in the long run, DRA proposes that the merged entity be required to increase the capacity made available at a subsequent auction. The amount of this increase and the date of the subsequent auction would be subject to regulatory review. DRA also contemplates that the merged entity could make additional wheeling services available either by constructing new facilities or reducing its own use of existing ones. Again, the details of these aspects of DRA's proposal, which are not de minimis in scope or controversy, have not yet been developed fully.

The length of the contractual periods DRA contemplates under its auction proposal are longer than those contemplated in the APMC proposal. For example, DRA's proposal provides specifically that wheeling services are to be made available for contractual periods corresponding to utility planning horizons, and sets a likely range of 25 to 40 years, whereas the maximum duration of service under the APMC is 14 years. DRA's proposal also contemplates that downward pricing flexibility would be permitted in certain events.

Finally, unlike the APMC, DRA's proposal contains a dispute resolution mechanism in the form of "regulatory adjudication," while encouraging private settlement via assignment of costs to the losing litigant. However, again, the details of this mechanism are unclear presently and the issues involved are contentious.

Nonetheless, in its scope and specification of details, DRA's proposal is comprehensive, visionary, and far superior to the APMC. It also represents an attempt to balance impacts, protecting ratepayers through incremental cost pricing provisions, while addressing the needs of Edison's competitors in these markets through its focus on nondiscriminatory access. It also has the advantage of addressing vertical and horizontal merger impacts, by going beyond transmission access provisions, and attempting to address market concentration, a horizontal issue. It seeks to link the PNW and SW markets and thereby attract additional buyers to those markets which will be adversely affected as a result of the proposed merger's monopsony effects. Furthermore, the proposal is the only one which links the PNW and SW regions, and addresses the fact that the merger will have the long-term impact of keeping these two regional markets separate unless the type of mitigation DRA suggests is adopted.

However, a major concern has been raised regarding the feasibility of DRA's proposal. As several parties have noted, the details of this proposal remain somewhat fuzzy. Even DRA acknowledges that its proposal requires refinement in a subsequent implementation phase in this docket, or in another appropriate forum. For example, issues such as mechanisms to determine the amount of wheeling to be provided by the merged entity, its choice of ceiling and floor prices, and procedures governing construction of new incremental facility additions or other facilities needed to provide service (especially in those cases where demand exceeds supply in the long-run), must be developed prior to implementation.

DRA's proposal relies heavily on incremental cost pricing principles, and FERC is just beginning to look at incremental cost pricing in this context. Therefore, applicants raise the spectre of a jurisdictional clash with FERC if the Commission adopts DRA's proposal.

Related to these feasibility problems is the fact that the DRA proposal requires the Commission to become heavily involved in overseeing the auction process. For example, the merged utility would be required to submit to this Commission its supply curve (the amount of firm transmission capacity which can be made available without affecting reliability at various prices beginning at short-run variable cost and ending with long-run incremental cost) prior to the auction. The reasonableness of Edison's supply curve would be subject to regulatory review either at the outset or retrospectively. However, this could be a rather complex and lengthy undertaking if, as applicants assert, the Commission must determine incremental variable costs on multiple varied transmission paths throughout the merged utility's system. Nonetheless, DRA's proposal would require that, prior to each auction, the Commission hold proceedings where these matters could be reviewed and resolved, both to ensure that auction impacts on native load customers are taken into account, and that the auction is held on terms which effectively carry out this Commission's orders regarding merger-related mitigation. Thus, the Commission will be undertaking the expanded role of ensuring that the auction process is fair to the merged utility's competitors, while protecting its retail customers.

Clearly, DRA's proposal raises significant implementation issues, jurisdictional questions, and the spectre of increased Commission involvement in setting and monitoring the parameters of the auction process. Applicants have not offered any solutions to these issues. On balance, we conclude that, at the present time, DRA's proposal will not avoid the horizontal and vertical adverse competitive effects which have been identified in the wholesale transmission and bulk power markets under review.

To constitute effective mitigation under § 854(b)(2), a proposal must avoid adverse impacts of the merger. This means that the proposal must be presently feasible, so that the Commission can establish it with the knowledge that it will work effectively at the time the merger is authorized. Our authorization of the merger, contingent upon further development of DRA's mitigation proposal, or refinement of its crucial missing variables in a subsequent proceeding, is legally impermissible because we cannot now ensure that the mitigation measure as ultimately adopted will be sufficient to avoid adverse competitive impacts. Once authorization is given, the merger cannot be undone. Therefore, a decision to allow the proposed merger to proceed without definitively resolving major mitigation details may have irreversible consequences. Presumably, this is why the Legislature has specified such a high mitigation standard in the amended version of § 854.

Furthermore, even if the statute permitted such a phased approval process, there is no assurance that DRA's proposal would work, given the jurisdictional and feasibility questions that have been raised.[57] Thus, the problems go beyond mere implementation or timing issues to

[57] For example, even if the terms of these transmission commitments could be tightened, and mechanisms provided to arbitrate or adjudicate conflicting claims to transmission service, this is a cumbersome arrangement. (continued...)

fundamental questions of feasibility. For all of these reasons, we conclude that the proposed merger's adverse competitive impacts cannot be avoided at this time by adoption of DRA's proposal.

3. Other Specific Proposals

Other specific conditions, which are less comprehensive than DRA's auction proposal, have also been presented. Because we have rejected applicants' mitigation approach, and have indicated that a comprehensive mechanism akin to DRA's auction proposal is preferable to mitigation measures of a more ad hoc nature, it is unnecessary to address many of Resale Cities' proposed merger conditions in greater detail.[58]

Similarly, the ad hoc mitigation proposals of PG&E and IEP were fully addressed in Part Nine of the PD, and need not be further addressed here.

NCPA's proposal for a tight pool, and its proposal that "best efforts" be required to open membership in the CPP to NCPA, do not appear to be supported by any evidence that the merger will have adverse impacts on power pooling issues per se.[59]

M-S-R's transmission proposals are keyed to its unique situation. We find that M-S-R's transmission proposals, which are designed to ensure that it obtains 150 MW of firm transmission commitments from Palo Verde to Midway, and from Lugo to Midway, are not specifically related to the merger. However, to the extent that M-S-R, like all other participants in these

---

[57](...continued)
It is unclear that it would work effectively given the dynamism of the bulk power markets, where purchase and sale opportunities arise without advance notice and expire within minutes or hours (Advisory Opinion, p. 59).

[58] The Resale Cities propose detailed merger conditions which address specific problems in their relationship with the merged entity, and are intended to limit the latter's ability to exercise market power over them. Many of the Resale Cities' proposals are presented to counter applicants' transmission service commitments and related conditions, and are designed to be adopted if the Commission approves applicants' suggested mitigation measures (Southern Cities' OB, p. 136). For example, Southern Cities' ten suggested conditions are supplemental to applicants' mitigation measures, addressing such matters as service area transmission, import transmission service, additions to the import transmission system (such as IFAs), participation in new transmission facilities, and nonfirm transmission service.

[59] NCPA also proposes generic transmission access conditions patterned after FERC's decision in Utah Power & Light, supra, although the specifics of its proposal, including implementation details, are sketchy. (NCPA's OB, Appendix A). However, NCPA's basic concerns that it have adequate transmission access, especially to alternative firm power markets in the desert SW, would be addressed through adoption of DRA's auction proposal, although the latter proposal would not afford such access at the cost-based rates NCPA desires.

markets, would be advantaged by a proposal that would improve transmission access to the SW, its concerns would be met, at least in part, by DRA's auction proposal.

In conclusion, we find that the proposed merger's competitive impacts are better addressed through a comprehensive scheme such as DRA's auction proposal rather than through adoption of these ad hoc proposals which address matters unique to the situations of the parties proposing them.

4. Conclusion

Having reviewed the mitigation proposals of applicants and other parties, we conclude that DRA's transmission proposal is preferable to all other measures presented for consideration. However, that comprehensive proposal requires significant additional implementation efforts, and it is uncertain that even after such efforts have been undertaken, the outstanding jurisdictional and feasibility questions would be resolved in a manner consistent with the statutory mitigation requirements applicable to this merger (§ 854(b)(2)). The statute requires avoidance of adverse competitive impacts. However, today there is no proposal dealing with adverse merger-related wholesale transmission and bulk power impacts which meets this test. PU Code § 854(b)(2) does not permit authorization of the proposed merger subject to future imposition of conditions designed to avoid adverse competitive impacts. Rather, the statute requires that the proposed merger not be approved unless adverse impacts on competition can be avoided at the time of approval. We find they cannot.

F. Adverse Impacts Associated with Affiliate/Vertical Integration Can Be Avoided Only Though Partial Divestiture

1. Current SCEcorp Protections and Existing Regulatory Mechanisms

We find that current regulatory mechanisms are inadequate to deal with the adverse impacts of the vertical integration this merger will effect. This is because the present holding company decision's protections are not directed to the broader scope of issues posed by the merged entity, and due to Edison's course of action in evading compliance with its conditions. While we might broaden the decision's scope, Edison's track record on compliance would undermine the efficacy of such changes.

The holding company decision provides less direct Commission ratemaking control over affiliate transactions than SDG&E ratepayers currently enjoy. It is fundamentally illogical that a mitigation measure which provides less direct ratemaking control than the pre-merger status quo could be effective, in and of itself, in preventing the greater post-merger harms associated with increased self-dealing opportunities, increased ratepayer costs, and adverse competitive effects on nonaffiliated QFs, not to mention evasion of regulation. Thus we take no comfort in applicants' contention that there is some benefit to bringing SDG&E's current PDCC subsidiaries under the SCEcorp holding company structure (Applicants' OB, p. VII-11, VII-14), since the actual impact of this change is to lessen the Commission's direct ratemaking control over these entities. Likewise, we find unmerited applicants' reliance on the holding company conditions to protect ratepayers and competitors from increased self-dealing through affiliate company transactions with the regulated gas distribution facilities acquired from SDG&E (Applicants' OB, p. VII-27). The issues posed are greatly beyond the scope of the matters considered by the Commission in its 1988 holding company decision, and applicants' reliance on the decision presumed, incorrectly, that the merger would not expand the nature of the Commission's required oversight of these gas operations (Jurewitz, Exh. 60, pp. 107-109).

Even those who believe the holding company conditions are prima facie adequate mitigation measures must pause in reflecting upon the practical experience of this Commission. The protections are only credible if the Commission is ensured the necessary access to holding company books and records to effectively validate them (D.88-01-063, Ordering Paragraph 1.1). Yet, as this record clearly demonstrates, despite applicants' pre-existing obligations and the Commission's stated intention to construe the holding company conditions and its statutory authority in the broadest possible fashion, applicants have often failed timely or willingly to provide the information necessary for the Commission's reviews of affiliate transactions (Kinosian, Exh. 10,300, p. IV-36 to IV-42). Even in this proceeding, where applicants are anxious for a speedy Commission decision, they have been less than forthcoming in addressing the affiliate issues posed by the assigned ALJs and Commissioners following the May 11, 1989 PHC. More than any other factor, applicants' reluctance to provide information as required by holding company decision Condition No. 1, and thereby satisfy their obligations under the regulatory compact struck in D.88-01-063, undercuts the notion that reliance should be placed on this mitigation vehicle, even were it modified in our decision today.

Nor does the existing ECAC reasonableness review protect ratepayers adequately in the larger post-merger environment. The ECAC's rapid schedule, its resource intensive nature, its reliance on the good faith provision of utility/holding company information, and its focus on fuel and purchased power costs (in this instance the QF purchased power contracts) to the exclusion of other significant affiliate-related issues (such as transmission access) make the ECAC an unsuitable forum to protect against the adverse impacts identified in this decision. The Commission's pre-merger experience is that the ECAC has not been an ideal forum for adjudicating contested affiliate issues. This casts serious doubt on the ability of this mechanism to resolve the greater problems associated with the expanded self-dealing opportunities facilitated by the merger.

The third existing regulatory mechanism on which applicants rely is the competitive bidding protocol. However, this protocol only addresses the initial contracting stage, not the contract administration stage, where abuses can raise the spectre of substantial excess ratepayer costs (Jurewitz, Exh. 10,729, pp. C008224). Additionally, as Vernon points out, competitive bidding does not address indirect self-dealing, which may occur when Mission Group companies like Mission Engineering deal with Mission Energy partners in pre-operation project development ventures (Clay, Exh. 40,460, p. 9), or when nonaffiliated entities such as Luz transact business with a Mission Group affiliate (Bumgardner, Exh. 10,300, pp. II-20 to II-21). We have determined already that these transactions will be facilitated post merger. In addition, as Vernon notes, competitive bidding in its various forms is heavily dependent upon utility input, and does not remove all subjectivity from Edison's contract award decisions, thus raising the question of whether it is a sufficiently neutral vehicle to protect ratepayers, notwithstanding applicants' claims.

We do not find applicants' contract preapproval condition adequate to deal with increased post-merger self-dealing opportunities. As DRA and intervenors have noted, applicants' proposal is fundamentally flawed in that it addresses only the initial contract stage, and its mitigating effects would be so limited. It is also necessary to protect ratepayers and competitors from the effects of contract administration self-dealing abuses, which can be significant due to the long-term duration of QF contracts. In addition, as DRA notes, preapproval is Commission resource intensive, and requires review of the contract separate from other resource planning decisions.

Nor do we find SCEcorp's internal corporate policy, that any dealings with QFs in which Mission Energy is interested must be more beneficial to Edison ratepayers than comparable dealings with unaffiliated QFs, adequate in and of itself to mitigate the adverse impacts of the merger. While we applaud this corporate policy, the stakes are simply too high, and the internal conflicts of interest too great (Kinosian, Exh. 10,300, p. IV-5) to find this well-intentioned policy, which is unenforceable in any meaningful regulatory sense, an adequate mitigation measure.

Similarly, the independent audit by Coopers & Lybrand is insufficient because it: 1) does nothing to ensure that contract administration practices comport with Commission policy; 2) is subject to the same information access constraints that have plagued DRA; 3) is subject to Edison's reserved right to review and comment; and 4) does not compare Edison's administration of affiliate and nonaffiliate contracts (DRA's OB, p. 368; Kinosian, Exh. 10,310, p. IV-20).

In sum, because Edison has repeatedly failed to provide the requisite access to books and records mandated in the present holding company decision, we find that its failures would continue to undercut any new regulatory protections we might impose on the post merger entity. Therefore, we must look beyond existing regulatory mechanisms tailored to the pre-merger status quo and applicants' proposals to determine whether other proposed measures will adequately mitigate the merger's identified adverse impacts.

2. DRA's Prohibition Proposal

DRA's recommendation that the merged utility be prohibited from signing any future contracts with Mission Energy has a certain appeal. It eliminates future direct self-dealing problems between those particular affiliated companies and the need for additional regulatory oversight in this discrete area.

We are less concerned than DRA that prohibition does not mitigate "brain drain," for we are not persuaded that the merger itself will cause additional movement to Mission Energy or the other affiliates. Only 3 years have passed since holding company formation was authorized, and it would be preferable to have historical data spanning a greater number of years to get a better perspective on the issue of "brain drain." However, it appears as applicants contend, that the significant movement of personnel underlying DRA's concerns occurred during initial staffing of the affiliate companies (Bumgardner, Exh. 732). We cannot find, on the basis of the record before us, that an outflow comparable to the initial one is ongoing, or that the merger per se will trigger such movement.

As a practical matter, the effect of adopting DRA's proposal is to grandfather the existing 13 Edison/Mission Energy contracts, and thereby confine Edison/Mission Energy self-dealing to pre-merger contracts. Were this recommendation adequate to mitigate the adverse impacts of the merger, and therefore suitable for adoption, we would require as an additional measure, that each of the 13 contracts not be renewed at the end of its current term, so that ultimately, the merged utility would have no contracts with Mission Energy, or any successor entity.

The chief problem with DRA's proposal, however, is that it is a less than comprehensive solution to the adverse effects identified. It does not address indirect self-dealing, nor would it prohibit other Mission Group Companies, such as Mission Engineering, from dealing with the 13 grandfathered projects or with other QFs selling to the merged utility. This is a problem given our finding that the merger increases the likelihood of self-dealing in these specific areas. In addition, prohibition does not protect SDG&E's ratepayers ultimately from paying the costs associated with self-dealing vis-a-vis these 13 contracts, a liability they would not have absent the merger.

Nor does prohibition assure that the Commission's post-merger regulatory burden will be reduced. The 13 existing contracts which presently provide 1468 MW to Edison, or 76% of Mission Energy's 1989 sales (Kinosian, Exh. 10,300, Appendix C), will become part of the larger merged entity's resource plan post merger, and must be reviewed in ECAC reasonableness proceedings. Our experience in some recent ECAC proceedings, which were highly contentious due to disputes over the availability of information possessed by the partners, does not suggest that demands on regulation will be reduced following the merger.

Finally, grandfathering the existing Edison/Mission Energy contracts will not eliminate adverse merger impacts on other QF competitors. It will be impossible in the expanded service territory to ensure that merged utility self-dealing with the existing Mission Energy projects is avoided or that such self-dealing will not adversely affect nonaffiliated QFs or otherwise impair their transmission access opportunities, especially given the enhanced transmission access available to the merged entity following the merger.

For all of these reasons, prohibition is not a satisfactory mitigation measure.

3. Partial Divestiture of Mission Energy

The only measure that could be adopted in mitigation of the identified vertical impacts is divestiture. This is the primary DRA recommendation, seconded by the Attorney General, San Diego, and UCAN.

However, we believe DRA's recommended total divestiture of Mission Energy is both overbroad and unnecessary to address the merger's identified impacts. A more narrowly tailored partial divestiture, confined to the Mission Energy projects which operate in the WSCC, is sufficient to address the increased self-dealing, ratepayer costs, and anti-competitive problems resulting from this merger. It makes no sense to require divestiture of Mission Energy's international, East Coast, or other projects outside the WSCC (which will neither supply the merged entity's energy needs nor enable it to use its control over transmission to disadvantage competing QF sellers), except to address companywide "brain drain" or cross-subsidization problems. However, we have not found such companywide problems to be merger impacts.

Following partial divestiture, Mission Energy projects outside the WSCC would be subject to the holding company reporting and auditing conditions. Meanwhile, partial divestiture of Mission Energy projects located within the WSCC area, plus a comprehensive ban on Mission Energy's involvement in future projects in that area, severs the affiliate link only to the extent necessary to eliminate self-dealing between the merged entity and those portions of its unregulated affiliate's geographic operations capable of (i) serving the merged utility's energy needs or (ii) enabling it to use the transmission grid to disadvantage its competitors. Such limited divestiture is precisely tailored to the adverse effects of the merger, by ensuring that nonaffiliated QFs are not competitively disadvantaged in their dealings with the merged entity or in their transactions with other prospective purchasers throughout the discrete geographic area where the merged entity controls transmission.

Furthermore, partial divestiture represents adequate mitigation because it is a clear-cut, definitive remedy, which also allows Mission Energy to continue as an ongoing entity in the WSCC, albeit under different ownership. It also is less Draconian than full divestiture because it allows SCEcorp to retain its Mission Energy projects outside the WSCC, while eliminating all forms of Mission Energy self-dealing, both direct and indirect, in the defined area.

Given the increased funds available for post-merger expansion of Mission Energy's operations, both within and outside California, and the potential that self-dealing abuses will attend this expansion and lead to increased costs for the merged utility's ratepayers, partial divestiture is the only sufficiently ameliorative remedy. Partial divestiture enhances competition by decisively eliminating the unfair advantage Mission Energy-related self-dealing poses to nonaffiliated QFs within the geographic area where the bulk power and transmission markets serving the merged entity are located. Partial divestiture limited to the markets serving the merged utility, will clearly minimize the Commission's Mission Energy-related regulatory burdens on a prospective basis, although several reasonableness reviews for past record periods must still be undertaken. For the future, however, the Commission will not need to be involved to protect against self-dealing in the initial contracting stages, or in contract administration, since the principal cause for concern, the affiliate link, will be severed. This should avoid lengthy proceedings which would otherwise be necessary to review the reasonableness of these transactions. In addition, by leveling the competitive playing field, partial divestiture should result in a decrease in other proceedings, such as complaints filed by nonaffiliated QFs, and should otherwise lessen the demand on resources now devoted to Mission Energy-related affiliate issues by Commission staff at all levels.

We reject applicants' contention that divestiture will facilitate uneconomic self-generation by the merged entity, as DRA has cited several persuasive counter arguments, detailed previously and not repeated here. Thus, there is no reason to refrain from imposing this mitigation measure on that basis.

4. DRA's Recommendations Re the Other (Non-Mission Energy) Mission Group Companies

While the Proposed Decision addressed DRA's Mission Group conditions, there is no need to further discuss these conditions given the outcome of today's decision.

G. Conclusion

In Section III of this decision, we have concluded that the weight of the evidence supports a finding that the proposed merger will have adverse effects on competition in three broad categories (wholesale transmission and bulk power markets, and the area of affiliate transactions), and that with one exception, these adverse effects cannot be avoided through mitigation measures. Thus applicants have failed to prove by a preponderance of the evidence that the proposed merger will not have adverse impacts on competition and that such impacts can be avoided through adoption of mitigation measures. The statutory requirements of § 854(b)(2) are not met. This failure compels us under the requirements of § 854 to deny the proposed merger.

IV. SECTION 854(c): CONSIDERATION OF THE PUBLIC INTEREST

A. Introduction

In addition to determining whether the proposed merger will result in net benefits to ratepayers and evaluating the merger's effects on competition, we must also consider seven other criteria and find, on balance, that the acquisition is in the public interest under the seven criteria set forth in § 854(c).

Also, we may provide and consider mitigation conditions as to each criterion to prevent significant adverse consequences which may result from the merger.

Not all parties to this proceeding addressed each criterion. We will discuss each criterion in sequence, and where appropriate consider mitigation measures for adverse consequences.

B. Section 854(c) Criteria

1. Financial Condition of the Merged Company

Section 854(c)(1) requires the Commission to consider whether applicants' proposal will maintain or improve the financial condition of the resulting merged company.

As part of their showing of net benefits under Section 854(b)(1), applicants presented testimony supporting their estimates that the merger would save $97.7 million in capital costs from 1991 through 2000. Applicants also projected savings from lowered depreciation rates of $38 million. (Miller, Exh. 28A, Table 1.) These expected savings result from the reduced financing costs associated with the SDG&E component of the merged company. Our focus in this section, however, is not so much on the savings that will result from the consolidation of SDG&E with Edison as on the financial health of the resulting merged company. Our discussion will accordingly concentrate on this issue.

a. Dilution

As a consequence of the proposed stock exchange, SDG&E's shareholders will receive a premium representing the difference between the market value of 1.3 shares of SCEcorp's stock and the market value of one share of SDG&E's common stock. Some intervenors believe that a dilution in the value of SCEcorp's stock will result. Applicants deny that any dilution in the value of SCEcorp's stock will occur.[60]

It is undisputed that the exchange of one share of SDG&E's stock for 1.3 shares of SCEcorp's stock will result in a dilution of the book value per share for current shareholders of SCEcorp. This book value dilution will have a detrimental effect on the financial condition of the merged company. However, the more important question is whether the merger would result in a dilution in earnings per share. If the merger increases the earnings of SCEcorp in an amount sufficient to offset the dilution, then the financial condition of the company would be unaffected by the share exchange. The unregulated subsidiaries of SCEcorp appear to offer the greatest potential for improved profitability and earnings. DRA points out that the increased payments to QFs resulting from the merger should improve the earnings of the Mission Energy subsidiaries.

Although the evidence in this area is mixed, we conclude that it is likely that the merger will increase SCEcorp's earnings in an amount sufficient to overcome investors' concerns about

---

[60] Applicants contend that the merger will enhance the merged company's long-term value and financial prospects, a development that should be reflected in the market value of SCEcorp's shares. (Fohrer, Exh. 17, p. 8.) An improved and larger customer base, a more diverse power supply and fuel mix, greater efficiencies, and a stronger management team will enable the merged company to improve its opportunities to earn its authorized return on common equity. Applicants believe that SCEcorp's shareholders agree with this assessment, as demonstrated by their overwhelming approval of the merger.

DRA notes that from an accounting perspective, the 1.3:1 exchange offer will cause a dilution of approximately 6.74% in book value per share for current SCEcorp shareholders. (Fua, Exh. 10,600, p. V-5.) However, whether there is a corresponding dilution in earnings per share depends on the performance of SCEcorp's unregulated subsidiaries. Assuming no change in the corporate status of Mission Energy following the merger, DRA believes that SCEcorp's profitability will be enhanced by the increase in payments to QFs due to the merger. DRA also performed an analysis of the stock price of SDG&E and Edison before and after their agreement to merge, and concluded that there is currently no economic dilution resulting from the merger since shareholders of both firms expect modest benefits.

Based on share prices at the end of 1988, Southern Cities calculate that the merger will result in a dilution of the book value of SCEcorp's stock by about $340.4 million. (Corrigan, Exh. 43,410, p. 11.) To recover this dilution in rates would require additional revenues of nearly $1.2 billion from 1990-2000. (Corrigan, Exh. 43,410, p. 12.) There will also be a dilution in earnings per share of approximately 7.4%, since the combined earnings of SDG&E and Edison will be spread over a larger number of shares than are currently outstanding. (Fohrer, Exh. 67, FERC Tr. 1594, 1699-1700, FERC Exh. 899, p. 1.) Southern Cities believe applicants failed to present any credible or consistent explanation for how SCEcorp's shareholders will recover dilution of the book value and earnings per share that applicants admit will result from the proposed merger. If the dilution is not offset, it will undermine the merged company's financial integrity and have an adverse effect on the cost of capital.

Vernon agrees that the premium SCEcorp will pay to SDG&E's shareholders will dilute SCEcorp's equity and can be expected to affect financial markets and increase Edison's cost of common equity.

the loss resulting from the dilution in book value per share. SCEcorp's stockholders apparently share this assessment, since they voted overwhelmingly to approve the merger. Because investors appear not to view the dilution associated with the merger as creating a greater risk, we conclude that the financial condition of the merged company in this regard will be maintained or improved.

b. Capital Structure

Applicants expect the merged company to maintain Edison's current AA bond rating, even after the debt component of its capital structure rises as the common equity ratio of the SDG&E component of the merged company is lowered from SDG&E's presently authorized 49.5% to Edison's authorized 46%. (Fohrer, Exh. 4, p. 12; Fohrer, Exh. 37, pp. 22-23.) The merged company will be strong enough, in applicants' view, to reduce the equity level of the SDG&E component and to raise the corresponding debt ratio without incurring higher debt costs normally associated with increased leverage and financial risk. Some intervenors disagree.[61]

After reviewing the evidence on this point, we conclude that the merged company's capital structure for financial reporting purposes is more likely to reflect the weighted average of both merger partners' current capital structures. (See Harris, Exh. 20,700, pp. 81-84.) Thus, the merged company will be somewhat less leveraged than Edison currently is. The 1.3:1 share exchange will also increase the number of the merged company's total outstanding shares, further raising the equity ratio. It is also reasonable to expect pressure to be exerted on the Commission to recognize the merged company's less leveraged real capital structure, even though doing so would raise the merged company's revenue requirement. To some extent,

---

[61] San Diego disputes applicants' assumption that the merged company will assume the regulatory capital structure of Edison. San Diego believes the merged company will initially have a capital structure reflecting the weighted average of both merger partners' current capital structures. To achieve a 46% equity ratio, the merged company would either have to buy back equity or issue more debt. As its debt level increases, the merged company would face higher costs and increased financial risk. (Harris, Exh. 20,700, pp. 83-84).

The Attorney General notes that applicants made no promise even to request a regulatory capital structure with a 46% equity ratio for the merged company. Even if applicants had committed to make such a request, they could not assure that the Commission would accede to the request. Thus, the Attorney General regards any assumptions about the merged company's capital structure after 1994 to be purely speculative. (Attorney General's OB, p. 88.)

Vernon contends that immediately after the effective date of the merger, the merged company will have an equity ratio higher than the two independent companies' combined equity ratio. When SCEcorp issues 1.3 shares for each SDG&E share, the result will be an increase in the total outstanding shares of the merged company and an increase in the equity ratio. (Vernon's OB, pp. 40-41.)

therefore, the merged company's financial condition depends on future Commission willingness to have ratepayers absorb increased costs resulting from the merged company's capital structure. The tendency towards a higher equity ratio and the corresponding higher revenue requirement suggests that the merged company will have a financial condition slightly better than the condition of Edison as an independent company, although the merged company may face increased regulatory risk in this area.

Similarly, we conclude that the merged company will likely continue the bond ratings of Edison as an independent company. Although Edison has a slightly higher rating than SDG&E, the evidence shows that the difference between the current bond ratings of the two companies is small, and their consolidation will not change this portion of the overall financial condition of the merged company. (See Fohrer, Exh. 402.) To the extent that the deferrals of generating and transmission resources that applicants have proposed are realized, the reduced financing requirements of the merged company should strengthen its financial condition.

c. Return on Equity

Applicants also expect that the merged company will maintain Edison's currently authorized return on equity of 12.85%, although SDG&E's currently authorized return on equity of 12.90% (D.89-11-068) is higher.

However, the increased number of SCEcorp's outstanding shares resulting from the 1.3:1 share exchange would increase the equity ratio, and higher revenues will be required to maintain the return on equity at 12.85%. Because of the higher equity ratio resulting from the merger, merely maintaining the return on equity at 12.85% would require ratepayers to incur an added cost associated with the merger. Again, the merged company's financial condition in this respect depends on the Commission's future willingness to have ratepayers absorb increased costs resulting from the merger. Thus, the merged company may face increased regulatory risks in this area.

We find little financial evidence that the return on equity authorized for the merged company is likely to differ from the return on equity authorized for Edison as an independent company. Although the merged company would face a regulatory risk that the Commission would not allow recovery of the higher costs necessary to maintain Edison's return on equity for the merged company, we conclude, despite some reservations, that the return on equity aspect of the financial condition of the merged company will be maintained.

d. Higher Dividends for Preferred Stock

Under applicants' proposal for the merger, SDG&E's existing preferred and preference stock will be converted into SCEcorp's preferred and preference stock when the merger is consummated. The SCEcorp preferred and preference stock will have a higher dividend rate than the currently outstanding SDG&E shares. Applicants believe these increased payments to SDG&E's preferred shareholders provide compensation for acceptance of less favorable voting and dissolution rights. (Page, Exh. 69, pp. vii, 75-85.)

According to applicants, the costs associated with these higher dividend rates will amount to about $18 million from 1991 through 2000. (Fohrer, RT 5395-5396.) It is apparent, however, that the proposed increased dividends are payable well beyond the year 2000, at a rate of about $2 million per year. Applicants' quantification of these increased costs from 1991 through 2000 does not fully depict the merger-related costs of the decision to pay SDG&E's preferred shareholders this increased compensation.

The increased dividend to SDG&E's current preferred and preference shareholders indicates that SCEcorp's preferred and preference stock carries a slightly higher overall risk than SDG&E's corresponding issues. We conclude that this higher risk and the increased costs to the merged company of its preference and preferred stock represent a detriment to the financial condition of the merged company.

e. The Costs of Defeasing the Industrial Development Bonds

From 1983 through 1987, San Diego issued six series of Industrial Development Bonds (IDBs) in the total amount of $550,600,000 and lent the proceeds to SDG&E. Pursuant to the Internal Revenue Code, the IDBs are exempt from state and federal income taxes because they were issued to provide "facilities for the local furnishing of electric energy or gas" in "a city and one contiguous county, or two contiguous counties" (26 U.S.C. § 142(a)(8), (f); 26 U.S.C. § 102(b)(4)(E)). The proceeds of Series 83A and 83B were used to finance distribution facilities and a portion of the Southwest Powerlink (SWPL). The remaining four issuances (Series 85A, 86A, 86B and 87A) were used to finance gas and electric distribution facilities throughout SDG&E's service territory. (Weisenmiller, Exh. 25,002, pp. 6-7.) If the proposed merger is consummated, electric facilities financed by the bonds will become part of a much larger service area, which exceeds two counties. Thus, the merger may threaten the tax-exempt status of these bonds.

SDG&E currently has several IDB-related covenants with San Diego. For example, San Diego's Loan Agreement with SDG&E on Series 86B provides that SDG&E will not merge with and be absorbed into another corporation unless SDG&E delivers to the trustee a bond counsel opinion that the tax-exempt status of the bonds is not affected adversely by the merger. (Bryson, RT 1206-1208.)[62]

Applicants have now received a private letter ruling from the IRS. It permits applicants to redeem Series 86B and 87A and to defease the remaining four issues in question shortly after effective date of the merger without affecting the tax-exempt status of the bonds. Applicants estimate that the cost of defeasing the bonds according to the terms of the letter ruling is $59 million. (Fohrer, RT 5429; Applicants' OB, pp. IV-73 to IV-74, fn. 57.) The cost of defeasance essentially raises the cost of debt for this limited portion of the merged company's financing. To that extent, the requirement to defease the existing six IDBs of SDG&E will slightly worsen the financial condition of the merged company.

---

[62] In the Agreement and Plan of Reorganization, dated November 30, 1988, as amended March 1, 1989, the merger partners explicitly addressed the IDB issue, and provided that "the obtaining of any consent or approval under the IDBs shall not be a condition to the parties' obligation to consummate the Merger." (Page, Exh. 69, pp. A-30 to A-31.)

In the March 10, 1989 Joint Proxy Statement and Prospectus, the merger partners provided the following information to shareholders considering the merits of the Agreement and Plan of Reorganization.

> [B]ased on its analysis and the advice of nationally-recognized bond counsel, SCEcorp believes that the Merger will not adversely affect the tax-exempt status of interest payments on the IDBs and expects to obtain an opinion of nationally-recognized bond counsel to that effect. In addition, SCEcorp is planning to file a revenue ruling request with the Internal Revenue Service to obtain further assurance as to the tax-exempt status of the IDBs. SCEcorp believes that it is unlikely that the Internal Revenue Service would decide that the Merger would render the interest on the IDBs includable in the taxable income of the holders. However, in such event, Edison anticipates that it would take steps to cause the redemption, retirement, refunding or defeasance of any IDBs affected by such adverse ruling. (Page, Exh. 69, pp. 56-57.)

f. The Merged Company's General Financial Condition

DRA also reviewed the financial condition of the merged company from a more general perspective and concluded that investors' perception of the financial strength of the merged company justified a 25 basis point reduction in the merged company's return on equity.[63]

DRA believes the merged company's equity investors should face a financial risk equivalent to or lower than the risks for the separate companies' investors, since the combined company will be quite sound financially.[64] Applicants have pointed out several factors,

---

[63] DRA evaluated both the financial risk and business risk of the merged company. The level of business risk a company faces is associated with the dependability of its revenues. Financial risk is associated with a company's ability to meet its debt obligations and is typically measured by the degree of leverage in its capital structure. (Siegal, Exh. 10,600, pp. V-2 to V-3.)

In assessing business risk, DRA points to applicants' testimony that the merger will result in significant synergistic efficiencies (including reduced risk of bypass, improved access to generation sources in the SW and Mexico, and greater operating flexibility resulting from the more diverse locations of oil- and gas-fired plants), leading to permanent, long-term qualitative benefits unquantifiable in monetary terms. (Ault & Juliff, Exh. 5, p. 20.) Assuming that a merger is the most cost-effective way to achieve such synergies, DRA believes the merged company's business risk should be the same as or lower than the risk of the two independent companies. DRA notes that these assessments are shared by the investment community, which expects reduced risk from the merger and projects benefits for shareholders. (Siegal, Exh. 10,600, pp. V-15 to V-17.)

[64] DRA's conclusion is supported by use of the DCF model and comparable group analysis. The DCF model recognizes that current market price of a share of common stock equals the present value of the expected stream of dividends and the future sale price of the share of stock, discounted at the investor's discount rate. The discount rate that equates the market price of the stock to the present value of the stream of cash receipts represents the expected rate of return. This discount rate represents the investor's opportunity cost of capital, or the rate available on alternative investments with comparable risk.

According to financial theory, the existing stock price reflects all publicly available information, and the price changes only upon receipt of new information. The implications for the merger are that (1) stock price changes are precipitated by the announcement of the merger proposal and subsequent announcements regarding merger developments, and (2) changes in the stock prices incorporate the market's evaluation of the merger based on the data available to the public at the time of the announcements. Thus, the price of the common stock of a firm is an important indicator of the investors' perception of the value of the merger to shareholders. If the merger is perceived to be beneficial to shareholders, that perception will most likely be reflected in higher stock prices. The converse is also true. If the merger is perceived to be detrimental to shareholders' interests, the common stock price is likely to decrease. (Siegal, Exh. 10,600, p. V-23.)

DRA also examined the changes in the differential between investor-required returns for applicants as independent utilities and the returns required for a comparable group of 21 energy utilities. (Siegal, Exh. 10,600, p. V-22.) Comparable group analysis requires that total group performance, and not the particular performance of individual members, be examined and compared to the performance of the utility in question. With a reasonable

(continued...)

including Standard & Poor's willingness to raise SDG&E's bond rating to that of SCEcorp if the merger is consummated, that reflect this reduced risk. The improved bond rating should directly lower the merged company's cost of debt financing compared with that of the two independent companies. The superior bond rating, in turn, indicates that all the company's securities are more sound financially, and common equity investors should enjoy greater value and require a lower return. Other factors DRA weighed included the merged company's pre-tax interest coverage ratio and internal generation of funds. (Siegal, Exh. 10,600, p. V-18.)

Perhaps because DRA's analyses supported its recommendation to reduce the merged company's return on equity, applicants disputed DRA's analyses on two grounds.[65]

---

[64](...continued) sample size, variations in risk among the group should balance (Siegal, RT 2783, 2797). DRA compared pre-offer and post-acceptance returns for SCEcorp with returns of a 21-utility sample, and found that the required return on SCEcorp's shares declined as much as 14 basis points relative to the sample.

[65] First, applicants find fault with many of the details of DRA's analysis. Applicants believe DRA has ignored that dividends expected by SDG&E's shareholders after the merger will not be based on SDG&E's dividend levels, but on SCEcorp's levels times 1.3. Similarly, SDG&E's stock will be valued at 1.3 times SCEcorp's stock price, and future dividend growth will be that of the merged company, not SDG&E. Applicants believe the DCF model, correctly applied, predicts that SDG&E's shareholders' post-merger required return will equal that of SCEcorp's shareholders. (Fohrer, Exh. 32, pp. 7-8.)

Applicants also believe DRA's comparable group analysis is faulty. While acknowledging that other factors may influence price in the post-acceptance timeframe, DRA assumes all changes in SCEcorp's stock price not reflected in the average price variation of the sample are attributable solely to the merger. Applicants argue that DRA ignores that each utility's stock price, including SCEcorp's, varies according to many known and unknown factors. (Fohrer, Exh. 32, pp. 9-10.)

Applicants' second criticism is that DRA has misinterpreted the merger's impact on shareholder value and risk. (Fohrer, Exh. 32, p. 13.) The merged company becomes more leveraged as it reduces SDG&E's common equity level (49.5% to 46%), thereby slightly increasing risk. (Fohrer, RT 1613-14, 1628.) DRA's conclusion that the merger has resulted in a moderate appreciation of shareholder value for both companies' shareholders is based on an erroneous comparison of the change in SCEcorp's stock price relative to the 21-utility sample. (Fohrer, Exh. 32, p. 13.) Applicants maintain that SCEcorp's stock price variation is well below the average of the other utilities whose stock prices changed during this period. (Applicants' OB, p. IV-68.) DRA has ignored the impact of many other factors, unchanged by the merger (including nuclear risk, regulatory risk, legislative changes, geography, and economic developments such as renewed inflation, rising interest rates and fuel costs), affecting investors' risk perceptions and limiting the merger's impact on the total risk profile. (Fohrer, Exh. 32, p. 14.) DRA acknowledges that it did not examine such factors. (Siegal, RT 2769-72.)

Vernon believes that DRA's assessment that the investment community perceives the proposed merger as beneficial for affected shareholders is based on an erroneous reading of market data.[66]

Applicants claim that the merger will produce synergistic benefits, which appear to be reflected in the results of the Discounted Cash Flow (DCF) and qualitative analyses undertaken by DRA, notwithstanding applicants' contention that Edison's stock prices have merely "held up well with the merger." (Siegal, Exh. 10,600, pp. VI-33 to VI-36; Fohrer, RT 1585.) These efficiencies, which applicants claim reduce the merged company's business risk, include reduced bypass risk, improved access to generating resources in the SW and Mexico, and greater operating flexibility due to more diverse location of oil- and gas-fired plants, resulting in permanent long-term benefits which are unquantifiable in dollar terms. In addition, the investment community projects shareholder benefits and a financially sound merged company. The fact that the merger partners' stock prices have been closer to 1-for-1 parity than the 1.3-for-1 exchange does not undercut either DRA's recommendation or the existence of the qualitative improvements discussed above, because this may merely reflect the fact that some discounting is occurring due to uncertainty about the outcome of the merger proposal.

The results of DRA's DCF analysis show discernable reductions in the merged company's required return on equity relative to the comparable group, ranging from 17% to 33%.

In addition, no party has identified changes unrelated to the merger which might explain the changes shown in the DCF analysis (Fohrer, RT 1592-1593). DRA's assessment that the

[66] First, Vernon argues SCEcorp's stock has not performed particularly well since the initiation of merger talks, compared to broader market indices. (Fohrer, RT 1595.) Second, Vernon asserts that one cannot consider the relevant stock market price changes to be merger-related unless one finds the market believes the merger will eventually be consummated. Because the merger partners' stock prices have been closer to a 1-for-1 parity than to the 1.3-for-1 exchange relationship, Vernon believes the market is quite unsure of the outcome. (Vernon's OB, p. 46.)

Vernon maintains that if the merger occurs, investors and potential investors in future years may consider it to have diminished the value of SCEcorp's common stock. And after the merger is consummated, no means will exist to gauge investor perception of the merger, since no one will ever know how the post-merger SCEcorp stock price compares with what the price would have been had the merger not occurred. (Fohrer, RT 1582, 1703-1705, 5484-85; Vernon's OB, p. 47.)

In any market-based rate of return analysis, SCEcorp's stock price would be used as a proxy for the stock of Edison, whose stock is not now and will not be publicly traded; therefore adverse investor reaction to the merger could end up increasing Edison's cost of capital and hence its post-merger authorized rate of return. (Fohrer, RT 5484-85.)

merger is the dominant force driving the stock price at the relevant time (Fua, RT 2877-2878) is supported by the evidence.

We conclude that DRA's analyses show that investors perceive the merged company to be strong financially. This perceived strength should have the effect of lowering the costs of capital for the merged company. Since we have rejected the merger under §§ 854(b)(1) and (2), it is unnecessary for us to determine whether the merged company's return on equity should be lowered by 25 basis points, as DRA recommends. However, we believe that DRA's recommendation is an approximate indication of the financial health of the merged company.

g. Depreciation

Applicants project that the financial strength of the merged company will permit a reduction in the composite depreciation rate for SDG&E's portion of the merged company's assets from 3.9% (SDG&E's currently authorized rate) to 3.7% (Edison's currently authorized rate). (Fohrer, Exh. 7, pp. 23-24.)

DRA suggests that the assumed depreciation rate for the merged company should be a weighted average of the last authorized depreciation rates for the independent companies. (Han, Exh. 10,500, pp. V-18 to V-19.)

The evidence in this proceeding demonstrated to our satisfaction that the merged company would have the ability to maintain the lower composite depreciation rate of Edison. Although applicants cite this ability as evidence of the financial strength of the merged company, the immediate effect on the merged company would be to lengthen the period of capital recovery and to lower the merged company's cash flow in the short term. These effects will have a slightly detrimental effect on the financial condition of the merged company.

h. Mitigation

The merger would result in the exchange of one share of SDG&E's stock for 1.3 shares of SCEcorp's stock. This exchange of shares would cause a dilution of 6.74% in book value per share for current shareholders of SCEcorp. However, investors perceive that the earnings resulting from the merger are sufficient to offset the increased risk presented by this dilution in book value. Thus, we have concluded that the financial condition of the merged company would be maintained despite the dilution resulting from the share exchange.

The share exchange would also increase the merged company's total outstanding shares, leading to a less leveraged and less risky capital structure. However, the higher equity ratio resulting from the share exchange would increase the merged company's revenue requirement, and the merged company would face an increased regulatory risk associated with the increased revenues needed to maintain the merged company's capital structure. For similar reasons, we found that the merged company would maintain Edison's currently authorized return on equity of 12.85% and Edison's current bond ratings. Maintaining Edison's current return on equity would require higher revenues, and the merged company would face a regulatory risk that the Commission would not allow recovery of these higher costs.

We also concluded that the terms of the exchange of SDG&E's preferred and preference stock for SCEcorp's corresponding issues reflect a higher risk associated with the merged company. In addition, we found that the costs of debt associated with the six series of IDBs would be higher because of the redemption and defeasance necessary to maintain the tax-exempt status of the bonds. We found that the lowering of the composite depreciation rate associated with SDG&E's assets would have a slightly detrimental effect on the merged company's cash flow in the short term.

In reviewing DRA's analysis of the overall financial health of the merged company, we concluded that the analysis showed that the merged company would be less risky for investors, reflecting the perceived good financial health of the merged company.

Mitigating the adverse effects of the merger on the company's financial condition is difficult to accomplish without creating other adverse consequences. For example, the Commission could increase the authorized rate of return to the merged company to offset the adverse financial effect of the merger, but this action would create unacceptable consequences for ratepayers. No feasible mitigation of the adverse financial effects of the merger has been proposed by the applicants or other parties.

We conclude that the merger would have some detrimental effects for the merged company, primarily in the near term. Despite these near-term detriments, investors appear to be confident of the financial health of the merged company. This investor confidence would lower the cost of capital for the merged company, which in turn would overcome some near-term detriments. Therefore, even absent mitigation, we conclude that overall applicants' proposal would maintain the financial condition of the merged company.

2. The Quality of Service

Section 854(c)(2) requires us to consider whether the merger will maintain or improve the quality of service to public utility ratepayers in the state. Although we focus on the quality of service to Edison's and SDG&E's customers, we must also consider the merger's effects, if any, on other California ratepayers.

a. Direct Effects on Quality of Service

Applicants believe the merger will improve the quality of service to ratepayers in SDG&E's service territory in three ways. First, the combined system will be more reliable, will have a better resource mix, and will be able to withstand increases in fuel price or other adversity better than SDG&E's system. (Budhraja, Exh. 7, p. 12.) Second, the merged company will add six new local offices to SDG&E's service territory and will appoint area managers in each district office. Applicants propose to improve service to customers currently served by SDG&E by increasing the number of telephone service employees in order to offer 24-hour, 7-days-a-week service and to reduce the average time to answer customers' telephone calls from the current 60 seconds to 30 seconds. (Eastman, Exh. 6, pp. 26-29.) Third, Edison will bring improved conservation and load management programs to SDG&E's service territory. These programs have reduced peak demand by 10% in Edison's service territory. (Bryson, Exh. 2, p. 19.)

In addition, applicants assert that Edison's record on the quality of service to its customers is slightly better than SDG&E's. (White, Exh. 13, p. 13.)

Applicants contend that no party has claimed that the merger will result in a deterioration in the quality of service, and the obligation of the merged company to "maintain or improve" the quality of service has not been disputed.[67]

---

[67] DRA disputes applicants' claim that the merger would have an improved resource mix.

DRA contends the record shows that only 4% of Edison's total capacity comes from wind, solar, geothermal, and biomass; that the overwhelming majority of Edison's excess capacity is fossil-fueled generation; and that there is very little difference in expected generating resource use between the merged company and the independent companies. (See, DEIR, p. 2-7.)

DRA disagrees vehemently with applicants' contention that no party disputes that the merger will improve the quality of customer service. The only concrete improvements applicants mention are extended staffing of customer service centers. DRA believes SDG&E could increase staffing on its own.

DRA also challenges applicants' testimony on the general quality of service. Applicants' witness disclosed he had discussed the case only with Edison's attorneys and knew nothing of the relative quality of service of the two companies. (White, RT 2075-2076, 2081-2082.)

San Diego and UCAN argue that proposed reductions in marketing and energy services will be harmful to the interests of commercial customers. On a proportionate basis, SDG&E has committed to spend 300% more on energy conservation than Edison in response to CPUC conservation programs (see D.90-08-068). Finally, these parties believe that the location of the merged company's corporate headquarters contributes to a decline in responsiveness to local communities.

(continued...)

Several of applicants' claims of improved service do not withstand scrutiny. For example, applicants argue that the merged company would have a greater diversity of energy sources than SDG&E has. However, the merger does not alter the two merger partners' mix of generating resources for several years, and the immediate effect of the merger is to increase reliance on Edison's oil- and gas-fired reserve units. Bringing these units into operation necessarily means that they are no longer available to back up other operating units and thus to enhance the reliability of Edison's system. To the extent that the reliability improvements claimed for the merged company exist, they come at the expense of the improved reliability the Edison system obtains by keeping these generating units in reserve. The loss of the incremental reliability supplied by these units diminishes the quality of service to Edison's current customers.

Furthermore, applicants have not sufficiently justified their proposal to increase the hours when telephone service is available in SDG&E's territory. Applicants' primary justification is that Edison currently offers 24-hour, 7-days-a-week telephone service. However, applicants have not shown that the level of service offered by Edison is efficient, effective, or desirable.

Similarly, applicants have not justified their proposal to open six new branch offices in SDG&E's territory. Applicants' rationale is that these new offices are necessary to lower the ratio of customers to branch and district offices to the level that currently exists in Edison's territory. Again, applicants have failed to show that the ratio in Edison's territory is the optimal and most efficient ratio. Without such justification, we cannot assume that the costs of adding the new branch offices are outweighed by the benefits to customers.

On the other hand, the language of the statute requires us to consider whether the merged company will "maintain or improve" the quality of service to ratepayers. While the evidence on direct effect of the merger does not support a conclusion that service will improve, neither does it show that service will deteriorate. Consequently, we find that the merger will have no direct effect on the merged company's ability to maintain the current quality of service to ratepayers.

---

[67](...continued)

The Attorney General concludes that the merger will maintain, but not materially improve, the quality of service to SDG&E's and Edison's ratepayers.

b. Loss of Across-the-Fence Rivalry

There is a perhaps indirect, but indisputably important, influence on the quality of utility service which we elect to term "across-the-fence rivalry." It arises when existing or potential customers are able to compare the rates and quality of service between utility providers in adjacent service areas. If significant disparities are discovered, at least three consumer reactions may be anticipated, each of which will pressure the management of the less desirable utility to narrow the gap. Existing customers who are facing other pressures to relocate, such as plant modernization or expansion, may select a site within the area served by the preferred utility. New customers, without an existing location in either service area, will make the same election. These will include residents who may be accommodated by housing or commercial development in areas of the service territory which admit such expansion. Finally, existing consumers with neither the opportunity nor means to relocate will take their complaints to the management of the utility deemed to charge excessive rates or deliver inferior service.[68]

The hearing record shows clear evidence of this rivalry between Edison and SDG&E. There was testimony that the competitive pressure and desire to close the differential between SDG&E's and Edison's rates prompted SDG&E's management to implement a retail rate reduction program in the early 1980s. Between 1985 and 1990, SDG&E lowered its system average cost and its rates by six cents per kilowatthour (kWh), to a level lower than Edison's then prevailing rates. (Applicants' OB, p. V-4.) The former Attorney General calculated that, based on SDG&E's 1988 sales of approximately 13 billion kWhs and reductions of six cents per kWh, the savings to SDG&E ratepayers resulting from this rivalry could be as high as $780 million per year. (Attorney General's RB, p. 74).

The UCAN submission also contained direct evidence that rivalry with Edison encouraged SDG&E to strive to improve efficiency and customer service as it sought to determine, by means of management audits and other studies, why its rates were so much higher than those of other California utilities. (Ault, RT 5848; Owens, Exh. 20,800, FERC Exh. 710, p. 184.)

Such evidence has convinced us that rivalry between Edison and SDG&E has worked to the public advantage in improving both the quality and cost of service to ratepayers. By

[68] In submissions before the ALJs and in the PD, various aspects of what we now term across-the-fence rivalry were denominated "retail" or "yardstick competition." We have rejected these labels and the accompanying attempted analysis under § 854(b)(2). In our view, such a discussion is misplaced for it is grounded on an assumed direct market competition which is clearly at variance with the fact that utilities in the energy field operate in retail service territories in which each enjoys a monopoly as defined and policed by the Commission. As we have noted, we find the public advantaged by the presence of proximate comparative data upon which ratepayers and utility managers may gauge success in discharging the duty to serve the public. Such a factor is properly evaluated in striking the balance contemplated by § 854(c).

eliminating SDG&E as a distinct neighboring entity, the merger will abolish the fence over which such assessments may be made by ratepayers.[69]

The record also suggests that locational decisions by new customers may be predicated upon comparative performance.[70]

c. Effects on Other Utilities' Ratepayers

PG&E is concerned that its ratepayers may suffer a degradation of service because a merger will mean the loss of SDG&E as an independent entity which can be used to arrange transmission access to suppliers in the SW. Presently, PG&E and SDG&E arrange low-cost brokering of power through the California Power Pool. The merged company would charge substantially more to transmit power, and this would adversely affect PG&E's electric customers. PG&E suggests, as a mitigation measure, that the merged company should be required to provide PG&E transmission service on a "junior firm" basis, which allows for interruption for specified operating reasons. (Gray, Exh. 43,150, pp. 6-7.)

Applicants respond to PG&E by noting that from 1987 through 1989, PG&E received less than one-half of one percent of its system requirements through purchases from SDG&E, and PG&E has not purchased brokered power for over a year. Thus, the claimed effect on PG&E's ratepayers is minuscule at most.

In addition, our previous findings that the merger will adversely affect competition in wholesale bulk power and transmission markets, to the detriment of the Resale Cities, require

[69] We do not suggest that the elimination of a distinct SDG&E will totally eliminate across the-fence comparative pressures. The hearing record supports a finding that such rivalry exists between the Resale Cities and Edison in reciprocal fashion. For example, the Resale Cities confront comparisons between their rates and those of Edison (Drews, Exh. 44,000, pp. 11-12; Hsu, Exh. 44,800, pp. 12-13; Russell, Exh. 40,000, p. 8). Edison has considered the strategic benefits of merging with municipal systems (Russell, Exh. 40,000, App. 3, p. 2). For this reason the Resale Cities must keep their rates down lest higher rates incline their customers to favor a takeover. (Hoyt, Exh. 43,900, pp. 11-12; Russell, Exh. 40,000, p. 106.)

From the opposite perspective, the evidence indicates that the threat of potential municipalization is an important spur to utilities such as SDG&E and Edison to operate efficiently and reduce costs. (Page, Exh. 66, FERC TR 1314, 1357, 1372, 1379).

[70] Activity perhaps best described as "fringe area competition" has existed between Edison and SDG&E in both the Coto de Caza and South Laguna areas. The rivalry in Orange County focused primarily on rate disparities between the two utilities. In South Laguna, the unrebutted evidence is that SDG&E expended at least $400,000 to retain its service territory and offered a 5% rate reduction along with other financial incentives to the City of South Laguna. (Page, Exh. 53,428.) We note in passing that such tactics may be illegal given the well understood duty of monopoly providers to treat all customers within the service territory in a nondiscriminatory manner.

a related finding. Specifically, because these adverse impacts may tend to raise the retail rates the Resale Cities charge their customers, the merger may alter the comparative balance between the merged company and the Resale Cities, affecting the Cities' quality of service to their customers.

We conclude that the merger could have detrimental effects on the quality of service to the ratepayers of PG&E and the Southern Cities. Because § 854(c)(2) requires us to consider the effect of the merger on the quality of service to ratepayers in the state, it is appropriate to weigh the effect on these utilities' ratepayers in our determination of whether the merger is in the public interest.

d. Mitigation

We have concluded that applicants' claims that the merger would improve the quality of service to ratepayers are not sustained. We have also concluded that one of the indirect effects of the merger would be the elimination of across-the-fence rivalry between Edison and SDG&E. This loss could have a significant detrimental effect on the quality of service to ratepayers in the form of higher rates than necessary and a lower quality of service. Mitigating the adverse effects of the loss of rivalry between SDG&E and Edison in the compelling circumstances on the evidence in this proceeding is essentially impossible. Because of these adverse impacts, the loss of SDG&E as a regulatory benchmark to Edison is exacerbated. In addition, we have found that the effects of the merger on competition in the wholesale bulk power and transmission markets could harm ratepayers of the Resale Cities and of PG&E. For all these reasons, we conclude that the merger would have an adverse effect on the quality of service to public utility ratepayers in the state.

3. Quality of Management

Section 854(c)(3) requires us to consider whether the proposal will maintain or improve the quality of management of the resulting merged company.

Applicants assert that combining the already strong management teams of Edison and SDG&E will produce an even stronger management. Edison is regarded as a very well-run company. (Liu, Exh. 12, p. 25.) SDG&E's management has recently turned a utility in financial trouble into a sound, highly regarded company. (Fohrer, Exh. 4, p. 17.) To ensure continuity in the merged company, Edison has entered into employment agreements with four of SDG&E's top executives. Applicants note that DRA acknowledges that the merged company should have at least the same quality of management as the two existing companies. (Jacobson, RT 2328-29.) These facts satisfy the requirement that the quality of management be maintained or improved, according to applicants.

The Attorney General argues that the different philosophies of Edison and SDG&E will combine in a way that will result in less effective management of the merged company than of SDG&E as an independent company.[71] We observe that the philosophies of both companies were shaped by the events of the last ten years. During this time, diverse sources of energy became available with the growth in alternative power sources and a surplus of energy in the SW. Edison relied on increased purchases from QFs, while SDG&E built transmission facilities to purchase power from other western utilities. Although SDG&E's approach was more successful in the past, it is not clear that these conditions and SDG&E's success will continue through the next ten years. We note that SDG&E's resource plan calls for construction of new oil- and gas-fired power plants in the next few years, and SDG&E's approach is responding to changing conditions.

The Attorney General also claims that diseconomies of scale will cause a decline in the quality of management of the merged company.[72] The issue of diseconomies of scale for the merged company was discussed in Part Three of the Proposed Decision. We agree with the Proposed Decision that the evidence in this case does not support the claim that the merger will result in diseconomies of scale that will affect the quality of management of the merged company. Thus we reject the Attorney General's contention. In addition, California already has one utility, PG&E, comparable in size to the merged utility. PG&E's management has not yet appeared to suffer from diseconomies of scale.

To the extent that the rivalry between SDG&E and Edison encourages innovative decisionmaking by their managers, the merger could have an adverse affect on the quality of

---

71 Citing different philosophies of the existing utilities' management, the Attorney General points out that Edison has pursued a strategy of acquisition that has led to a 50% increase in system costs, while SDG&E's strategy of purchasing power and avoiding capital costs has led to a 50% decrease in system costs. Since Edison is the dominant contributor to the merged company's management, its philosophy will prevail, to the detriment of ratepayers.

72 The Attorney General argues that diseconomies of scale affect management as well as other aspects of the merged utility. Managers' ability to manage effectively declines as organizations grow larger, and the merged company, the nation's largest electric utility, will be subject to this principle. In addition, Edison and SDG&E operate in the same area and face many of the same problems. Management's knowledge that the Commission and investors would examine decisions in light of what nearby competitors were doing encourages innovative decisionmaking. The loss of yardstick comparisons and the resulting lack of rivalry from a nearby utility will inevitably cause the merged company's management to make less effective and creative decisions.

Applicants refute the Attorney General's claim that the added bureaucratic costs created by the increased size of the merged company will cause a decline in the quality of management, as discussed in detail in the Proposed Decision. In response to the Attorney General's contention that the loss of a nearby competitor will lessen the quality of management's decisions, applicants claim that the merger will make possible efficiencies that are only available indirectly through rivalry. (Pace, Exh. 21, pp. 101-102.)

management. However, we note that the evidence supporting the Attorney General's contention is sparse.

Edison and SDG&E are considered to be well-managed utilities. The management of the merged company will initially include four of SDG&E's top executives. We conclude that the quality of management of the merged company will at least be maintained.

4. Fairness to Employees

Section 854(c)(4) requires us to consider whether the merger will be fair and reasonable to affected public utility employees, including both union and nonunion employees.

a. Reductions in Positions

Applicants believe the merger will be fair to employees because they will be part of a stronger, more dynamic utility better able to meet future challenges. Employees will have more opportunity for career mobility because of the increased size and depth of the merged company. All SDG&E employees will be offered a position with the merged company. (Bryson, RT 1115, 1360.) Historic attrition rates justify applicants' expectation that normal attrition will equal or exceed the expected personnel reductions, and the merged company will likely hire new employees even during the transition. The opportunity for hiring new employees will help the merged company meet affirmative action goals. (Juliff, Exh. 40, pp. 26-27.)

DRA questions whether employees will be able to find comparable jobs within the merged company if their jobs are cut due to duplication. In addition, applicants' pledge to improve the number of minority employees and directors will take years to fulfill.

The Attorney General thinks the burdens of the merger fall disproportionately on SDG&E's employees. Attrition will not produce vacancies in all positions recommended for elimination. Competition between SDG&E's and Edison's employees will require either demotion or relocation for at least some of those employees. Applicants have not discussed all the factors that need to be considered in making employment decisions for the merged company. (Weisenmiller, Exh. 20,000, pp. III-18 to III-22.) Consequently, the merger cannot be considered fair to the employees of SDG&E.

We find that a large portion of the expected savings are realized through the merged company's ability to operate with fewer employees than the two independent companies. The Proposed Decision concluded that the merger will result in the eventual elimination of 1,153 positions. We accept this figure as a reasonable assessment of the magnitude of the reductions in positions expected from the merger. Job reductions on this scale could have a drastic effect on employees threatened with job loss. However, applicants propose several steps to minimize the effect of the merger on existing employees. Applicants have guaranteed that all SDG&E employees will be offered a position with the merged company and that equivalent working conditions will be available to any SDG&E or Edison employee displaced by the merger. Labor savings attributable to the merger will come through normal attrition, and no layoffs or early retirement incentives are expected.

We conclude that applicants' proposals to counteract the adverse effects of the merger on employees are sufficient to ensure that the merger will be fair and reasonable to affected employees.

b. Labor Relations

Local 47 of the IBEW, which represents 6,000 Edison employees, argues that the extension of Edison's labor practices to SDG&E's employees will have a detrimental effect on labor relations for the merged company.

Edison's policy towards labor relations results in a large number of formal grievances. Edison has a much higher number of grievances than SDG&E and other large utilities in the western United States. (Sanborn, Exh. 41,950, pp. 6-9.) The number of unfair labor practice claims filed against Edison is also very large compared to other utilities with employees represented by Local 47. The number of dismissals of these unfair labor practice claims is also very low for Edison. (Sanborn, Exh. 41,950, pp. 15-17.) Local 47 asserts that Edison has not kept its commitments to labor and to Local 47. (Sanborn, Exh. 41,950, pp. 17-19.)

Local 47 contrasts Edison's practices with SDG&E's approach of trying to work with the union and to resolve disputes before they become grievances. The number of filed grievances per employee for SDG&E is about one-tenth the number for Edison. In the past four years, only four unfair labor practice claims were filed against SDG&E, and all these have been settled, according to Local 47. (Sanborn, Exh. 41,950, pp. 19-21.)[73]

[73] San Diego also thinks the merger may have a detrimental effect on labor relations for the merged company. Applicants did not consider the effect of the two companies' different labor-management practices. More employee grievances have been filed against Edison than against SDG&E, and San Diego believes that the number of grievances is a good measure of employee productivity. Because of the differences in labor-management practices, San Diego expects that the productivity of SDG&E employees will decrease after the merger. (Weisenmiller, Exh. 20,000, pp. III-36 to III-39.)

The Attorney General also asserts that SDG&E has enjoyed much more harmonious labor relations than Edison. Because of the dramatic changes in the tone of labor relations, the merger will have adverse effects on the employees of SDG&E.

Applicants believe that the number of grievances filed by Local 47 against Edison is not reliable evidence of unacceptable labor relations. Applicants point out that Edison cannot prevent its represented employees from filing grievances, and thus the number of grievances is not a good indication of relations between the company and its unions. Applicants also explain the difference in the number of grievances filed against SDG&E as compared to Edison by noting that Edison's contract allows for grievances in more areas than SDG&E's contract does. Local 47 has provided no basis for evaluating the significance of the grievances.[74] Applicants

---

[74] The argument of Local 47 is undermined by the fact that Local 47 withdrew more than 85% of the grievances that became eligible for arbitration in 1989 and more than 90% of the grievances that became eligible for arbitration in 1988. Many of the pending grievances against Edison are "me-too" grievances, so that only 36 different issues have been presented in the 607 grievances filed against Edison. In addition, about half of the grievances cited by Local 47 involve a single issue.

Applicants point out that only one of the 76 unfair labor practices charges raised by Local 47 resulted in a decision by the National Labor Relations Board (NLRB) against Edison. Most of the other charges were either unilaterally withdrawn by Local 47 as having been found meritorious by the NLRB or were deferred to arbitration without any determination of their merit. The record establishes that of the 61 unfair labor practices charges cited by Local 47 as having been meritorious by the NLRB, only 10 resulted in the issuance of a complaint by the NLRB regional office. Furthermore, the issuance of a complaint does not mean that the underlying charge is meritorious; the complaint merely triggers an investigation based on probable cause. (Juliff, Exh. 40, pp. 39-40.)

Local 47 believes that applicants use distorted statistics in their testimony in this area. Although applicants claim that only 36 issues are presented by the 607 pending grievances, Local 47 points out that applicants do not arbitrate broad issues. Rather, applicants arbitrate specific grievances, and the result of a single arbitration often fails to resolve the underlying issue. Further, applicants have the power to reduce the number of grievances filed by Local 47 members. Since 40% of the grievances are filed from only five work locations, it would be relatively simple for management to address and solve the problems that apparently exist at these locations. The underlying fact remains undisputed: Local 47's ratio of filed grievances per employee in 1989 was exceeded only by the Utility Workers Union of America, Local 246, which represents approximately 2,000 Edison employees. (Sanborn, Exh. 41,960, pp. 3, 5-6.)

Although applicants stress that a high number of grievances eligible for arbitration are withdrawn by Local 47, applicants fail to give the reasons for these withdrawals. Many grievances are filed when disciplinary letters are placed in the personnel files of the employees, and Local 47 does not normally arbitrate this type of grievance. It takes five to seven years to get such a grievance to arbitration, and during that time witnesses retire and the topic of the disciplinary letter may lose its original validity. (Sanborn, Exh. 41,960, pp. 7-8.)

Local 47 believes that applicants have distorted the nature of the withdrawal of unfair labor practice charges. Contrary to applicants' claim, withdrawals of unfair labor practice charges are made without any determination of merit. These withdrawals result when the parties agree to settlements, when charges are deferred to arbitration, or when unfair labor practices are remedied by Edison before the NLRB regional office issues a formal complaint. Further, a charge is deferred to arbitration only if the NLRB makes an initial determination that the unfair labor practice charge has merit. According to Local 47, the fact remains that 61 of the 75 unfair labor practice charges set forth in Exhibit 41,954 were either found to be meritorious by the NLRB or settled by the

(continued...)

also point out that five of the 123 work locations, involving only 8% of Local 47's membership, account for nearly 40% of the grievances logged in 1989. The concentration of these grievances is not evidence of widespread discontent among Edison's employees, according to applicants.

Instead, applicants believe that there are many more reliable and objective indicators of the good labor relations that Edison maintains with its employees. Most Edison employees spend their entire work career with the company. Edison believes in promoting from within, and many of Edison's present senior managers are former line employees. In the past five years, three separate attempts were made to obtain union representation. All of these attempts were rejected overwhelmingly by the affected employees. Edison is the only utility in the country to have been identified as one of America's 100 finest employers, and has twice been so identified. (Juliff, Exh. 40, pp. 36-37.) There have been no strikes by Local 47 against Edison in more than 36 years. (Sanborn, RT 7129.) Edison's employees represented by Local 47 are the highest paid in the industry. (Sanborn, RT 7131.) Applicants conclude that Edison's relations with its employees, including those represented by Local 47, are outstanding.

The evidence on the quality of Edison's labor relations is ambiguous. On the one hand, Local 47 has established that Edison has an unusually high number of filed grievances per employee. On the other hand, applicants point to the evidence of strong loyalty to the company that Edison's employees display. On the basis of this evidence, we find it impossible to predict that labor relations will deteriorate due to the merger. We conclude that, at least in the short term, the merger will have no substantial effect on labor relations.

5. Fairness to Shareholders

Section 854(c)(5) requires us to consider whether the merger will be fair and reasonable to the majority of all affected public utility shareholders.

Shareholders of SCEcorp will experience long-term benefits as a result of the merger, according to applicants. The merger will produce a utility that is stronger than Edison, with a larger customer base, improved customer diversity, reduced potential for bypass, and greater efficiencies in generation and transmission. These factors will make it better able to serve its customers. Utilities that are better able to meet their customers' needs are better able to earn their authorized rates of return. (Liu, Exh. 12, p. 29.) Applicants contend that, although there is a potential for a short-term dilution of earnings per share for SCEcorp's shareholders, the benefits of the merger outweigh any potential dilution.

---

[74](...continued)
parties before the NLRB decided them. (Sanborn, Exh. 41,960, pp. 10-13.)

Applicants believe shareholders of SDG&E see immediate value in the merger, as shown by the exchange ratio of 1.3 shares of SCEcorp's stock per share. SDG&E's shareholders will enjoy the same long-term benefits as SCEcorp's shareholders.

The Attorney General presents three reasons why the merger is not fair to shareholders. First, the merger will dilute the value of the shares held by Edison shareholders. Second, shareholders of the merged company are liable for the costs of obtaining regulatory approval of the merger, which are estimated to total $60 million. (Fohrer, RT 5493-96.) Third, Section 854(b)(1) requires the Commission to devise ratemaking methods that place the risk of error of forecasting merger benefits on shareholders. If applicants' forecasts are incorrect, there could be heavy future costs payable by shareholders.

Applicants dispute the Attorney General's contention that shareholders were not informed of the dilution before voting to approve the merger. Shareholders of SCEcorp were advised of "an initial dilutive effect on SCEcorp's earnings per share and book value per share." (Page, Exh. 69, p. 45.) Applicants also dispute the Attorney General's claim that Section 854(c) requires an express finding of fairness to shareholders, citing the language of the statute that the Commission shall "consider" these criteria.

We find that there are several areas in which the shareholders of the merged company may face large, unexpected costs. Among these are the costs of obtaining regulatory approval and ratemaking methods that shift the burden of inaccurate forecasting to shareholders. However, shareholders were advised of some of these costs prior to their vote approving the merger. Investors have taken at least some of these costs into account in arriving at their decision to buy, sell, or retain shares of the two companies. In this context, fairness consists of full disclosure of pertinent information. We note that the securities laws take a similar approach. Applicants disclosed the merger's expected short-term effects on SCEcorp's earnings, and investors are aware that other costs incurred by SCEcorp or the merged company are subject to our review. In light of these facts, we conclude that the merger is fair to shareholders.

6. Benefits to State and Local Economies

Section 854(c)(6) requires consideration of whether the proposed merger will be beneficial on an overall basis to state and local economies, and to the communities in the area served by the resulting public utility.

Applicants believe the merger will benefit the economy and affected communities through lower rates, a stronger utility, and increased charitable giving and community service. (Bryson, Exh. 2, pp. 5-26.) The merged company will retain key SDG&E management employees and Board members. (Page, Exh. 3, p. 20-21.) The merged company will continue to purchase supplies and services in the San Diego area as long as those goods and services are comparable in price and quality to goods purchased outside the area. (Bryson, Exh. 2, pp. 25-26.) The merged company will maintain SDG&E's levels of charitable contributions for five years after merger approval. As one of the largest counties in the merged company's service territory, San Diego can expect a large share of the merged company's contributions and community service. (Bryson, Exh. 2, p. 27.) There will be as little disruption as possible to the local communities in the integration of the two companies. The San Diego division of the merged company will continue to be called San Diego Gas & Electric for two years following the merger, and SDG&E's headquarters building will continue to be used. Employee reductions are to be achieved through attrition. (Bryson, Exh. 2, pp. 24-25.) The DEIR also concluded that employee reductions would have no significant effect on local economies. (DEIR, pp. 8-30 to 8-40.) The merged company will also increase promotion and hiring of women and minorities. (Bryson, Exh. 10, 702.)[75]

Applicants have implicitly recognized that the merger may have an adverse effect on the communities and local economies in the San Diego area, and applicants have proposed several conditions to retain benefits for these affected economies and communities. We agree that these

---

[75] UCAN agrees with the County and APCD that the merged company's charitable contributions should increase at a rate greater than inflation. UCAN suspects that Edison may use corporate giving as a reward for community leaders who support Edison's policies.

UCAN fears that community development efforts supported by SDG&E, such as business marketing and industrial development, will not be supported by the merged company. Edison does not engage in these kind of activities. (Bryson, RT 1344-46.) SDG&E spends $240,000 on community development efforts, and these funds have a much greater impact than the actual dollars spent in terms of attracting new business.

UCAN asserts that the merged company's plans regarding the use of the SDG&E's headquarters building are unclear. SDG&E has a long-term contract with the owner of the building, so the merged company would need to find a use for it in any event. It is possible the space would be offered for lease, adding to office vacancy rates in downtown San Diego.

Additionally, Edison has not evaluated whether the merged company will continue to support SDG&E's natural gas vehicle program (Bryson, RT 1331). Loss of this program will add to pollution in the San Diego area.

After analyzing applicants' proposed service augmentations, UCAN concludes that SDG&E customers would rather have benefits that have immediate impacts on rates rather than such things as branch offices and better phone service.

Applicants respond that their commitments to the San Diego area extend beyond five years. This five-year period of somewhat special treatment is merger-related. However, after a certain period of time, San Diego will share in the benefits of a regional utility on the same basis as other communities. It is unrealistic to require conditions on such items as charitable contributions, support of local vendors, and San Diego representation on the Board of Directors to continue beyond five years. Conditions entirely unrelated to the merger, such as desalinization plants, should not be considered.

commitments will lessen the adverse impacts on the local communities. However, to meet the requirements of Section 854(c)(6), the merger must do more than lessen the adverse impacts; it must be beneficial to state and local economies and the communities served by the resulting merged company.[76] Applicants' attempt to show that the merger will benefit state and local

---

[76] DRA's view that the merger will harm the local economy and the affected communities is confirmed by the City of San Diego's determination that a transfer of SDG&E's franchise to Edison would not be in the public interest. In adopting Resolution R-274786, San Diego cited adverse environmental consequences, rate impacts, harm to bond ratings, loss of a locally headquartered utility, loss of local jobs and business, adverse effects from the merged company's dealing with its affiliate, and anti-competitive concerns as reasons not to transfer the franchise. (Weisenmiller, Exh. 21,003, pp. 2-3.) DRA also notes that the merged company's commitments to purchase local goods and services are of limited duration and that its pledges to hire and promote women and minorities are the minimum required by Commission General Order 156 (Bryson, RT 1121). Commitments to increase overall philanthropic contributions are made on the condition that the Commission provide rate recognition. (Bryson, Exh. 10,702, p. E184641.) Applicants admit that such rate recognition requires a change in Commission policy (Bryson, RT 1136).

The Attorney General argues that San Diego's opposition shows that local communities will be adversely affected by the loss of a valuable corporate citizen. The Attorney General notes that the pledge to sustain the level of contributions in the San Diego area is good for only five years and that any increase in the level of contributions is contingent upon changes in Commission ratemaking policies. Historically, SDG&E has contributed a higher percentage of its revenue than Edison. (Page, RT 1474-78.) After five years, it is likely that Edison will revert to its former position, according to the Attorney General. If that happens, contributions will fall below the level previously attained by SDG&E.

County and APCD contend that the merger will harm local communities. These parties recommend several conditions to approval of the merger to mitigate these harmful effects. According to the County and APCD, the Commission should require the merged company to:

- Relocate its corporate headquarters from Rosemead to San Diego.
- Include representatives from the San Diego area on its board of directors for more than five years.
- Maintain a minimum of 4,200 jobs in the San Diego area.
- Maintain SDG&E's level of purchases, at least $43.2 million, from local vendors beyond the promised five years.
- Increase its level of charitable contributions by more than the rate of inflation.
- Expand the low-income energy assistance programs in the San Diego area.
- Create, staff, and financially support two advisory boards: a nine-member Environmental Advisory Board and a nine-member ethnically diverse Community Advisory Board.

(continued...)

economies and the affected communities relies heavily on their contention that the merger creates large savings. As we concluded earlier, applicants have failed to prove that long-term savings will result from the merger. Because of this failure, we are unable to conclude that the merger will be beneficial on an overall basis to state and local economies and to the affected communities.

In addition, San Diego raised the concern that it would be unable to use future IDB financing because of applicants' proposed defeasance of its existing IDBs.[77] We conclude that it is reasonable to expect that the defeasing of the IDBs to carry out the merger could have a chilling effect on bondholders and on the future availability of funds for tax-exempt financings sponsored by the City of San Diego. If this effect occurs, it would also be harmful to the local economy.

As we discussed in the section on quality of service, the loss of rivalry between SDG&E and Edison could have adverse effects on the local communities and local economies. The primary consequences of this loss of rivalry relevant to this issue are the rate effects, which could prove detrimental to the local economies, and the effect on quality of service, which could be harmful to some or all of the communities in the area served by the merged company. These influences have been discussed previously, and there is no need to repeat our discussion here.

We also note that the EIR prepared in connection with this proceeding (discussed in Part Six of the Proposed Decision) concluded that the merger would have significant adverse impacts on the environment of Southern California. The EIR also concluded, however, that these adverse impacts could be adequately mitigated.

Various intervenors have proposed additional conditions to approval of the merger that would attempt to ensure that benefits are retained in the San Diego area. These proposed conditions assume that our decision is to approve the merger. Since we are denying the application, it is unnecessary to consider or comment further on these proposals. For this reason, the proposed mitigation monitoring decision is also moot.

---

[76](...continued)

- Create an advisory council on redevelopment of the sites of SDG&E facilities scheduled to be closed after the merger.

- Provide financial assistance for construction of a water desalinization plant.

[77] San Diego raises the concern that the effect of SDG&E's violating its bond covenants by defeasing the IDBs could adversely affect the City's future ability to issue IDBs. Bondholders expect San Diego to enforce its covenants with SDG&E in order to maintain its creditworthiness in bond markets. (Weisenmiller, Exh. 20,000, p. V-7.)

7. **Preservation of the Commission's Jurisdiction**

Section 854(c)(7) requires consideration of whether the merger proposal will preserve the jurisdiction of the Commission and how it will affect the capacity of the Commission to effectively regulate and audit public utility operations in the state.

The Commission's authority to regulate the merged company is not affected by the merger, according to applicants. The Commission's ability to regulate the merged company will be enhanced because instead of having two sets of proceedings, there will be only one. The size of the service territories and the number of customers served remain unchanged, so Commission resources will be freed for other matters. (Lester, Exh. 10, p. 20; Liu, Exh. 12, p. 22.)

Other parties point out that the loss of rivalry between SDG&E and Edison will also eliminate an important regulatory tool, yardstick comparisons between SDG&E and Edison. Since Edison and SDG&E compete for some of the same bulk power purchases, and the two utilities have access to the same markets, regulators may compare the two utilities' power purchases to measure the reasonableness of such purchased power costs. Regulators may also use SDG&E as a source of information to test whether Edison's generating facilities are efficient and competitively priced. (Noll, Exh. 10,200, IV-12.) Such benchmarks are useful in the effort to ensure that adopted rates are reasonable. The Attorney General cites several instances in the past when the Commission has experienced severe problems due to Edison's attempts to evade the Commission's jurisdiction. The Attorney General feels that the increased size of the merged company would hamper the ability of the Commission to regulate. UCAN repeats the Attorney General's arguments and also cites the loss of "yardstick competition" and the difficulty of effectively monitoring the merged company's dealings with its unregulated affiliates.

Although reducing the number of Commission proceedings is a benefit, we are not convinced that such a reduction will occur if the proposed merger is approved. It would be easy to conclude that the disappearance of SDG&E as a separate entity would simplify the Commission's regulatory tasks by reducing the number of utilities it regulates, but other characteristics of the merger undermine this facile conclusion.

For example, in our review of the proposed merger's impacts on competition, we concluded that the merged company will exert increasing pressure on the Commission's resources by expanding (1) the geographic scope and extent of potential self-dealing in its relations with its affiliates and (2) the scope of SCEcorp's unregulated activities. Such expanded markets and service areas will increase our staff's responsibilities and tax the resources required to ensure that ratepayers are protected in the post-merger environment. This is especially important in view of Edison's consistent failure to provide data on a timely basis as required by the regulatory compact struck in the holding company decision.

Because the merger will eliminate the rivalry between SDG&E and Edison, we conclude that the loss of SDG&E as a regulatory comparison is an adverse unmitigable impact of the proposed merger.

In sum, notwithstanding the loss of SDG&E as an independent utility (and indeed precisely because of such loss), the proposed merger will not appreciably reduce the complexity of the Commission's regulatory task, even if the merger ultimately results in fewer Commission proceedings. The merger would also remove SDG&E as a regulatory comparison against which we could measure the performance of the merged company and other California utilities. The proposed merger will have adverse impacts on the Commission's ability to regulate the merged utility effectively, and will increase the Commission's regulatory burdens.

C. Conclusion

Before we may approve the acquisition or control of a utility with gross annual California revenues exceeding $500,000,000, § 854(c) requires us to find that, "on balance," the acquisition is in the public interest. We read the statute as giving us broad discretion to weigh the seven listed criteria and other factors in our determination whether the acquisition is in the public interest. Thus, even if a merger proposal scores well on four criteria, the negative aspects of the other three criteria may predominate and lead us to find that the proposal is not in the public interest. The public interest balancing of § 854(c) is qualitative, not quantitative.

As Section 854(c) requires, we have considered the seven criteria listed in the statute.

We have found that the merger proposal will result in a slight deterioration of the financial condition of the merged company, but that overall applicants' proposal would maintain the financial condition of the merged company. We have found that the loss of rivalry between SDG&E and Edison is likely to lower the quality of service to public utility ratepayers in the state. The quality of management of the merged company will at least be maintained under applicants' proposal. In addition, under the circumstances of this case, the proposal is fair and reasonable to affected employees. Furthermore, the proposal is fair and reasonable to the majority of affected shareholders. On the other hand, the merger proposal is not beneficial on an overall basis to state and local economies or to the communities served by the merged company. The Commission's ability to effectively regulate the resulting merged company will be complicated and possibly compromised. Applicants have proposed several mitigation measures that would help prevent significant adverse consequences associated with the merger. However, some of the largest detrimental effects, particularly, the loss of rivalry between SDG&E and Edison, are unable to be mitigated.

In performing the balancing required under Section 854(c), we believe we also must consider other effects of the merger beyond the seven explicit criteria. In considering only the seven criteria, we conclude that on balance the detrimental effects of the merger, particularly of those associated with the loss of rivalry between SDG&E and Edison, lead to the conclusion that the merger is not in the public interest. This conclusion is reinforced by our determinations, previously discussed, that applicants have not demonstrated that the merger will result in long-term net benefits and our conclusion that the merger will have an adverse effect on competition.

For all these reasons, the result of our analysis under Section 854(c) is that on balance applicants have not demonstrated that the proposed merger is in the public interest.

V. Scheduling Future General Rate Cases

Our decision not to authorize the merger between Edison and SDG&E requires us to revisit the issue of the scheduling of proceedings for the independent companies.

In D.89-12-052, we directed Edison to file a test year 1992 general rate case (GRC) and instructed SDG&E to defer its regularly scheduled test year 1992 GRC. The deferral of SDG&E's GRC and a previous deferral of Edison's scheduled test year 1991 GRC (D.89-08-036) were actions we took to avoid the problems associated with processing the merger case at the same time as the merger partners' rate cases.

With the one-year deferral in the normal scheduling of Edison's GRC, Edison's next GRC after the one currently underway will occur for test year 1995. Under the current schedule of rate cases, both PG&E and Southern California Gas Company (SoCal) are scheduled for GRCs for test year 1993. Unless we alter the schedule for the GRC of another utility, the choices for SDG&E's next GRC are either test year 1993 (joining PG&E and SoCal) or test year 1994.

DRA believes a test year 1993 GRC is needed to enable SDG&E to resume normal operations. Deferring SDG&E's GRC any later means that the rates and revenue requirements in effect will be based on costs and other information from 1986. (Yager, Exh. 10,500, pp. I-22 to I-24.)

In response to applicants' objection that a test year 1993 GRC for SDG&E will conflict with the currently scheduled GRCs for PG&E and SoCal, DRA states that this is an administrative and scheduling problem that can be accommodated and has been addressed by its witnesses. (Yager, Exh. 10,500, p. I-24.) DRA suggests instituting informal discussions with PG&E and SoCal to see if either of their GRCs can be rescheduled.

After considering the arguments of the parties and the timing of our decision in this case, we conclude that the next GRC for SDG&E should be for test year 1994. Our decision in this case comes several months into 1991, and if we authorized a GRC for test year 1993, SDG&E

would have little time to prepare the detailed showing required for its notice of intention (NOI) preliminary to the filing of the GRC on January 1, 1992. In addition, processing the GRCs of three utilities — SDG&E, PG&E, and SoCal — in the same year would be administratively infeasible. We also recognize that SDG&E's management will have a formidable task in resuming life as an independent company after three years of planning for a merged existence. Although a test year 1994 GRC means that SDG&E's base rates will continue to be derived from out-of-date recorded figures, the modified attrition procedure we authorized for SDG&E for 1991 (D.89-12-052) will ensure that SDG&E's base rates receive a detailed and critical review.

Because SDG&E's rate case will be delayed for an additional year, we will authorize a modified attrition mechanism to be conducted for SDG&E in 1992. The modified attrition filing will be due on March 2, 1992, and any resulting rate changes will be effective January 1, 1993. In all other respects, the 1992 modified attrition mechanism should follow the details set forth in D.89-12-052 (p. 8, App. A). Because of our relatively limited experience with the modified attrition mechanism, however, we place SDG&E and interested parties on notice that the details of the modified attrition case in 1992 may be changed to reflect our experience with this year's modified attrition mechanism. The parties' proposals for changes to the mechanism should be presented as part of this year's proceeding. Any changes to the mechanism and a detailed schedule of the proceeding will be adopted in this year's proceeding.

SDG&E should continue to follow the schedule and procedures set forth in D.89-12-052, pp. 7-8, for processing its modified attrition filing to adjust rates on January 1, 1992 and to consider revisions to Schedules DT and GT.

Findings of Fact

1. On December 16, 1988, SCEcorp, Southern California Edison Company, and San Diego Gas & Electric Company filed an application under Public Utilities Code § 854 requesting authorization to merge SDG&E into Edison in accordance with their Agreement and Plan of Reorganization of November 30, 1988.

2. Under the Merger Agreement, SDG&E's shareholders will receive 1.3 shares of the common stock of SCEcorp, Edison's corporate parent, for each share of SDG&E common stock owned at the time of the merger.

3. Applicants propose to convert each outstanding share of SDG&E preferred or preference stock into an outstanding share of SCEcorp preferred or preference stock with similar provisions, except that higher dividend rates would apply.

4. Shareholders voted to approve the transaction in April 1989.

5. On February 1, 1991, the ALJs' Proposed Decision recommending denial of this application was served on all parties.

6. Edison and SDG&E each have gross California revenues of more than $500 million.

7. "Short term" and "long term" are not defined in § 854.

8. Applicants' detailed presentation on the costs and benefits of the merger extended only through 2000.

9. Applicants' projections of long-term labor savings do not take into account at least two effects that could reduce the projected savings. First, applicants do not account for the ability of a growing independent SDG&E to institute the administrative efficiencies that are not economically feasible for a utility the size of the current SDG&E. Second, applicants have not accounted for administrative inefficiencies that may result as the merged company grows even larger.

10. By considering the effects of resource deferrals only through 2000, applicants counted the capital savings associated with the deferrals as benefits of the merger but ignored the increased capital expenditures and the higher revenue requirements that will result after 2000.

11. Applicants' conclusion that deferrals of generating units result in net benefits depends on several assumptions, rather than on a detailed analysis of expected events and a

consideration of unforeseen circumstances. Applicants failed to test the sensitivity of their analysis to variations in key underlying assumptions.

12. Applicants make no projection of the extent to which the merger increases payments to QFs.

13. DRA estimates that the higher payments to QFs resulting from the merger will amount to $327 million from 2001 through 2005.

14. The offer of firm transmission service to the Northwest extends only from 1991 through 1997, and the service to the Southwest is contingent on the completion of the second Devers-Palo Verde (DVP2) transmission line. If DVP2 is not built, the service to the Southwest will be offered from 1991 to 1997.

15. Increased dividends to SDG&E's preferred and preference shareholders will not cease in 2000 but will continue indefinitely.

16. Lowering depreciation rates does not alter the cost or useful life of a particular asset. Although applying a lower depreciation rate will lower revenue requirements in the early part of an asset's useful life, it will increase revenue requirements later in the asset's useful life because a greater portion of the asset's cost will remain in rate base for a longer time.

17. Applicants propose to guarantee base rate reductions totalling $398.5 million from the date the merger is approved through 1994.

18. Applicants propose to pass on savings occurring after 1994 to ratepayers through normal ratemaking mechanisms.

19. Ratepayers will see the long-term benefits of the merger only if the forecasted savings are actually achieved by the merged company.

20. The consolidation of two companies performing similar functions in the production or sale of comparable goods or services is characterized as "horizontal," while economic arrangements between companies which conduct operations at several levels are characterized as "vertical."

21. Although Edison and SDG&E are each vertically integrated, their proposed merger presents vertical issues related to the merged entity's ownership of key resources and the effect of that ownership on competitors at retail, including the Resale Cities. In addition, the operations of the merger partners at defined levels (such as bulk power) present "horizontal" issues.

22. Market power is the ability to control the price or available quantity of a product in the marketplace. Traditional merger analysis assumes that an increased concentration of sellers, all else being equal, implies an increase in market power. While this conclusion can be overcome by other evidence, such as ease of entry by new suppliers into the market, analysis of market concentration is the starting point in accepted merger analysis.

23. In order to determine market concentration, it is necessary to define the "area of effective competition" by identifying both the relevant product market and the associated geographic market(s) affected by the merger.

24. Ancillary to this process is the identification of the firms that compete in the purchase or sale of each of the products for each of the relevant geographic areas, although accepted merger analysis also focuses on whether merger partners are potential, as well as actual competitors.

25. The product market is a range of products or services that are relatively interchangeable, so that pricing decisions by one firm are influenced by the range of alternative suppliers available to the purchaser. The relevant geographic market for each product market is the area in which sellers compete and in which buyers can practicably turn for supply.

26. To assess the effect of the proposed merger in each defined market, it is necessary to examine the market power of each separate firm (Edison and SDG&E) and of the merged company. A merger which affords the merging firms the power to control prices or to exclude competition is unlawful.

27. Under traditional market analysis, the market power resulting from the merger of two competitors is usually measured in terms of concentration, or market shares. This is a statistical analysis using the Herfindahl-Herschman Index (HHI), which calculates the sum of the squares of each firm's market share.

28. USDOJ's Merger Guidelines, embodying the policy for reviewing proposed mergers, indicates that a merger resulting in a market with an HHI exceeding 1800, to which the merger in question has contributed at least 50, will ordinarily be challenged as unlawful, as will a merger resulting in a market with an HHI between 1200 and 1800, to which the merger has contributed at least 100.

29. While HHI calculations may reach levels indicating very strong evidence of a § 7, Clayton Act violation, even in the absence of high HHIs, other empirical factors may support a finding of violation; likewise, the meaning and significance of HHIs can be assessed only after a number of structural and behavioral characteristics are also taken into account.

30. The second approach to assessing whether a proposed acquisition passes muster under § 7 of the Clayton Act is the direct approach, where the power to exclude competition is proved directly by actual exclusion, thereby eliminating the need to draw any inference from traditional market share analysis; where such direct evidence is presented, it is not necessary to prove any specific market share.

31. The traditional market analysis approach addresses only the horizontal effects resulting from the consolidation of two firms' operations at a single level in the chain of markets from production to ultimate sale.

32. Where firms are vertically integrated and conduct operations at several levels, such as applicants, a merger potentially presents an independent set of problems of foreclosure of competitors' access to suppliers or customers. These problems are assessed not by calculating market shares, but by realistically assessing the potential for market manipulation resulting in disadvantage to competitors or consumers.

33. Vertical mergers present special problems when the merging parties control an essential or "bottleneck" resource which can be used to exclude competitors or otherwise gain advantage in other markets; in the electric utility industry, the transmission grid has often been found to be a bottleneck resource.

34. While applicants have vigorously criticized other parties' vertical analyses, they have provided no independent assessment of the merger's vertical impacts, aside from acknowledging two generic problems in connection with vertical mergers.

35. The typical focus of an antitrust analysis is on the combining firms' ability to manipulate selling price--that is, to raise the price others must pay for the merged company's products (technically referred to as "monopoly" or "oligopoly" power, or more commonly as "seller market power").

36. In this proceeding parties have raised a second issue: Does the merger give the resulting entity unfair power to control purchase prices by eliminating competition between the merging firms in the bidding for up-stream resources (technically referred to as "monopsony" or "oligopsony" power, or more commonly as "buyer market power")?

37. The weight of the evidence supports the fact that while bulk power and transmission are closely interrelated, transmission services are routinely offered for sale separately from power.

38. Competition exists between Edison and SDG&E in supplying interruptible and short-term firm transmission service, including wheeling and the transmission component of sales of delivered bulk power. SDG&E's aggressive marketing of interruptible and short-term firm

transmission services has included sales as large as 500 MW to PG&E and 200 MW to the PNW, and the trend of these sales is upward, except for 1989, the year following announcement of the merger proposal.

39. Presently, SDG&E is in a position of control over transmission capacity to the SW, and at the point interconnecting Edison and PG&E service territories. SDG&E has the ability to provide transmission services using these facilities in the future. It is therefore appropriate in terms of assessing the competitive impacts of the proposed merger to take a longer term view of such competitive potentialities.

40. It is not unusual for SDG&E to broker amounts in excess of 261 MW to PG&E, notwithstanding north of SONGS constraints; furthermore, there is no reason to believe that PG&E's need for short-term firm transmission service, such as that provided by SDG&E at certain times north from its territory, will end.

41. SDG&E's transmission capacity may increase in the future due to additional planned transmission lines such as DPV2 and COTP, thus allowing it to become a bigger player as a supplier of short-term firm and interruptible transmission service.

42. In 1996, SDG&E's commitment to wheel power between CFE and Edison will expire, potentially freeing up an additional 70 MW of firm capacity, which would also increase opportunities for nonfirm or short-term firm transactions.

43. If DPV2 and COTP are built, SDG&E will have the option of acquiring additional transmission capacity to and from the SW and PNW to serve these needs for nonfirm or short-term firm transactions.

44. One premise of applicants' argument that the merger partners do not presently significantly compete in providing transmission service is that the transmission facilities in question do not reach common customers and/or common producers. However, this "origin/destination market" analysis ignores both existing, and potential future, competition between Edison and SDG&E in supplying interruptible and short-term firm transmission service.

45. SDG&E controls substantial capacity during many hours of the year which exceeds the needs of native load customers or of long-term transmission commitments. It is irrelevant for purposes of this competitive analysis that such transmission is not the mainstay or primary focus of SDG&E's utility business; it is relevant only that interruptible and short-term firm trading/transmission is a market in which SDG&E is an active supplier.

46. SDG&E is an active participant in the market supplying interruptible and short-term firm transmission, and its role in that market, absent the merger, is likely to expand in the future.

47. A second premise of applicants' argument that at present the merger partners do not compete significantly in providing transmission service is that native load requirements and technical system limitations constrain the amount of long-term transmission capacity available for sale. However, in its focus on long-term transmission capacity, this argument ignores SDG&E's role in supplying interruptible and short-term firm transmission service. Furthermore, in its focus on native load requirements and technical system limitations, this argument is contrary to the evidence that SDG&E is actively participating in these markets notwithstanding these claimed constraints.

48. Transmission markets between (i) California and the SW and (ii) California and the PNW have very different characteristics, which support viewing them separately.

49. The PNW offers different bulk power components, which are not available in the same quantities, at the same time, or at the same cost anywhere else in the WSCC bulk power market. These unique characteristics require viewing transmission between (i) California and the PNW and (ii) California and the SW, as separate geographic markets.

50. Attorney General's expert presented transmission capacity HHIs (after taking into account firm resources transmitted over that capacity and expected outages) for the transmission market between California and the SW over a multi-year period. According to his calculations, in 1991, pre-merger HHIs are 2300, post-merger HHIs are 2978, and the merger-related change in HHIs is 678.

51. San Diego's expert measured market shares for the transmission market between California and the SW on the basis of transmission capacity entitlements, on the rationale that the market share proportion of uncommitted capacity will be approximately the same for each firm in the market. The results of this exercise over the 1989-2000 period are pre-merger HHIs ranging from 2778-3015, post-merger HHIs ranging from 3464-3737, and merger-related HHI changes ranging from 635-754.

52. Southern Cities' expert calculated the pre-merger HHI concentration figure for the SW Interties market (transmission between the SW and Southern California) as 3042, the post-merger HHI figure as 3476, and the merger-related HHI increase as 434.

53. In addition to relying on market concentration calculations, Southern Cities' expert evaluated other competitive considerations, including the essential facility doctrine, changing market conditions, and barriers to entry, and did not base his conclusions solely on market concentration and market share calculations.

54. The principal technical criticism leveled against intervenors' HHI calculations is that they include committed capacity, thereby providing an unrealistic picture of the markets under review.

55. The failure to deduct committed capacity from total transmission entitlements may not be a fatal flaw, since the market share proportion of uncommitted capacity should be about the same for each firm in the market. This assessment is consistent with the HHI calculations of the Attorney General's expert (who netted out the proportion of physically available capacity used to transmit firm resources, and calculated a merger-related HHI change of 678) and the calculations of San Diego's expert (who did not make a similar adjustment but derived HHI changes consistent with those of the Attorney General's expert).

56. The HHI calculations presented by Attorney General, San Diego, and Southern Cities associated with the merger's impact on the market defined as transmission between California and the SW, greatly exceed the figure specified in the Merger Guidelines (50) as evidence of concern that a particular acquisition will unlawfully increase concentration in a particular market.

57. Given the HHI results, it is appropriate to review other direct evidence of the merged entity's ability to control the market for transmission between California and the SW, to ascertain whether this evidence supports the indications demonstrated by intervenors' HHI calculations.

58. While statistics reflecting the market shares controlled by the merger partners are a primary index of market power, only a further examination of the particular market, including its structure, history, and probable future, can provide the necessary information to gauge the acquisition's competitive effects.

59. For purposes of analyzing SDG&E's significance as "middleman" or "broker" in the California/SW short-term firm and interruptible transmission market, it is more appropriate to measure its importance from the perspective of purchasers in this market, rather than via MWh measurements.

60. SDG&E has acted as "middleman" or "broker" in the California/SW short-term firm and interruptible transmission market, and has served a significant and growing role which is not fully captured by applicants' analysis of "per MWh over the entire year" or similar MWh measurements.

61. SDG&E has served 12% of one entity's entire 1989 requirements in this "middleman" capacity.

62. Based on the analysis of horizontal merger issues, the loss of SDG&E as a competitive alternative to Edison in the California/SW short-term firm and interruptible transmission market will have adverse effects on competition; the direct evidence presented is consistent with the unfavorable inferences to be drawn from the HHI calculations.

63. San Diego's expert calculated market shares in the transmission market between California and the PNW over a multi-year period (1989-2000); the calculated pre-merger HHIs range from 819-2163, the post-merger HHIs range from 2034-2415, and the merger-related change in HHIs ranges from 207-252.

64. Southern Cities' expert calculated HHIs for the Pacific Intertie market (transmission between the PNW and Southern California) as follows: Pre-merger HHI: 3091, post-merger HHI: 3290, and change: 199.

65. The concentration ratios calculated by San Diego and Southern Cities associated with the merger's impact on the market defined as transmission between California and the PNW, result in merger-related increases in the HHI which are indicative of increased concentration in this transmission market.

66. Since the concentration ratios calculated by San Diego and Southern Cities result in merger-related increases in the HHI which indicate increased concentration in the market for transmission between California and the PNW, and exceed the threshold specified in the Merger Guidelines, it is appropriate to analyze other direct evidence bearing upon the structure, history and probable future of this transmission market, to ascertain whether these statistical results are credible.

67. It is more appropriate to analyze SDG&E's significance as a seller in the California/PNW transmission market from the perspective of purchasers in this market, rather than via MWh measurements.

68. As in the case of the California/SW transmission market, applicants rely on a MWh/hour benchmark to assess the significance of SDG&E's activities as "middleman" in the California/PNW transmission market, but MWh measurements do not fully capture the nature and extent of SDG&E's role in this transmission market.

69. SDG&E has made significant sales to PG&E, notwithstanding the north of SONGS constraints, and if SDG&E had been permitted to make these sales to Southern Cities, assuming present delivery point restrictions did not exist, its volume of sales to the Resale Cities would have increased ten-fold.

70. SDG&E has exerted a beneficial price restraining impact in the California/PNW transmission market, as illustrated by the Anaheim/Riverside replacement capacity experience, where SDG&E offered the Cities a price significantly lower than the price Edison was entitled to collect under the IOA, followed by Edison's offer of a price competitive with SDG&E's lower figure.

71. Applicants have provided no credible counter-evidence to indicate Edison refrained from charging these Cities the $1.57 per kW/day ceiling price due to anything other than SDG&E's more competitive alternative.

72. The merger will have adverse effects in that SDG&E will no longer participate as an effective counter-weight to Edison's domination of transmission study groups that are critical to determining transmission line ratings.

73. Based on the analysis of horizontal merger issues, it is clear that the loss of SDG&E as a competitive alternative to Edison in the California/PNW transmission market will have adverse effects on competition; the direct evidence presented by intervenors is consistent with the unfavorable inferences to be drawn from the HHI calculations.

74. The proposed merger will eliminate Anaheim and Riverside's independent firm transmission path to SDG&E, and will prevent Resale Cities from developing a more extensive buyer/seller relationship with SDG&E; therefore, it will have adverse competitive impacts on these cities.

75. Based upon analysis of horizontal merger issues, including the loss of SDG&E as a competitive alternative to Edison in the markets for transmission between the PNW and the SW and transmission to California from the PNW and SW combined, as well as evidence of substantial existing barriers to entry, the proposed merger adversely impacts competition in these markets; the direct evidence is consistent with the results of the market share analyses.

76. Two parties, San Diego and Southern Cities, have defined a network transmission market, but have not calculated market shares and concentrations because such data are not publicly available and are not contained in documents provided by applicants.

77. Southern Cities' expert defines the service area network transmission market as a market consisting of Edison's and SDG&E's combined service area network transmission facilities.

78. San Diego's expert defines a market called "transmission across Edison's territory," noting that SDG&E currently has transmission rights across this territory in connection with its Pacific Intertie entitlements and its CPP participation.

79. Both Anaheim and Riverside, surrounded by Edison's service territory, have firm transmission rights through Edison's system from SONGS for use in transmitting their share of SONGS power, and have the option of purchasing replacement power from either Edison or SDG&E. With the merger, Anaheim and Riverside lose this firm transmission path to a non-Edison utility.

80. In 1989 neither Anaheim nor Riverside purchased any transmission service from SDG&E via their firm transmission path at SONGS. Since 1987 SDG&E has sold a total of $10,000 of transmission service to Anaheim, and has sold no transmission service to any other Resale City.

81. The fact that the two resale cities which have an available firm transmission path to SDG&E have not heavily used it since 1987 does not contradict Southern Cities' claim that the Resale Cities are adversely affected by the lack of delivery points within Edison's service territory. The reasons why post-1987 sales were not higher are unclear, and this fact must be weighed against Resale Cities' stated desire to expand their purchases from SDG&E and testimony that they would do so absent present delivery point restrictions.

82. San Diego's expert defined the markets served by transmission facilities between PNW and SW that pass through California or Utah, as "transmission between the PNW and SW." After considering the transmission requirement imposed on PacifiCorp in FERC's UP&L/PP&L merger decision, he calculated a pre-merger HHI of 2136, a post-merger HHI of 2676, and a merger-related HHI increase of 540.

83. San Diego, Southern Cities, and DRA analyzed a market for "Transmission to California from the PNW and SW Combined" under a variety of titles ("transmission from the SW to Northern California or PG&E, and from the SW to Anaheim and Riverside"; "Combined Pacific Intertie and SW Intertie"; and DRA's Combined NW and SW to California).

84. San Diego's expert defined a market for "transmission from the SW to Northern California or PG&E, and from the SW to Anaheim and Riverside," and calculated multi-year (1989-2000) HHIs. Pre-merger HHIs ranged from 2052 to 2282, post-merger HHIs ranged from 2495 to 2792, and the merger-related increase in HHIs ranges from 446 to 509.

85. Southern Cities' expert calculated pre-merger and post-merger percentage shares for transmission entitlements over a "combined Pacific Intertie and SW Intertie." For 1991, the pre-merger HHI concentration figure is 2905, the post-merger figure is 3300, and the merger-related change in HHI is 395.

86. DRA has concluded, based on pre-merger ownership of shares of transmission from the WSCC into Southern California, that current and future wholesale power purchasers in Southern California are already faced with concentrated ownership of transmission facilities; DRA calculates market shares with a post-merger HHI of 4200, and an increase of 1,180.

87. DRA performed HHI calculations reflecting the effect of eliminating the transmission bottleneck resulting from Edison's control of Southern California transmission. These figures for 1985, 1987, and 1988 result in pre-merger HHIs ranging from 721-1038, post-

merger HHIs ranging from 910 to 1252, and resulting merger-related increases ranging from 173 to 214.

88. The concentration ratios calculated by San Diego, Southern Cities and DRA for the market defined as "Transmission to California from the PNW and SW Combined" indicate merger-related increases exceeding the threshold of concern identified in the Merger Guidelines.

89. DRA's alternative calculations, adjusted to reflect elimination of barriers to transactions between the SW and PNW, reveal much smaller increases than those DRA calculated earlier, but DRA's results still exceed the Merger Guidelines' threshold of concern.

90. The calculations presented by San Diego for "transmission between the PNW and SW" also exceed the threshold of concern identified in the Merger Guidelines.

91. The calculations performed by DRA and intervenors in these other defined transmission markets are consistent with those derived in connection with two previously examined (and closely related) interregional transmission markets ("transmission between California and the SW" and "transmission between California and the PNW"), and are evidence that the merger will increase concentration in these markets. Therefore, it is appropriate to analyze other direct evidence bearing on the structure, history and probable future of these other transmission markets, to test the credibility of these statistical results.

92. Completion of some additional transmission projects, such as Mead-Adelanto and related lines, is not certain, and completion of DPV2 is too far distant to meet the Merger Guidelines' two-year ease of entry standard (Merger Guidelines, § 3.3).

93. Disappearance of SDG&E as a separate entity following the merger may increase, rather than diminish, the merged company's market share in transmission between California and PNW.

94. The merged company controls the few remaining transmission corridors available for construction of high voltage transmission paths into Southern California, and this is further evidence of its present and future control of transmission in the markets reviewed.

95. We have examined five transmission markets (four interregional transmission markets and the network transmission market). These are: (1) transmission between California and the SW; (2) transmission between California and the PNW; (3) transmission between the PNW and the SW; (4) transmission to California from the PNW and the SW combined; and (5) network transmission.

96. Based upon examination of market concentration and direct evidence of structural and behavioral characteristics in these five markets, in connection with the review of the

proposed merger's horizontal impacts, the acquisition of SDG&E by SCEcorp will have adverse effects.

97. In the case of the so-called "Riverside energy issue," Edison allowed occurrence of a situation which precluded Riverside's sales of excess energy to Azusa, Banning, and Colton, merely because the excess imports could not be accommodated under applicable Edison rate schedules.

98. Parties in equal bargaining positions would have quickly resolved the contractual impediment underlying the so-called "Riverside energy issue" so that Riverside could be paid for the energy it brought into the system (which unquestionably benefitted the entire system to some extent).

99. The effect of Edison's refusal to provide SDG&E with additional delivery points has been to constrain SDG&E from engaging in wholesale power transactions with the Resale Cities.

100. The effect of Edison's actions in connection with the claimed line-loading problems preventing Nevada Power from selling power to Vernon, was to shift a portion of the loop flow burden to NPC, while also precluding Vernon's purchase from NPC.

101. Edison's refusal to permit Anaheim to integrate Cholla as a capacity resource for approximately five years was disadvantageous to Anaheim, although the withdrawal of the APS offer mooted this dispute.

102. Edison has the ability to supply nonfirm transmission to the Resale Cities on a pre-scheduled basis, and there is no operational impediment issue which would support Edison's refusal to schedule nonfirm transmission more than one hour in advance; Edison would retain the ability to interrupt pre-scheduled ITS to the same extent and on the same terms as interruptible transmission provided on an hour-by-hour basis.

103. Without the ability to pre-schedule, the Resale Cities cannot meaningfully compete with Edison for nonfirm purchases.

104. Edison's refusal to respond, between 1985 and 1989, to AEPCO's request that Edison provide AEPCO with transmission service exceeding 10 MW to its customer, the Anza Electric Cooperative, is uncontroverted.

105. The above-noted historical examples demonstrate that Edison has used its strategic control over transmission to the competitive disadvantage of other utilities, who are buyers and sellers in the relevant interregional transmission markets, and who are located in the network transmission market.

106. Applicants do not dispute the fact that Southern Cities have borne a proportionate share of the Pacific Intertie costs, as well as the cost of Edison's transmission facilities in general, through their wholesale and fully-allocated transmission rates.

107. Edison provides the Resale Cities' import transmission equal to approximately 12% of their peak load (not "87% of peak load" as applicants claim), and only a small percentage of total import transmission from the PNW and the SW.

108. The New Business Relationship (1990 IOAs) is an improvement over the previous situation, but still does not assure that Edison will provide the service area transmission or import transmission required to effect integration under the 1990 IOAs; furthermore, the 1990 IOAs do not prevent Edison from overcharging for replacement capacity. Thus, some fundamental transmission access problems between Edison and the Resale Cities remain unresolved, notwithstanding the 1990 IOAs.

109. Edison controls the majority of available capacity from the SW during 1993 to 2000, and this control plus Edison's transmission access policies have effectively forced other utilities to explore the construction of new transmission lines that might not otherwise be needed.

110. There is undisputed testimony of record that Edison engineered the LADWP swap in order to remove LADWP as a participant in the Mead-Adelanto transmission line project, in order to prevent or hamper construction of that line. Mead-Adelanto is one of the planned lines upon which Edison relies to counter adverse testimony concerning its transmission access policies.

111. The merger will adversely impact transactions between PG&E and SW energy suppliers; using its essentially independent path from the SW to PG&E under the provisions of the CPP, SDG&E has brokered power across Edison's system to PG&E in off-peak hours at a contractually-fixed 2 mill markup, but this competitive alternative will be lost due to the merger.

112. PG&E's loss is not confined to off-peak hours, since these sales have also occurred in shoulder hours and some on-peak hours.

113. SDG&E has afforded unique opportunities to PG&E, which will be lost if the merger is approved, to the economic detriment of PG&E's ratepayers.

114. It is undisputed that SDG&E represented a significant counter-weight to Edison's dominance of transmission planning groups, which play a crucial role in rating the capacity of existing and new transmission lines. Such ratings are fundamental to assessing available transmission capacity, and are thus a key underpinning of statewide transmission access policies.

115. With the merger, SDG&E will be eliminated from the transmission planning groups, leaving the merged utility in a totally dominant position. This may have adverse effects on the future competitive development of the transmission markets under review.

116. The fact that there does not today exist a complete long-term transmission path between SDG&E and any of the utilities Edison encircles is a significant defense, but it ignores the realities of the current market and a potential for a more open market in the future.

117. Several new transmission lines currently under study will not be constructed in sufficient time to constitute effective ease of entry under § 3.3 of the Merger Guidelines; Edison is making no effort to construct DPV2 prior to 1997, and several other lines are either on hold or in the study phase (Mead-Phoenix, Mead-Adelanto, and Utah-Nevada).

118. In the case of the Mead-Phoenix, Mead-Adelanto, and Utah-Nevada proposed transmission lines, LADWP's role is crucial to the participation of the Resale Cities, and its absence may adversely affect the viability of these projects from the prospective of the Resale Cities, thus vitiating an ease of entry determination under § 3.3 of the Merger Guidelines.

119. Assuming COTP is completed on schedule, it may not be a good substitute for the Pacific Intertie with its depreciated original cost, and transmission dependent utilities argue they will not benefit from the COTP project unless access from Tesla to Edison's network is specifically ensured. These factors vitiate an ease of entry determination under § 3.3 of the Merger Guidelines.

120. The record review of past, present, and future vertical impacts of the proposed merger indicates that the proposed merger will adversely impact competition between the merged utility and the Resale Cities in the defined transmission markets, and will have adverse impacts on PG&E's ratepayers as well.

121. Southern Cities' expert used the essential facility doctrine as an adjunct to his market concentration analysis; Vernon, with its focus on § 2 Sherman Act monopolization issues, used the essential facility doctrine to support its assertion that control of an essential facility is dispositive of the issue of market power. Applicants assert that the essential facility doctrine is inapplicable because it has not been used in § 7 Clayton Act proceedings, or in the alternative, that it is unhelpful in determining whether the merger will create market power.

122. Of the three positions outlined in the preceding finding, Southern Cities' approach is the most reasonable because it is consistent with our previous determination that asserted violations of applicable federal antitrust statutes are not dispositive of the competitive analysis under § 854(b)(2).

123. The parties have not placed in issue Element No. 1 of the essential facility doctrine, the merged utility's control of an essential facility, and this fact is consistent with our previous findings.

124. Element No. 2 of the essential facility doctrine is the inability to practicably or reasonably duplicate an essential facility.

125. If duplication is economically feasible, which is an issue of fact, a facility does not fall within the essential facility doctrine.

126. We do not have a sufficient evidentiary record to determine whether or not duplication of the Pacific Intertie is economically feasible.

127. The merger will adversely affect competition between applicants and the Resale Cities in the network transmission market defined by Dr. Taylor. Furthermore, the evidence submitted in connection with Element No. 2 of the essential facility doctrine is consistent with previous findings that the proposed merger will have adverse impacts on competition between the merged utility and the Resale Cities in the defined California/SW transmission market.

128. Evidence submitted in connection with Element No. 3 of the essential facility doctrine, the denial of access, is consistent with previous findings that the proposed merger will have adverse competitive impacts on competition between the merged utility and the Resale Cities, due to the latter's limited access to import transmission facilities in the defined transmission markets.

129. Element No. 4 of the essential facility doctrine is feasibility of access.

130. Notwithstanding the demands and needs of native load customers, and the obligation to serve, the merger partners have provided transmission access to others for purposes not related to native load needs.

131. Network facilities are built to serve Edison's entire service area load, including the Resale Cities' load, and import transmission lines are built with a view to the needs of total load area requirements, including those of Resale Cities. These determinations are consistent with previous findings on the merger's competitive impacts on the defined transmission markets.

132. The record evidence is consistent with Elements No. 1, 3, and 4, and partially consistent with Element 2 of the essential facility doctrine, used by this Commission as a framework to test determinations previously made in connection with the merger's impacts on transmission-related issues.

133. Given the geographic impediments associated with the Cajon and San Gorgonio Passes, the relevant transmission lines between California and the SW are nonduplicable. Furthermore, the physical constraints noted by intervenors in connection with the L.A. Basin and service area facilities also indicate that these lines are nonduplicable.

134. Applicants' delivered bulk power analysis is inconsistent with our treatment of transmission as a separate product market and our disposition of transmission access issues in previous sections of this decision.

135. The costs of transporting electricity from the PNW to Southern California and from the SW to Southern California differ greatly.

136. There is limited capacity to transmit electricity between the PNW and SW, except through Southern California.

137. Given the factors noted in preceding findings, it is appropriate to separate the SW and PNW regions and treat them as separate submarkets in the analysis of the merger's impacts on bulk power markets.

138. Firm energy tends to be more highly valued and more costly to supply than economy energy because it involves a commitment to provide capacity over an extended time period. It is also distinguished by greater supply reliability, which is typically valued by wholesale purchasers.

139. Economy energy tends to have more pricing latitude than firm energy; its lower bound is determined by the seller's incremental generation cost and its upper bound is determined by the buyer's opportunity cost of other supplies.

140. In 1985 and 1988, the average price for firm energy exceeded the average price for economy energy in both SW and PNW regions.

141. Based on the factors outlined in preceding findings, it is appropriate to focus on the proposed merger's impacts on competition in four bulk power markets: PNW firm power, SW firm power, PNW economy transactions, and SW economy transactions.

142. DRA's concentration ratios relative to seller market power in the PNW firm bulk power market show no increase in the HHI index in 1985, 1987, and 1988. This result is consistent with applicants' direct evidence that SDG&E and Edison do not compete in the sale of long- or medium-term power.

143. DRA's concentration ratios relative to buyer market power in the PNW firm bulk power market indicate increases in the HHI index for 1985, 1987, and 1988 well below the

threshold of concern contained in the Merger Guidelines, and applicants have presented direct evidence consistent with these results.

144. There is no competition between the merger partners as buyers in the PNW long-term firm bulk power markets.

145. Edison will not be in the market for new long-term bulk power supplies for several years.

146. There will be many other competing buyers in the long-term bulk power markets in the next decade.

147. Supply of new generating capacity in the PNW firm bulk power market is likely to be quite elastic, with nonutility suppliers furnishing a significant portion of new capacity requirements.

148. The proposed merger will not have adverse impacts via the exercise of either seller market power or buyer market power in the PNW firm bulk power market.

149. DRA's concentration ratios relative to seller market power in the SW firm bulk power market show an increase in the HHI index well within the Merger Guidelines' threshold for 1985, 1987, and 1988, and these results are consistent with applicants' direct testimony.

150. The proposed merger will not have adverse impacts of a seller market power nature in the SW firm bulk power markets.

151. DRA's concentration ratios relative to buyer market power in the SW firm bulk power markets show an increase in the HHI index exceeding the threshold specified in the Merger Guidelines by significant amounts. For 1985, the post-merger index is 1738 and the merger-related increase in the index is 569; for 1987, the post-merger index is 1687, and the merger-related increase in the index is 518; and for 1988, the post-merger index is 2470, and the merger-related increase in the index is 1014.

152. These results are cause for some concern, but are tempered by the high elasticity of firm supply in this market, which effectively means that the amount of energy available for sale in these markets is responsive to price, and sellers can therefore protect themselves from any attempt by the merged entity to exercise buyer market power.

153. The proposed merger may have adverse impacts via the exercise of buyer market power in the SW firm bulk power markets.

154. The role of SDG&E and Edison in the PNW nonfirm bulk power market is minor and sporadic, and their sales volumes in this market are insufficient to have any seller market power impact on competition.

155. The proposed merger will not adversely impact competition in the PNW nonfirm bulk power market via the exercise of seller market power.

156. When viewed in the context of the WSCC's total economy energy sales for the period reviewed by applicants' expert (and as confirmed by DRA's concentration ratios) the merger partners are predominantly buyers, not sellers of economy energy; however, this does not tell the entire story in the SW. Before concluding that the merger does not enable the merged entity to exercise seller market power in the SW short-term market, we must examine other direct evidence bearing on the future.

157. Since 1987 when FERC approved the WSPP, which has since become the nation's largest power pool, SDG&E has played an active and growing role in these SW short-term bulk power markets, and it is appropriate to review the competitive impact of SDG&E's loss on this market.

158. The focus of our review of the emerging short-term bulk power markets is direct evidence of SDG&E's growing role as energy broker and the fact that the merger will end SDG&E's involvement in this emerging marketplace in its nascent stage.

159. It is necessary to focus on the interrelatedness of transmission and bulk power issues in order to understand the dynamics of this emerging bulk power market.

160. SDG&E plays a unique role in brokering or trading bulk power both using its entitlements and arranging sales for such entities as M-S-R on a delivered basis, which means that it arranges for the source of generation and for the transmission all the way to a point where M-S-R can take delivery.

161. No other utility in this state has undertaken a brokering or trading role comparable to that of SDG&E, and SDG&E has undertaken this role due to its unique energy management focus; in addition, SDG&E has been particularly inventive in using the transmission grid to facilitate its brokering and trading activities.

162. PG&E and M-S-R, parties to some of these brokering transactions with SDG&E, regard them as significant, even if applicants do not.

163. Although oil and gas prices may increase, the relative relationship between them and purchased power prices tends to remain the same, indicating that a utility like SDG&E will

have the ability to participate in bulk power markets as a seller at times and should not be dismissed as a future competitor.

164. While some of SDG&E's current trading partners may become independent in the future, other utilities will continue to rely upon SDG&E's staff and resources and will continue their relationship with broker SDG&E.

165. While reaching no specific conclusion that the merger will have adverse seller market power effects in the SW nonfirm bulk power markets, we find that the proposed merger will result in the loss of SDG&E as a key participant in the emerging SW short-term (or nonfirm) bulk power markets, and that this is an adverse impact on competition.

166. Buyer market power (also known as monopsony power or oligopsony power) is the ability of the merged entity to reduce the price it pays for purchased energy/capacity below competitive levels. By reducing its purchases, the merged entity could reduce the price it pays, and thereby cause a price reduction for all purchases by all buyers in the defined market.

167. If the merged utility can exercise buyer market power, it will be able to redistribute wealth from utilities who sell this power to itself, and that redistribution may have adverse efficiency consequences if it results in a reduction in output.

168. If the price of SW nonfirm bulk power is depressed, ratepayers may benefit from this redistribution of wealth. However, this is not a justification for ignoring the competitive injury to the SW short-term bulk power markets associated with the exercise of buyer market power. Ratepayers may be short-term winners, but long-term losers, given the adverse long-term efficiency consequences of the exercise of buyer market power. Therefore, it would be shortsighted to ignore or minimize these consequences simply because they may favorably impact California ratepayers in the near term.

169. The problem with applicants' focus on USDOJ's FERC position is that the basis for the latter is USDOJ's participation in the evidentiary record developed at FERC, and USDOJ has taken no position on the merger based upon the evidentiary record before this Commission. Therefore, USDOJ's position at FERC does not support the notion that this Commission should ignore the buyer market power impacts of the merger developed in its own evidentiary record.

170. None of the four conditions for applying the safe harbor doctrine is met in the case of the proposed merger: the proposed merger is not a shipping association or joint venture, and it is not limited to a product/service that is less than 20% of the value of the delivered product (electric power); furthermore, the applicants cannot satisfy the 35% test vis-a-vis all electric power moving between any two major distribution points.

171. It is inappropriate to apply a more lax standard to buyer market power issues than to seller market power issues in the overall § 854(b)(2) review.

172. Both DRA and applicants have reviewed concentration ratios for SW nonfirm bulk power markets.

173. Applicants' post-merger HHIs for SW nonfirm bulk power markets (1985, 1986, and 1987) are 1660, 1410, and 1245, with associated HHI changes due to the merger of 369, 426, and 349.

174. DRA's market concentration ratios for the SW nonfirm bulk power markets for 1985, 1987, and 1988 show a post-merger index of 1736, 1139, and 1741, and a corresponding merger-related increase in HHIs of 352, 366, and 704.

175. Given the levels cited above, there is concern that the merged entity will be able to exercise buyer market power in the SW bulk power markets, and it is appropriate to review other direct evidence to test these statistical results.

176. Both DRA and applicants have calculated concentration measures for the PNW nonfirm bulk power market.

177. Applicants have reviewed 1985, 1986, and 1987, and have calculated post-merger HHIs in the PNW nonfirm bulk power market of 1502, 849, and 1261, and merger-related HHI changes of 194, 83, and 101.

178. DRA has calculated concentration measures for the PNW nonfirm bulk power markets for 1985, 1987, and 1988, showing post-merger HHIs of 1495, 1587, and 1542, and merger-related increases in HHIs of 162, 94, and 4.

179. These HHIs are below the safe harbor measure and Professor Joskow's recommended HHIs.

180. There is testimony of record that Edison has actually exerted buyer market power in the PNW nonfirm bulk power market.

181. Having rejected applicants' safe harbor argument, and the argument that a more lax HHI standard should be used, there is indeed some potential concern that the proposed merger will increase the merged utility's buyer market power in the PNW nonfirm bulk power markets. This is a conservative assessment of the testimony which indicates that Edison actually has exercised buyer market power in this market in the past.

182. It is appropriate to consider available transmission concentrations in the buyer market power analysis for economy energy, and the evidence demonstrates that such available capacity will be increasingly concentrated over the next decade due to the merger, thus supporting the notion that the merger will facilitate the exercise of buyer market power.

183. ITS is not a good substitute for firm transmission, and purchasers will be reluctant to enter this market without firm access to long-term transmission capacity; furthermore, ITS is subject to curtailment, thus eroding its attractiveness.

184. There is no record evidence that 400 MW is sufficient to mitigate the buyer market power effects the merger will create in the SW market and will likely create in the PNW market.

185. Applicants' argument that the 250 MW to the SW exceed the 30 to 50 MW reduction estimated by the Cournot Oligopsony Model ignores the fact that this computer simulation model is not the basis for determining the amount of transmission access which should be made available to mitigate the merger's impacts.

186. Other transmission projects which are planned for the future do not alleviate entry barriers in these markets.

187. No conclusion can be drawn regarding the Mead-Phoenix project or other planned projects such as the Inland Pacific and Mead-Adelanto lines, because it is uncertain when these lines will be built. They clearly will not be constructed within the two years specified in the Merger Guidelines to constitute effective mitigation to entry barriers.

188. Assuming DPV2 is built later in the 1990s, its effectiveness in mitigating entry barriers is questionable since the applicants will own or control most of its capacity.

189. The impacts of opportunities for collusion and price regulation as constraints on the exercise of buyer market power are unclear based on the evidence of record.

190. DRA supported its concentration calculations using applicants' SERAM model to determine that the supply of nonfirm energy is inelastic. DRA also examined the merged utility's demand for power and determined that it was relatively flat, thus leading to the conclusion that exercise of buyer market power will significantly reduce demand.

191. DRA did not rely exclusively upon HHIs in formulating its opinion on the buyer market power issue.

192. DRA used the Cournot Oligopsony Model to confirm and support its buyer market power findings, and no party has presented a similar model; since the model is proffered by

DRA only as confirmation of its other results, which are supported by analysis of other structural and behavioral factors, reliance on the model is not crucial to the outcome of this decision.

193. DRA's and applicants' market concentration calculations relative to the exercise of buyer market power in PNW and SW nonfirm bulk power markets are supported by record evidence of structural and behavioral factors.

194. The proposed merger will adversely impact competition in the SW nonfirm bulk power market by enabling the merged entity to exercise buyer market power.

195. The proposed merger may adversely affect competition in the PNW nonfirm bulk power market by enabling the merged entity to exercise buyer market power in that market.

196. Previous findings that the proposed merger will increase the merged utility's control over network transmission and various interregional transmission markets, and that its vertical aspects vis-a-vis Edison and the Resale Cities adversely impact competition, are consistent with the analysis of vertical impacts in the bulk power markets, due to the interrelatedness of transmission and bulk power.

197. The merged utility will be in a dominant position, capable of forcing the Resale Cities to purchase power from the merged entity and also of distorting pricing in the WSCC bulk power market. This will increase Resale Cities' costs and impair their ability to compete at retail with the merged entity in serving the Resale Cities' customers.

198. With the loss of their independent path to SDG&E at SONGS, Anaheim and Riverside must deal with the merged entity and will have no other options. Furthermore, any future opportunity Resale Cities have to gain delivery points from SDG&E, and thereby gain alternative bulk power sources, is foreclosed by the merger; thus the merger's vertical aspects do have an impact on the control area bulk power markets.

199. There is no conclusive evidence that the Blythe Project will not be completed at some point following the merger, with the participation of the Cities; furthermore, it cannot be said with certainty that the Cities will be unable to fill the void left by SDG&E in future joint venture transmission/generation projects; thus we do not find that the merger will have adverse impacts in this area.

200. A more accurate characterization of the dispute between Edison and SDG&E regarding delivery points is that SDG&E was unsuccessful, for a variety of reasons, in obtaining additional delivery points from Edison; whether, in the absence of the merger, SDG&E would be able to obtain such delivery points is unknown for certain, but the merger will put an end to this inquiry.

201. The proposed merger will result in the loss of Anaheim's and Riverside's access to SDG&E as an alternative bulk power supplier through the firm transmission path at SONGS, as well as the foreclosure of future opportunities to gain delivery points from SDG&E, a non-Edison bulk power supplier with a track record of innovative energy marketing strategies in bulk power packaging activities. These are adverse impacts on competition.

202. Pursuant to D.88-01-063 (the "holding company decision"), applicant holding company (SCEcorp) is not itself a regulated public utility, but owns both utility-related and nonutility subsidiaries.

203. The holding company's nonutility Mission Group subsidiary owns 100% of Mission Energy Company (Mission Energy), which operates and develops major cogeneration and other energy projects throughout the country; Mission Energy is the most significant of the Mission Group subsidiaries which transact business with Edison, the holding company's regulated electric utility subsidiary.

204. As of October, 1989, Mission Energy owned interests in 39 projects totaling 3,656 MW; during 1991 Mission Energy QFs will account for 39% of the merged company's total QF purchases, and Edison's payments to Mission Energy are projected at $1 billion by 1997.

205. Mission Group subsidiary Mission Power Engineering Company (Mission Engineering) provides engineering, construction, and consulting services in the energy field. Its projects include electric generating units, transmission lines, and substations.

206. Mission Group subsidiary Mission First Financial (Mission Financial) provides energy-related venture capital and invests in leveraged leasing transactions, project financing, and high quality securities.

207. Mission Group subsidiary Mission Land Company (Mission Land) is a real estate development firm which builds industrial business parks and engages in land acquisition, construction, management, and sales.

208. Unlike its merger partner Edison, SDG&E is not part of a holding company, but directly owns Pacific Diversified Capital Company (PDCC) which, at the time of this application, owned four nonutility subsidiaries: Mock Resources (oil and gas marketer), Wahlco (air pollution control systems), Phase I Development (real estate development), and Integrated Information Systems (a computerized mapping software and consulting company).

209. PDCC has recently disposed of its 51% interest in Mock Resources, but if the merger is approved nothing will prevent the merged entity's future affiliation with an unregulated gas procurement enterprise under the holding company structure.

210. SDG&E's subsidiary PDCC grew very little between 1987 and 1988.

211. If the merger is effected, Edison will own PDCC and PDCC's interests in its subsidiaries. While applicants have not yet formulated a definitive plan for the integration of the PDCC subsidiaries into SCEcorp, it is likely that eventually these subsidiaries will be transferred to and operated under the Mission Group and that PDCC will be dissolved.

212. The melding of SDG&E into the holding company structure and the prospective integration of PDCC's subsidiaries into the Mission Group will trigger significant regulatory impacts.

213. Currently PDCC and its subsidiaries are subsidiaries of a regulated SDG&E, whose operations are subject to the direct ratemaking authority of the Commission. With their contemplated transfer to the Mission Group, the Commission will lose direct regulatory control over PDCC and its subsidiaries.

214. If approved, the merger will accomplish a new type of vertical integration, bringing SDG&E within the SCEcorp holding company structure, and effectively integrating its regulated electric and gas utility operations with the unregulated SCEcorp subsidiary Mission Group and its lower tier unregulated subsidiaries.

215. As a direct consequence of the merger, the holding company corporate structure, with its regulated and unregulated components, will be imposed upon SDG&E and its ratepayers.

216. In its decision authorizing Edison to reorganize and create a holding company structure, the Commission imposed conditions which will apply to the merged utility, unless augmented as a condition of approval.

217. Applicants' initial case-in-chief was deficient because it failed to address the SDG&E/Mission Group vertical integration, and applicants were directed to address the merger's impacts on their unregulated subsidiaries' operations to enable the Commission to assess the potential post-merger environment in which the merged entity and its unregulated subsidiaries will function.

218. In the augmentation of their case-in-chief, applicants contended that the merger does not affect their unregulated subsidiaries. Despite this "no impact" position, applicants proposed, as an additional safeguard, that "the merged company will not enter into any contract to purchase electric energy and/or capacity from a qualifying facility in which SCEcorp or any subsidiary or affiliate thereof is a beneficial owner, except (1) with the prior approval of the Commission or (2) pursuant to a competitive bidding or other standard procedure established by the Commission."

219. Edison, which has engaged in past affiliate self-dealing consistent with the Commission's findings in the recent KRCC proceeding (D.90-09-088), will be the surviving entity following the merger, under which the holding company structure will remain intact.

220. There is no evidence that SDG&E intends to enter the affiliate QF supply arena if the merger is disapproved.

221. Neither SDG&E's current corporate structure, nor its existing "energy management" philosophy and practices, nor its historical lack of QF self-dealing is compatible with a post-merger self-dealing scenario.

222. SCEcorp's corporate structure, policies and practices, not SDG&E's, will guide the merged entity, if approval is granted.

223. SCEcorp plans no fundamental change in its dealings with affiliates post merger, and its minimalist contract preapproval recommendation is consistent with this "business-as-usual" post-merger scenario.

224. Unless applicants' preapproval proposal is effective in mitigating adverse identified impacts, the Edison/Mission Energy self-dealing activities may continue and increase post merger, impacting an entirely new set of ratepayers in an expanded geographic service territory.

225. The merged entity will have access to more cash post merger, due to SDG&E's cash flow, and other financial factors, thus facilitating the likely expansion of Mission Energy's and the other unregulated affiliates' operations, and opening the door to further self-dealing.

226. Post merger, Mission Energy will have opportunities to make earlier and larger generation sales to Edison, since the merger increases Edison's new resource needs, while deferring SDG&E's needs; as these opportunities increase, the Commission can reasonably anticipate ever-increasing self-dealing problems.

227. The merged entity's demand in future years will be higher than Edison's alone, so existing excess capacity will be absorbed faster, and more QFs will be able to sell to the merged entity sooner than would be the case absent the merger. This will expand opportunities for all QFs, including Mission Energy, in a post-merger environment dominated by the merger partner which has engaged in past self-dealing abuses.

228. These expanded opportunities are not confined to Mission Energy, but may extend, unless prohibited, to other Mission Group affiliates, such as Mission Engineering and Renewable Energy Capital Company which may enter into business transactions with both affiliated and nonaffiliated QFs.

229. The acquisition by the merged entity of SDG&E's gas system opens up additional avenues for merged utility/affiliate self-dealing following the merger, including dealings with future unregulated gas procurement subsidiaries, manipulation of queue position to favor an affiliate, sale of excess transmission capacity entitlements to an affiliate at terms unfavorable to ratepayers, and transfer of sensitive market information.

230. The merger will provide SCEcorp and its subsidiaries with transmission control and access to additional areas such as Mexico and the Imperial Irrigation District (IID), thereby opening these areas to expansion by these affiliates, on terms more favorable than those presently available.

231. The merger will increase opportunities for self-dealing both in Edison's current service territory and in the new merged entity's larger service territory, thereby potentially exposing a whole new set of ratepayers to these problems.

232. Another adverse impact of vertical integration, increased ratepayer cost, may be triggered by increased payments to existing Mission Energy projects attributable to the merged utility's increased marginal cost. Such increased payments provide the merged entity additional incentive to sign more purchase power contracts with Mission Energy, or to otherwise favor its affiliate post merger.

233. Due to the expanded opportunities created by the merger, the merged utility will be in a position to sign additional purchase power agreements with all QFs including its Mission Energy affiliate. If additional Mission Energy transactions occur, ratepayers may well end up paying inflated capacity and energy prices, unless existing protections are adequate to protect against the effect of the increased self-dealing in contract execution and contract administration post-merger.

234. The merger sets in motion a series of events that facilitate Mission Energy's expansion within and outside the merged entity's service territory, both to meet the merged entity's increasing needs and to take advantage of additional development opportunities in areas not subject to rigorous air quality standards applicable in SCAQMD, such as the IID and Mexico.

235. These opportunities for out-of-service territory development and increased transmission access may alter the competitive picture in QF markets not currently open to Mission Energy or not currently controlled by the merged entity.

236. Given the historical record of transmission access problems experienced by nonaffiliated QFs, and SCEcorp's incentives to favor Mission Energy in this area, nonaffiliated QFs located in the expanded post-merger service territory and/or attempting to move power in

the geographic markets in which the merged entity controls transmission access, may likely experience additional competitive difficulties, absent Commission action.

237. If the merged entity acts on its inherent incentives to sign contracts with affiliated QFs in preference to nonaffiliated QFs, as it draws down its current surplus capacity, nonaffiliated QFs who would otherwise be ready to meet future energy needs may be disadvantaged.

238. SDG&E will no longer be an alternative purchaser to nonaffiliated QFs, and while additional purchasers may be available, the transmission access necessary to complete such transactions is controlled by the merged entity post merger, thus positioning the merged entity to impede these transactions, if it is so inclined, to further the interests of its Mission Energy affiliate.

239. By expanding the geographic scope and extent of potential self-dealing, the opportunities of Mission Energy, and the scope of SCEcorp's unregulated activities, the merger may increase demands on Commission resources now devoted to affiliate issues.

240. Only applicants assert that the proposed merger has pro-competitive elements, associated with applicants' Transmission Service Commitments, their undertakings in connection with Incremental Facilities Additions (IFAs), and their claim that the merger will make available 400 MW of firm transmission service (250 MW to the SW and 150 MW to the PNW) pursuant to the APMC.

241. Applicants' specific undertakings in these areas are inadequate because they fail to address horizontal-side transmission market impacts and would do nothing to alleviate post-merger concentration in the wholesale transmission and bulk power markets identified above.

242. The Transmission Service Commitments, the IFA proposal, and the APMC are woefully inadequate in dealing with the merger's identified adverse vertical impacts, and these inadequacies totally undercut applicants' assertion that this merger is pro-competitive.

243. Even if we give applicants the "benefit of the doubt" and consider these elements as "pro-competitive" in the balance of adverse/pro-competitive merger elements, their obvious shortcomings (which also make them ineffective mitigation measures) lead us to the inevitable conclusion that the balance of pro- and anti-competitive merger impacts is unfavorable to applicants.

244. Whether viewed separately via a market-by-market assessment of impacts consistent with the PD's approach, or aggregated and balanced as Attorney General Lungren advises, the proposed merger will adversely impact competition.

245. The merger's identified impacts are not merely de minimis or confined to one market; its demonstrated effects are significant and harmful, and pervade multiple product/geographic markets for wholesale transmission and bulk power.

246. Given the net impacts of the proposed merger on transmission, bulk power, and affiliates issues, the proposed merger will adversely affect competition under § 854(b)(2).

247. Applicants' transmission-related conditions fall into two categories: their Transmission Service Commitments, and their proposal, augmented by the Additional Proposed Merger Conditions (APMC), to auction 400 MW of transmission service (250 MW to the SW and 150 MW to the PNW).

248. Applicants' Transmission Service Commitments build upon Edison's existing SONGS License Conditions (the "NRC Commitment"), under which Edison has committed to include in its transmission planning for facilities within its service territory sufficient capacity to meet the transmission service needs of other utilities; if the merger is approved, Edison offers to extend its NRC commitment to the combined Edison/SDG&E system, and also to expand the NRC commitment in two basic respects.

249. If the merger is approved, Edison will extend its NRC commitment to the transmission of power produced by a QF in the merged company's service territory to outside utilities.

250. If the merger is approved, Edison will extend its NRC commitment to cover construction of Incremental Facility Additions (IFAs) where needed to provide transmission service requested by other utilities. IFAs are defined to include new facilities, upgrades of existing or planned facilities, or the acceleration of planned facilities, either to expand the merged company's interconnections with adjacent utilities, or to expand transmission capacity within the merged company's service territory.

251. Applicants propose that IFAs will become part of the merged company's transmission system, but must not interfere with its use of facilities to meet its service obligations to native load customers and its contractual commitments to others.

252. Applicants require that the merged company be appropriately compensated for the transmission services to be provided under the IFA proposal, and applicants interpret "full compensation" to mean incremental cost-based compensation.

253. Applicants require that any commitment to provide transmission service which involves new facilities must be conditioned upon obtaining necessary governmental approvals.

254. Applicants have agreed that their merger-related transmission service commitments, including the SONGS license conditions, will be filed with FERC to facilitate post-merger enforcement.

255. The proposed merger will cause anti-competitive problems on both the vertical and horizontal sides, but applicants' transmission service proposals do not address the horizontal-side impacts in any way, since they do nothing to alleviate post-merger concentration in the relevant wholesale transmission and bulk power markets.

256. On the vertical side, the definition of service area transmission contained in applicants' transmission service commitments is inadequate to address Resale Cities' needs to purchase bulk power from non-Edison sources in order to vitiate the adverse vertical-side impacts of the proposed merger.

257. Applicants' service area transmission definition excludes certain key facilities which are entirely within the merged utility's service territory, including Lugo Substation and the three 500 kV lines from Lugo to the Miraloma and Serrano Substations, and the two lines from Lugo to the Vincent Substation as well as the entire 230 kV system of SDG&E. These facilities are necessary to permit Resale Cities to obtain access to alternative bulk power markets.

258. The NRC commitment, as extended by applicants to the post-merger environment, would require that utilities purchasing from QFs, and not QFs themselves, request transmission service. This requirement may have adverse effects on QFs' ability to participate in these markets, because some utilities require executed power sales contracts before they consider wheeling requests, while others have required QFs to obtain wheeling rights before executing power sales contracts. Allowing the QFs themselves to request transmission service would avoid this uncertainty, but this is an option that applicants have foreclosed.

259. Applicants have interpreted "full compensation" in the context of the IFAs to mean incremental cost, which is a change from Edison's longstanding commitment to provide transmission within its service territory to the Resale Cities on a rolled-in cost basis. Applicants' proposal in this regard would place the Cities in a worse situation than at present in cost terms, instead of improving their overall situation through effective mitigation measures.

260. The open-ended cost responsibility for incremental upgrades contained in the IFA proposal may make it more difficult for QFs to finance projects.

261. Applicants' present IFA proposal gives the merged entity too much discretion to determine whether or not a particular transmission request should be fulfilled under the NRC commitment (as "load-related"), or whether the request should be treated as an IFA request

because it is "resource-related." This open-ended discretion may exacerbate existing problems by causing disputes which delay completion of IFA projects.

262. The IFA proposal as presently structured does not provide ownership options, and any facilities constructed pursuant to the IFA arrangements will revert ultimately to the merged entity.

263. Applicants' transmission service commitments, including the IFA proposal, place too much discretion with the merged company, and that fact, coupled with the limitations of the proposal noted above, make the transmission service commitments inadequate as a mitigation measure.

264. The additional proposed merger conditions, which embody an agreement between applicants and USDOJ entered into in June 1990, cover both (i) transmission issues and (ii) affiliate power supply transactions.

265. The APMC proposal amplifies applicants' original offer to provide 400 MW of firm transmission service post-merger; however, it permits parties purchasing any portion of the 250 MW transmission service offered between Palo Verde Switchyard and Devers Substation, to purchase and obtain by auction transmission service between the Devers Substation and one or more of three points: a point in the L.A. Basin Network; the Sylmar Converter Station; and/or the Midway Substation. Service between Devers and points in the L.A. Basin Network or the Sylmar Converter Station is firm bidirectional service, but service between Sylmar Substation and Midway Substation is firm in the northward (Devers to Midway) direction only.

266. The APMC also provides for 150 MW of firm bidirectional transmission service between the Nevada-Oregon Border (NOB) and the Sylmar Converter Station.

267. Each entity purchasing service between NOB and Sylmar under the APMC auction also has the right to purchase and obtain transmission service between the Sylmar Converter Station and a delivery point in the L.A. Basin. Service from NOB to the Sylmar Converter Station and from Sylmar to the delivery point in the L.A. Basin is firm bidirectional service until January 1, 1998. Service from south (point in the L.A. Basin Network) to north (NOB) continues from January 1, 1998 to January 1, 2001.

268. Entities who have an entitlement to either of the transmission services subject to the APMC have the right to resell that transmission service to any other entity, including the merged company.

269. Participants in the APMC auction for transmission service to the SW must buy this service on a bundled basis, meaning that they must buy the link from Palo Verde to Devers Switchyard, coupled with a second link from Devers to Sylmar, Midway, or the L.A. Basin.

270. Participants in the APMC auction for transmission service to the PNW can buy this service on an unbundled basis.

271. Service to the SW will continue until May 31, 2005 contingent upon DPV2 being built and placed into service by May 31, 1997; if this does not occur, the 250 MW transmission service to the SW will terminate in May, 1997.

272. Service from the SW under the APMC auction will continue for a maximum period of 14 years, or may cease at the end of 1997 if DPV2 is not constructed.

273. Bidirectional transmission service to the PNW under the APMC proposal is certain only until 1998, and from 1998 to 2001 is unidirectional only (south to north).

274. The APMC proposal contemplates two separate and uncoordinated auctions, meaning that a utility must succeed in two auctions to get service linking the PNW and SW, and that only a maximum of 150 MW is available to link these separate markets; furthermore, the connection linking the two regions has a maximum duration of seven years (1998).

275. The APMC, a one-time event during which two separate uncoordinated auctions will be held to dispose of 400 MW, does not address the long-term problems identified in the wholesale transmission markets, where mitigation could be accomplished only by the availability of reasonably priced long-term transmission service. Case-by-case contracting, such as that underlying the APMC proposal, is an inadequate vehicle for opening up these transmission markets on a nondiscriminatory basis in the long term.

276. Both the duration and quantity of transmission service offered under the APMC are inadequate.

277. There is no independent oversight of the APMC mechanism because implementation has been left to the merged entity, which will be responsible for resolving ambiguities and conflicts outside any formal dispute resolution forum.

278. It is unclear that any dispute resolution forum could effectively resolve conflicts related to short-term transmission service provided under the APMC, because decisions regarding short-term service must be made quickly and often on the spot, to avoid lost opportunities.

279. The APMC proposal is restricted to "entities," a definition which excludes QFs and IPPs.

280. Although the APMC proposal includes a provision for resale or assignment, this remedy is probably impracticable, due to the unbundling of the service which may not make it attractive for resale.

281. The merged company is not restricted from buying APMC-related transmission service under an assignment arrangement, so there is no guarantee that all auctioned service will eventually be used as mitigation of the proposed merger's adverse competitive impacts.

282. The APMC's price mechanism, the "90% to 120% of base rate" calculation, is premised on a very rough range and was somewhat arbitrarily derived; applicants have provided no examples to demonstrate how the auction mechanism would work in actual practice.

283. Bidders in the APMC auction will pay different prices for the same service rather than a uniform price, and transmission will not necessarily be awarded to the highest bidder on each segment, since the entire bid under the APMC proposal is evaluated as a whole.

284. Ranking bids on a net present value basis, as contemplated under the APMC proposal, may discriminate against those who need transmission more in later years.

285. Applicants' APMC proposal does not avoid the anti-competitive aspects of the proposed merger in the wholesale and bulk power markets under review; in contrast, DRA's transmission proposal considers the needs of buyers and sellers in the wholesale transmission markets for 25 to 40 years in the future, as well as in the short-term.

286. DRA proposes a mandatory auction to be held annually or every few years; DRA's single price auction contemplates unbundled point-to-point service under an auction scheme that would be repeated periodically.

287. The amount of wheeling services to be provided under DRA's auction mechanism would be determined by the demand for same at a price sufficient to cover long-run incremental costs, and the mechanics of this procedure would be overseen by regulators. Therefore, regulators would be involved in determining the amount of transmission service to be auctioned in response to the competitive problems identified in this proceeding.

288. DRA's proposal for determining the amount of transmission service to be auctioned is a marked improvement over the arbitrary assignment of a fixed MW amount (400 MW), as proposed by applicants.

289. DRA's proposal contemplates that Edison would identify a bidding price range with the ceiling price equal to or larger than the embedded cost of the point-to-point service, plus the cost of any identifiable present or future incremental facility additions required to provide the service. Edison will determine the floor price as less than the sum of the embedded

cost of the point-to-point service and the cost of any identifiable present or future incremental facility additions required to provide service, but no lower than the short-run incremental cost of transmission service.

290. DRA intends that ratepayers will be protected by the use of incremental cost pricing in development of the floor price, although the use of marginal cost pricing is disputed by those parties who believe they would be adversely affected by the departure from embedded cost, and who believe their unique position justifies preferential treatment.

291. DRA's use of marginal cost is controversial, and would require additional refinement in a contentious regulatory forum.

292. DRA's auction proposal also addresses those situations where demand exceeds supply in both short- and long-run, a situation which applicants' APMC proposal does not address.

293. Where demand exceeds supply in the long run, DRA proposes that the merged entity be required to increase the capacity made available at a subsequent auction; the amount of this increase and the date of the subsequent auction would be subject to regulatory review.

294. DRA also contemplates that the merged entity could make additional wheeling services available either by constructing new facilities or by reducing its own use of existing ones. Again, the details of these portions of DRA's proposal, which are not de minimis in scope or controversy, have not been fully developed at the present time.

295. The contractual periods contemplated in DRA's auction proposal are longer than the 14-year maximum period contemplated in the APMC proposal.

296. DRA's proposal specifically provides that wheeling services are to be made available for contractual periods corresponding to utility planning horizons, and specifies a likely range of 25 to 40 years.

297. DRA's proposal also contemplates that downward pricing flexibility will be permitted in certain events.

298. Unlike the APMC, DRA's auction proposal contains a dispute resolution mechanism in the form of "regulatory adjudication", while encouraging private settlement via assignment of costs to the losing litigant.

299. In its scope, specification of details (such as (1) quantity, (2) bidding price ranges, (3) scenarios for dealing with exceed demand in both short- and long-run, (4) duration, (5) downward pricing flexibility, and (6) dispute resolution), DRA's proposal is comprehensive

and visionary. It also represents an attempt to balance impacts, protecting ratepayers through incremental cost pricing provisions, while addressing the needs of Edison's competitors in these markets through its focus on nondiscriminatory access.

300. DRA's proposal also has the advantage of addressing vertical and horizontal merger impacts, by going beyond transmission access provisions and attempting to address market concentration, which is a horizontal issue. The proposal seeks to link the PNW and SW markets and thereby attract additional buyers to those markets where competition would be adversely affected due to the proposed merger's monopsony effects.

301. DRA's proposal is the only mitigation measure in the record which links the PNW and SW regions, and addresses the fact that the merger will have long-term impacts in keeping these two regional markets separate, unless the type of mitigation which DRA suggests is adopted.

302. One major concern is the feasibility of DRA's auction mechanism, since its details remain somewhat fuzzy, and even DRA acknowledges that the proposal requires refinement in a subsequent implementation phase in this docket or another appropriate forum.

303. Issues such as the appropriate mechanism to determine the amount of wheeling to be provided by the merged entity, its choice of ceiling or floor prices, and the procedures that would govern construction of new incremental facility additions or other facilities needed to provide service (especially in those cases where demand exceeds supply in the long run), must be developed before DRA's proposal can be implemented.

304. DRA's auction proposal relies heavily on incremental cost pricing principles, and FERC is just beginning to look at these issues in this context; therefore, there are jurisdictional issues that must be addressed prior to adoption of DRA's proposal.

305. DRA's auction proposal requires the CPUC to become heavily involved in overseeing the auction process.

306. The merged utility would be required to submit to this Commission its supply curve (the amount of firm transmission capacity which can be made available without affecting reliability at various prices beginning at short-run variable costs and ending with long-run incremental cost) prior to the auction. The reasonableness of Edison's supply curve would be subject to regulatory review either at the outset or retrospectively. However, this could be a rather complex and lengthy undertaking, if, as applicants assert, the Commission must determine incremental variable costs on multiple varied transmission paths within the merged entity's service territory.

307. DRA's auction proposal would require that prior to each auction the Commission hold proceedings to review and resolve these matters, both to insure that auction impacts on native load customers are taken into account, and that the auction is held on terms which effectively carry out this Commission's orders regarding merger-related mitigation.

308. DRA's proposal raises significant implementation issues, jurisdictional questions, and the prospect of increased Commission involvement in setting and monitoring the parameters of the transmission auction process.

309. At the present time, DRA's proposal will not avoid the adverse merger-related impacts (both horizontal and vertical) which have been identified in the wholesale and transmission bulk power markets under review.

310. Other parties have presented specific mitigation proposals which are less comprehensive than the DRA auction proposal; for example, the Resale Cities propose detailed merger conditions which address specific problems in their relationship with the merged entity, and are designed to limit the latter's ability to exercise market power over them.

311. Many of the Resale Cities' proposals are presented to counter applicants' transmission service commitments and related conditions, and are designed to be adopted if the Commission approves applicants' suggested mitigation measures.

312. Southern Cities have suggested ten conditions supplemental to applicants' mitigation measures, addressing such matters as service area transmission, import transmission service, additions to the import transmission system (such as IFAs), participation in new transmission facilities, and nonfirm transmission service.

313. Because we have rejected applicants' mitigation approach, and have indicated that a comprehensive mechanism akin to DRA's auction proposal is preferable to ad hoc measures, it is unnecessary to address many of Resale Cities' proposed merger conditions in greater detail.

314. NCPA's proposal for a tight pool, and its proposal that "best efforts" be required to open membership in the CPP to NCPA, do not appear to be supported by any evidence that the merger will have adverse impacts on power pooling issues. NCPA also proposes generic transmission access conditions patterned after FERC's decision in Utah Power & Light, although the specifics of its proposal, including implementation details, are sketchy. However, NCPA's basic concern that it have transmission access to alternative firm power markets in the desert SW would be adequately addressed through adoption of DRA's auction proposal, although the latter proposal would not afford such access at the cost-based rates NCPA desires.

315. M-S-R needs DPV2 to be operational in 1993, and it also requires transmission from Lugo to Midway in order to avoid the stranding of its inland SW resources. However, the

merger is not responsible for the delay in DPV2 which is keyed to the difficulty applicants have encountered in meeting other Commission requirements regarding revenue enhancements. M-S-R, like all participants in DPV2, faces certain regulatory risks and uncertainties in connection with the completion of that project, which are only marginally related to the merger, if at all.

316. The merger does not impact M-S-R's ability to obtain service from Lugo to Midway in connection with the PMAL projects, and applicants deny that they promised M-S-R 150 MW of firm transmission service from Lugo to Midway prior to the merger and then retracted that promise after the merger agreement was executed.

317. M-S-R's transmission proposals, designed to ensure that it obtains 150 MW of firm transmission commitments from Palo Verde to Midway and from Lugo to Midway, are not specifically related to the merger. However, to the extent that M-S-R, like all other participants in these markets, would benefit from a proposal improving transmission access to the SW, its concerns would be met at least in part by DRA's auction proposal.

318. The holding company decision provides less direct Commission ratemaking control over affiliate transactions than SDG&E ratepayers currently enjoy, because the accounting and reporting mechanisms under which the holding company operates would replace Commission's current direct ratemaking control over SDG&E's affiliate transactions.

319. A mitigation measure which provides less direct ratemaking control than the pre-merger status quo will not be effective, in and of itself, in preventing the greater post-merger harms associated with increased self-dealing opportunities, increased ratepayer costs, and adverse competitive effects on nonaffiliated QFs, as well as evasion of regulation.

320. Increased self-dealing through affiliate company transactions with the regulated gas distribution facilities acquired from SDG&E raises issues greatly beyond the factual scope of the matters considered by the Commission in its holding company decision, eroding the argument that existing conditions are adequate mitigation in this area.

321. The holding company decision's accounting and reporting protections are credible only if the Commission is ensured the necessary access to holding company books and records effectively to validate the protections.

322. As this record clearly demonstrates, despite SCEcorp's preexisting duties and the Commission's stated intention to construe the holding company conditions and its statutory authority in the broadest possible fashion, applicants have often failed timely or willingly to provide the information necessary for the Commission's reviews of affiliate transactions.

323. Applicant SCEcorp's reluctance to provide information as required by holding company decision Condition No. 1, and thereby satisfy its obligations under the regulatory

compact struck in D.88-01-063, undercuts the notion that reliance should be placed on this mitigation vehicle, even if it were modified in our decision today.

324. The ECAC procedure's rapid schedule, its resource intensive nature, its reliance on the good faith provision of utility/holding company information, and its focus on fuel and purchased power costs (in this instance the QF purchase power contracts) to the exclusion of other significant affiliate-related issues, such as transmission access, make the ECAC an unsuitable forum through which to mitigate the adverse impacts identified in this decision.

325. The Commission's pre-merger experience is that the ECAC has not been an ideal forum for adjudicating contested affiliate issues, and this casts serious doubt on the ability of this mechanism to resolve the problems associated with the expanded self-dealing facilitated by the merger.

326. The existing ECAC reasonableness review is not adequate mitigation in terms of protecting ratepayers or competitors from increased self-dealing in the post-merger environment.

327. The competitive bidding protocol addresses only the initial contracting stage, not the contract administration stage, where abuses due to increased self-dealing opportunities can result in substantial excess ratepayer costs.

328. Competitive bidding does not address indirect self-dealing, which may occur when Mission Group companies like Mission Engineering deal with Mission Energy partners in preoperation project development ventures, or when entities including nonaffiliated QFs such as LUZ (an energy supplier to the merged utility) transact business with a Mission Group affiliate.

329. Competitive bidding in its various forms is heavily dependent upon utility input; thus it may not be a sufficiently neutral vehicle to protect ratepayers.

330. Applicants' contract preapproval proposal addresses only the initial contract stage, and its mitigating effects would be thus limited.

331. It is also necessary to protect ratepayers and competitors against post-merger abuses in contract administration, which can be significant due to the long-term duration of QF contracts and the expanded unregulated opportunities created by the merger.

332. Contract preapproval is Commission resource intensive and requires piecemeal review of resource planning decisions.

333. Applicants' contract preapproval condition is inadequate to deal with increased post-merger opportunities for self-dealing.

334. SCEcorp's internal corporate policy that any dealings with QFs in which Mission Energy is interested must be more beneficial to Edison ratepayers than comparable dealings with unaffiliated QFs, is not adequate to mitigate the adverse impacts of the merger.

335. The stakes are simply too high, and the internal conflicts of interest too great to find this well-intentioned policy, which is unenforceable in any meaningful regulatory sense, an adequate mitigation measure in and of itself.

336. The independent audit by Coopers & Lybrand is insufficient as post-merger mitigation because: (1) it does nothing to ensure that contract administration practices comport with Commission policy; (2) it is subject to the same information access constraints that have plagued DRA; (3) it is subject to Edison's reserved right to review and comment; and (4) it does not compare Edison's administration of affiliate and nonaffiliate contracts.

337. Consistent with applicants' Request for Official Notice, the record reflects the existence of the "QF Reasonableness Report of Independent Auditor Coopers & Lybrand" in A.90-06-001, but not the truth of the matters asserted therein.

338. Taken as a whole and individually, current regulatory mechanisms tailored to the pre-merger status quo, applicants' proposed protections, and SCEcorp's existing corporate policies are inadequate to deal with the adverse impacts of the vertical integration this merger will effect.

339. DRA's recommendation that the merged utility be prohibited from signing any future contracts with Mission Energy eliminates (1) future direct self-dealing problems between those particular affiliated companies, and (2) the need for additional regulatory oversight in this discrete area.

340. The effect of adopting DRA's proposal is to grandfather the existing 13 Edison/Mission Energy contracts, and thereby confine Edison/Mission Energy self-dealing to existing pre-merger contracts.

341. DRA's proposed prohibition is a less than comprehensive solution to the adverse effects identified.

342. We are less concerned than DRA that the proposal fails to address "brain drain," for we are not persuaded that the merger itself will cause additional movement to Mission Energy or the other affiliates, since it appears, as applicants contend, that the significant movement underlying DRA's concerns occurred during initial staffing of the affiliate companies.

343. The record evidence of employee movement from Edison to affiliate companies spans only a three-year period, and the Commission will continue to monitor these movements pursuant to Ordering Paragraph 1.6 of D.88-01-063.

344. Prohibition does not address indirect self-dealing, nor would it prevent other Mission Group Companies, such as Mission Engineering, from dealing with the 13 grandfathered projects or with other QFs selling to the merged entity; such dealings present a problem in view of our finding that the merger increases the likelihood of self-dealing in these specific areas.

345. Prohibition does not protect SDG&E's ratepayers ultimately from paying the costs associated with self-dealing vis-a-vis these 13 pre-merger contracts, a liability they would not have absent the merger.

346. Prohibition does not reduce the Commission's post-merger regulatory burden, since the 13 pre-merger contracts will become part of the larger merged entity's post-merger resource plan, and their associated costs must be scrutinized for ratemaking purposes post merger.

347. It will be impossible in the expanded service territory to ensure that merged utility self-dealing with the existing Mission Energy projects is avoided.

348. It will be impossible in the expanded service territory to ensure that merged utility self-dealing with the existing 13 projects will not adversely affect nonaffiliated QFs or otherwise impair their transmission access opportunities, given the enhanced transmission access available to the merged entity following the merger.

349. Grandfathering the existing Edison/Mission Energy contracts will not eliminate adverse merger impacts on other QF competitors.

350. Prohibition is not a satisfactory mitigation measure.

351. Divestiture of Mission Energy projects located or operating in the WSCC area, coupled with a comprehensive ban against Mission Energy's involvement in the WSCC market, is a clear-cut, definitive remedy, which also allows Mission Energy to continue as an ongoing entity in the WSCC, albeit under different ownership.

352. Partial divestiture eliminates all forms of self-dealing, both direct and indirect, involving Mission Energy in the defined area.

353. Partial divestiture enhances competition by decisively eliminating the unfair advantage Mission Energy-related self-dealing poses to nonaffiliated QFs within the geographic area where the bulk power and transmission markets serving the merged entity are located.

354. Partial divestiture will not facilitate uneconomic self-generation by the merged entity, because: (1) there is no evidence that nonaffiliated QFs or other alternatives would be unavailable to replace affiliated QF projects in the defined area; (2) the Commission's policies encourage utility efficiency, not inefficiency; and (3) Edison appreciates the Commission's strong encouragement against uneconomic generation and its requirements that power plant projects be put out to bid to QFs.

355. Partial divestiture limited to the markets serving the merged utility's resource needs will minimize the Commission's Mission Energy-related regulatory burdens on a prospective basis, although several reasonableness reviews for past record periods must still be undertaken.

356. For the future, however, the Commission will not need to be involved to protect against self-dealing in initial contracting stages, or in contract administration, since the principal cause for concern, the affiliate link, will be severed.

357. Partial divestiture will allow the Commission to avoid lengthy proceedings which would otherwise be necessary to review the reasonableness of merged utility/Mission Energy transactions in the post-merger environment of increased self-dealing potential.

358. By leveling the competitive playing field, divestiture should result in a decrease in other proceedings, such as complaints filed by nonaffiliated QFs, and should otherwise lessen the demand on resources now devoted to Mission Energy-related affiliate issues by Commission staff at all levels.

359. Partial divestiture is less Draconian than full divestiture because it allows SCEcorp to retain its Mission Energy projects outside the WSCC. The adverse impacts of the merger can be adequately mitigated by severing the affiliate link between the merged utility and those portions of the unregulated Mission Energy's geographic operations capable of (i) serving the former's energy supply needs, or (ii) disadvantaging its competitors through control of the transmission grid.

360. Applicants have made no affirmative showing regarding the economic efficiency of common ownership that would support their criticism of DRA's divestiture proposal.

361. Partial divestiture of Mission Energy projects located or operating in the WSCC area, coupled with a comprehensive ban against Mission Energy's (or a successor entity's) involvement in the same geographic area, would adequately mitigate the identified adverse impacts of the vertical integration effected by the merger.

362. The 1.3:1 exchange offer will cause a dilution of approximately 6.74% in book value per share for current SCEcorp shareholders. This book value dilution will have a detrimental effect on the financial condition of the merged company.

363. It is likely that the merger will increase SCEcorp's earnings in an amount sufficient to overcome investors' concerns about the loss resulting from the dilution in book value per share.

364. The merged company's capital structure for financial reporting purposes is likely to reflect the weighted average of both merger partners' current capital structures.

365. The merged company will likely maintain the bond ratings of Edison as an independent company. The difference between the current bond ratings of the two companies is small, and their consolidation will not change this portion of the overall financial condition of the merged company.

366. It is reasonable under the circumstances to assume that the merged company will have the same return on equity as Edison.

367. The proposed increased dividends to current holders of SDG&E's preferred and preference stock are payable well beyond the year 2000, at a rate of about $2 million per year.

368. The increased dividend to SDG&E's current preferred and preference shareholders indicates that SCEcorp's preferred and preference stock carries a slightly higher overall risk than SDG&E's corresponding issues. This higher risk and the increased costs to the merged company of its preference and preferred stock represent a detriment to the financial condition of the merged company.

369. From 1983 through 1987, San Diego issued six series of Industrial Development Bonds (IDBs) in the total amount of $550,600,000 and lent the proceeds to SDG&E.

370. Applicants have now received a private letter ruling from the IRS that permits applicants to redeem Series 86B and 87A and to defease the remaining four issues in question shortly after effective date of the merger without affecting the tax-exempt status of the bonds.

371. The cost of defeasing the bonds according to the terms of the letter ruling is $59 million.

372. The cost of defeasance essentially raises the cost of debt for this limited portion of the merged company's financing, which will slightly worsen the financial condition of the merged company.

373. DRA's analyses show that investors perceive the merged company to be financially strong. This perceived strength should have the effect of lowering the costs of capital for the merged company.

374. The merged company would have the ability to maintain the lower composite depreciation rate of Edison. The immediate effect on the merged company would be to lengthen the period of capital recovery and to lower the merged company's cash flow in the short term. These effects will have a slightly detrimental effect on the financial condition of the merged company.

375. The merger would have some detrimental effects for the merged company, primarily in the near term, but overall, applicants' proposal for carrying out the merger would maintain the financial condition of the merged company.

376. Between 1985 and 1990, SDG&E lowered its system average cost and its rates by six cents per kilowatthour (kWh), to a level lower than Edison's comparable rates. SDG&E's rates are projected to remain lower than Edison's until at least 1993 or 1994.

377. By eliminating SDG&E as a separate entity, the merger will extinguish direct retail rate comparisons between Edison and SDG&E.

378. To the extent that rivalry between SDG&E and Edison has produced improvements in customer service and lowering of rates in the past, its elimination by the merger will have an adverse effect on the quality of service.

379. Retail rate comparisons exist between the Resale Cities and Edison in reciprocal fashion.

380. The benefits related to fringe area rivalry flow primarily from a comparison of Edison and SDG&E retail rate levels. The merger would extinguish fringe area rivalry between Edison and SDG&E, and to that extent, the merger would have an adverse effect on the quality of service to some utility customers in the state.

381. Applicants' claims that the merger would improve the quality of service to ratepayers are not sustained.

382. The elimination of rivalry between Edison and SDG&E could have a significant detrimental effect on the quality of service to ratepayers in the form of higher rates than necessary and a lower quality of service.

383. The effects of the merger on competition in the wholesale bulk power and transmission markets could harm ratepayers of the Resale Cities and of PG&E.

384. The merger would have an adverse effect on the quality of service to public utility ratepayers in the state.

385. The management of the merged company would initially include four of SDG&E's top executives.

386. The quality of management of the merged company will at least be maintained.

387. The merger will result in the eventual elimination of 1,153 positions. Job reductions on this scale could have a drastic effect on employees threatened with job loss. However, applicants propose several steps to minimize the effect of the merger on existing employees.

388. Applicants' proposals to counteract the adverse effects of the merger on employees are sufficient to ensure that the merger will be fair and reasonable to affected employees.

389. At least in the short term, the merger would have no substantial effect on labor relations.

390. Shareholders of SDG&E would receive immediate value from the merger, because of the 1.3:1 share exchange ratio.

391. In the context of this case, fairness to shareholders consists of full disclosure of pertinent information.

392. Applicants disclosed the merger's expected short-term effects on SCEcorp's earnings, and investors are aware that other costs incurred by SCEcorp or the merged company are subject to our review. We find that the merger would be fair to shareholders.

393. The defeasing of the IDBs to carry out the merger could have a chilling effect on bondholders and on the future availability of funds for tax-exempt financings sponsored by the City of San Diego.

394. The loss of rivalry between SDG&E and Edison could have adverse effects on the local communities and local economies.

395. We are unable to conclude that the merger will be beneficial on an overall basis to state and local economies and to the affected communities.

396. The merger may increase the demands on the Commission's resources by expanding the geographic scope and extent of potential self-dealing in the merged company's relations with its affiliates and the scope of SCEcorp's unregulated activities.

397. Because the merger will eliminate the rivalry between SDG&E and Edison, the loss of SDG&E as a regulatory benchmark is an adverse unmitigable impact of the proposed merger.

398. The proposed merger would not appreciably reduce the complexity of the Commission's regulatory task.

399. The proposed merger would have adverse impacts on the Commission's ability to regulate the merged utility effectively, and would increase the demands on the Commission's resources.

400. The next GRC for SDG&E should be for test year 1994.

401. Because SDG&E's rate case will be delayed for an additional year, we will authorize SDG&E to file for a modified attrition allowance in 1992, for rates to be effective January 1, 1993.

Conclusions of Law

1. The 1989 amendments to § 854 require the Commission to make certain specific findings before a merger or acquisition can be approved.

2. This merger comes under the provisions of the amended § 854.

3. Section 854(c) requires the Commission to consider the criteria listed in Paragraphs (1) to (7) but permits the Commission to consider other factors in making its overall determination of whether the merger is in the public interest.

4. The Commission must find that the requirements of both § 854(b)(1) and § 854(b)(2) have been met. Nothing in § 854 indicates that the findings under Paragraph (1) may be balanced against the findings under Paragraph (2).

5. Section 854 requires applicants to prove three elements in connection with Subsection (b)(1). First, applicants must show that the proposed merger will result in net benefits to ratepayers in the short term. Second, applicants must prove that the merger will provide net benefits to ratepayers in the long term. Third, applicants' proposal must provide a ratemaking method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted short- and long-term benefits.

6. For purposes of this proceeding, the short term should relate to the current general rate case cycle of three years. The time between the expected approval of the merger and the

completion of the merged company's first general rate case, estimated to be four years, is an appropriate time for consideration of short-term benefits in this case.

7. The definition of the long term may vary with the circumstances of each individual case. For purposes of this case, the period of the long term should recognize the normal planning horizons of electric utilities. In this case, the forecast of costs and benefits of the merger should assure us that the benefits will extend for at least several years into the next century.

8. Applicants have failed to provide the necessary evidence to sustain their burden of proving by a preponderance of the evidence that there are net benefits associated with the merger after 2000.

9. Applicants have failed to meet their required burden of proving that the merger will result in long-term net benefits to ratepayers.

10. Applicants' ratemaking proposal does not meet the statutory requirement for a ratemaking method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted long-term benefits of the merger.

11. Placing the risk associated with realizing forecasted savings on shareholders is part of the purpose of the amendments to § 854.

12. Section 854(b)(2) requires that before authorizing this acquisition, the Commission must find that the proposal does:

> Not adversely affect competition. In making this finding the commission shall request an advisory opinion from the Attorney General regarding whether competition will be adversely affected and what mitigation measures could be adopted to avoid this result.

13. Applicants must prove by a preponderance of the evidence that the proposed merger will not have adverse impacts on competition.

14. If applicants fail to produce evidence that the proposed merger will not have adverse effects on competition, or if evidence of the existence of merger-related adverse competitive impacts is more convincing, a finding of adverse competitive impacts is required.

15. If the Commission finds that the proposed merger will have adverse effects on competition, this triggers a second inquiry regarding what mitigation measures could be adopted to avoid merger-related adverse competitive effects.

16. Applicants have the burden of proof on this mitigation issue, and they must carry that burden by a preponderance of the evidence (§ 854(e)); however, the statute also places an affirmative obligation on the Attorney General to advise this Commission as to appropriate mitigation measures, and the Attorney General's advice is to be weighed in the balance.

17. The California Public Utilities Commission (CPUC or Commission) and the Federal Energy Regulatory Commission (FERC) have undertaken parallel reviews of the public interest aspects of the proposed merger, including competitive impacts. Both agencies must approve the proposal before it can be consummated.

18. There is a body of case law which addresses the Commission's decisionmaking process and leaves no doubt that the Commission is required to assess the competitive impacts of its determinations.

19. Competition is one of the factors bearing on the exercise of this Commission's discretion, and it is one of the factors that must be considered by the Commission in its decision-making process.

20. The Commission has authority to take interstate bulk sales and transmission access issues into account in deciding <u>other</u> issues which are within its direct jurisdiction.

21. As an administrative agency created by the Constitution, the Commission has no power to refuse to enforce § 854(b)(2) on the basis of federal pre-emption, unless an appellate court has made a determination that enforcement of the statute is prohibited by federal law or federal regulations (Cal. Const. Art. 3, § 3.5).

22. The Commission will assess impacts bearing upon interstate transmission and bulk sales to the extent necessary to give full force and effect to § 854 and otherwise to protect the interests of California ratepayers.

23. On May 7, 1990, Attorney General Van de Kamp submitted an Advisory Opinion pursuant to § 854(b)(2), concluding that the acquisition cannot be approved under § 854 because (i) it will adversely affect competition in wholesale and retail electric power markets, and (ii) some of the adverse effects can be avoided by appropriately conditioning the merger, but some of the effects are not susceptible to relief through conditions (Advisory Opinion, p. 1).

24. The ALJ took official notice of the Attorney General Van de Kamp's Advisory Opinion as a "legal opinion based on specified assumptions" and allowed parties to brief how the facts developed in the evidentiary record support or negate the assumptions underlying the Advisory Opinion.

25. Applicants' motion requesting official notice of the USDOJ Post-Hearing Brief filed at FERC raises a matter subject to discretionary, not mandatory, official notice under Evidence Code § 452.

26. We take official notice of the fact that USDOJ, a party in FERC Docket EC89-5-000, filed a Post-Hearing Brief recommending adoption of the Additional Proposed Merger Conditions, but we decline to take official notice of USDOJ's underlying arguments or assumptions for the truth of the matters asserted therein, in the absence of a sponsoring USDOJ witness.

27. Any step beyond such limited official notice would prejudice the rights of other parties to test the assumptions and factual underpinnings of USDOJ's agreement with applicants, and would be at odds with applicants' representations to the ALJ.

28. Applicants' request for official notice of the USDOJ Post-Hearing Brief should be granted as limited above; consistent with this result, Southern Cities' Motion to Strike References in Applicants' Opening Brief, directed to the USDOJ Post-Hearing Reply Brief, should be denied.

29. The Legislature was aware of the Attorney General's planned advocacy role at the time § 854 was amended, and placed no restrictions on his participation in this proceeding.

30. After reviewing his predecessor's legal analysis, Attorney General Lungren requested and received authorization to file his Motion for Leave to File a Supplemental Brief, for the purpose of raising matters relating to the statutory construction and application of § 854(b)(2), and on February 27, 1991, the ALJs issued a ruling permitting Attorney General Lungren to "file a supplemental brief limited solely to 'the legal standard to be employed under § 854(b)(2)'", but specifically limiting supplemental arguments to existing facts of record. On March 8, 1991, Attorney General Lungren filed his Supplemental Legal Brief.

31. On March 26, 1991, DRA filed a Motion to Strike Applicants' Response to the Attorney General's Supplemental Brief as inappropriate reargument of facts explicitly barred by the February 21 and 27 ALJ Rulings. San Diego and Southern Cities support DRA's Motion.

32. On April 10, 1991, Southern Cities filed a Motion to Strike Attachment A to Applicants' Supplemental Brief on SB 52. Attachment A is Applicants' Response, which is the subject of DRA's March 26, 1991 Motion to Strike, and Southern Cities' Motion to Strike raises concerns very similar to those raised by DRA.

33. It appears, however, that applicants have presented no new facts or evidence not already contained in this record; therefore, we do not consider their reargument of the facts to

be an explicit "relitigation" of the evidence. On that basis, we deny both DRA's Motion to Strike Applicants' Response and Southern Cities' Motion to Strike Attachment A to Applicants' Supplemental Brief on SB 52.

34. The § 854(b)(2) required finding that the proposed merger does "not adversely affect competition," is uncommon to statutory law, where the more familiar merger analysis is whether "the effect such acquisition may be substantially to lessen competition or tend to create a monopoly." (Clayton Act, Section 7.)

35. Given the uncommon nature of the phrase, "adversely affect competition", we infer that if the Legislature had any model in mind it probably lies in recent CPUC decisions which contain findings on the competitive affects of various proposals.

36. While the two Attorneys General take opposing views as to how the Commission should gauge whether a proposed merger will result in adverse impacts on competition, they apparently agree that the Commission is not constrained by the Clayton Act standard, and may disapprove a transaction whose impacts are harmful, but less than "substantial" under the Clayton Act; this is the standard we apply to the facts presented by the proposed merger.

37. Attorney General Lungren maintains that the Commission is free to assess pro- and anti-competitive impacts in all markets prior to making a determination that the acquisition will result in adverse effects on competition; this methodological approach is somewhat less stringent than that suggested by his predecessor, and would allow the Commission more flexibility to approve a merger whose pro-competitive elements might otherwise be disregarded under application of the more stringent methodology.

38. While the evidentiary record developed in this proceeding was keyed to the analysis provided by Attorney General Van de Kamp, and Attorney General Lungren's supplemental argument was presented after the record was closed, we have not allowed any party to present new facts responsive to Attorney General Lungren's briefs and argument. Nonetheless we may take the advice of both Attorneys General into account in reviewing the record before us.

39. The record developed by all parties has relied heavily on the models for measuring competitive impacts developed under the Clayton Act, in particular; because the parties have used these accepted analytical tools and precedents, they will largely guide our review of the proposed merger; however, the scope of our review is not constrained by these tools and precedents.

40. The California Legislature has required us to determine whether this merger will adversely affect competition, and has not specified that our determination must rest on a finding that the proposal violates standards set forth in relevant federal antitrust statutes; we infer from

this silence that the Legislature did not intend to constrain our already existing authority over the SCE/SDG&E merger, but rather, to emphasize our longstanding obligation to consider, on a case-by-case basis, the competitive impacts of our decisions.

41. If necessary and appropriate, our decision may also rely on the body of common law which predates the recent amendment to § 854 (Northern California Power Agency, and related cases; cited supra).

42. Recent amendments to § 854 have not narrowed the scope of our review of competitive impacts by limiting our authority to disapprove an acquisition to those instances where we are able to make a finding that it meets the Clayton Act's "substantial lessening of competition" test; rather, the recent amendment complements longstanding common law standards and makes our decisionmaking obligation more explicit.

43. The Commission may assess incipient injury to competition pursuant to § 854(b)(2).

44. Our decisionmaking authority over this merger, and its broad public interest aspects, is not so limited that it must be premised on whether the acquisition violates federal antitrust statutes.

45. Treating transmission as a separate product market is consistent with long-standing court and administrative agency determinations; therefore, it is appropriate that we examine transmission as a separate product market that excludes local generation.

46. Applicants' argument that they do not presently compete significantly in providing transmission service, and that this fact refutes any argument that the proposed merger will impact competition in relevant transmission markets, is inconsistent with the evidence of record.

47. The essential issue raised in the review of historical disputes between Edison and the Resale Cities is whether such historical events shed light upon the proposed merger's vertical impacts.

48. Nothing in the SCM Corp. v. Xerox Corp. case precludes the Commission from exercising its discretion under § 854(b)(2) to assess any and all evidence relevant to the post-merger transmission markets. While the SCM opinion states that the analysis ordinarily employed is prospective, it does not specify a hard and fast restriction in that regard.

49. SCM Corp's language is keyed to a § 7 Clayton Act analysis; while the Commission's review of the proposed merger's competitive impacts under § 854(b)(2) may be guided by the authorities underlying a § 7 Clayton Act analysis, it is not so restricted.

50. The exercise of the Commission's discretion to review the competitive impacts of the proposed merger under § 854(b)(2) is not restricted by SCM Corp. v. Xerox Corp. to a prospective analysis; the Commission may consider historical events, as they shed light on the likely post-merger environment, including transmission access policies.

51. The "Order Granting Edison's Motion for Summary Judgment on Plaintiff's Foreclosure Claim," in City of Vernon v. Southern California Edison Co., Case No. CV 83-8137 MRD, before the United States District Court, Central District of California, (the Vernon Judgment) is part of the record of the district court and may be officially noticed pursuant to Rule 73 which tracks Evidence Code § 452(d) providing that judicial notice may be taken of the "[r]ecords of (1) any Court of this State or (2) any Court of Record of the United States or any State of the United States."

52. The record developed in this docket (A.88-12-035) is the one upon which the Commission will rely in deciding the facts at issue.

53. The nature and extent of the record developed in this docket and that developed in Case No. CV 83-8137 MRD, differ, and the issues and parties before the Commission are not identical to those in the District Court proceeding.

54. Edison cites the Vernon Judgment for the proposition that Edison's practice of placing its customers' needs ahead of the needs of others, including the Resale Cities, is not anti-competitive. However, the issue before this Commission is not whether Edison's asserted practice of placing its native load customers' needs ahead of the Resale Cities' needs is anti-competitive; the issue is whether Edison has avoided making existing amounts of transmission capacity in excess of native load needs available to competing buyers and sellers on a pro-competitive basis.

55. The record developed in this docket may or may not support a finding that "Edison has provided Vernon with significant transmission service...for outside resources, and as a result...[m]ost of Vernon's power needs are being met by outside resources 'wheeled' to Vernon by Edison.;" this Commission is not precluded from independently reviewing the evidence before it to reach its own determination on this issue, and the District Court findings have no res judicata effect in this forum.

56. As part of its overall public interest assessment under § 854(c)(2), the Commission is required to review and consider the adverse impacts of the proposed merger on all California ratepayers, not just the merger partners' ratepayers.

57. Section 854(c)(2) refers to the maintenance or improvement of "the quality of service to public utility ratepayers in the state;" therefore, the literal terms of the statute require

the Commission to take an expansive view and consider the proposed merger's impacts on California ratepayers as a whole, as it assesses the overall public interest under § 854(c).

58. It would be erroneous to assess the merger's impacts under § 854(b)(2) solely on the basis of the existing configuration of the relevant transmission grids, since the transmission system is dynamic, and the potential for expansion cannot be disregarded. To the extent the merger forecloses such possibilities, it adversely affects competition by constraining the competitive roles of other utilities.

59. Pursuant to § 854(b)(2), the relevant transmission markets should be examined as if no improper contractual limitations were in place, and such limitations should not be used as a shield to resist imposition of pro-competitive transmission access policies or conditions.

60. It is appropriate to use the four elements of the essential facility doctrine, not to determine whether each element is satisfied, but rather to determine whether the evidence submitted in connection with each element is consistent with existing findings regarding the proposed merger's vertical impacts under § 854(b)(2).

61. Adopting Southern Cities' approach, and using the doctrine as an adjunct to other evidence of record, is the most constructive approach, and is consistent with our prior determination of the extent of our discretion to assess the competitive impacts of the proposed merger under § 845(b)(2).

62. Applicants are not required to share an essential facility if such sharing would be impractical or inhibit their ability to serve customers adequately; pro-competitive access to transmission lines must be tempered by native load requirements.

63. The proposed merger may have adverse competitive impacts of a buyer market power nature on the SW firm bulk power markets.

64. The scope of our authority to review the proposed merger's competitive impacts under § 854(b)(2) also encompasses the area of incipient injury to competition. Thus we must examine the direct evidence presented concerning SDG&E's growing and potential role in the emerging SW bulk power market before drawing any definitive conclusion about the merger's seller market power impacts therein, based solely on DRA's calculated HHIs or applicants' historical sales figures.

65. The loss of SDG&E as a key participant in the emerging SW short-term (or nonfirm) bulk power markets is an adverse competitive consequence of the proposed merger.

66. Even assuming that the standards for reviewing buyer market power are more lax than the standards for reviewing seller market power, the Commission's broader § 854(b)(2)

authority would permit it to refrain from using a more lax standard if the direct evidence of buyer market power persuaded it that the merger would result in adverse competitive effects.

67. The Commission's review of the merger's competitive impacts is not restricted to the Sherman or Clayton Acts, and it could refuse to approve the merger based on a finding of adverse competitive impacts not rising to the level of a violation of federal antitrust statutes; thus, Kartell v. Blue Shield of Massachusetts does not control this Commission's § 854(b)(2) review.

68. It is incorrect that the antitrust laws do not apply to the existence and exercise of buyer market power.

69. The USDOJ Merger Guidelines recognize buyer market power, indicating that: "The exercise of market power by buyers has wealth, transfer, and resource misallocation effects analogous to those associated with the exercise of market power by sellers."

70. The use of applicants' higher HHI thresholds is not explicitly sanctioned in the USDOJ Merger Guidelines, or anywhere else.

71. Even if it is true that USDOJ enforcement of antitrust statutes has been weak recently, that is not an excuse to ignore buyer market power competitive impacts under § 854(b)(2).

72. USDOJ's acceptance of this merger based on its participation at FERC fails to reinforce applicants' argument that USDOJ has less rigorous standards for reviewing buyer market power problems; the extent of USDOJ's involvement in the FERC proceeding and the nature of the negotiating process that culminated in applicants' agreement with USDOJ is all information outside this record; the considerations that underlie USDOJ's agreement have not been subjected to cross-examination in this forum, or even at FERC where the agreement is not in evidence; the record at FERC which presumably underlies USDOJ's FERC position was markedly different from this one in that it did not include DRA's detailed analysis of buyer market power; thus it is pure speculation to draw any conclusions regarding USDOJ's reaction to the record developed here, where USDOJ was not a party.

73. The Commission is required to assess the merger's vertical, as well as its horizontal, competitive impacts pursuant to § 854(b)(2). The Commission will also assess any adverse impacts of this vertical integration on ratepayer cost of service pursuant to its regulatory authority under §§ 707 and 854.

74. The Commission must assess the impacts of the SDG&E/Mission Group vertical integration on its own jurisdiction and capacity to effectively regulate and audit public utility operations within this state (§ 854(c)(7)).

75. Pursuant to § 854(e), applicants have the burden of proving by a preponderance of the evidence that the SDG&E/Mission Group vertical integration will not have unmitigable adverse impacts on competition, cost of service, and the Commission's jurisdiction and capacity to effectively regulate and audit the merged entity.

76. Applicants argue that the only relevant affiliate-related issue is the Commission's jurisdiction and capacity to regulate in the post-merger environment (§ 854(c)(7)). But this is only one of the issues the Commission must review. The other major related issue is one which applicants have chosen to meet via their "no impact" testimony: Will the vertical merger between SDG&E's electric utility operations and SCEcorp's unregulated supplier (Mission Group) facilitate the evasion of Commission regulation that would otherwise limit the exercise of market power in distribution?

77. Because it ignores the obvious vertical integration issues posed by the merger, applicants' "no impact" posture is deficient.

78. In failing to even address vertical integration issues, applicants have failed to meet their burden of proof that the merger will have no impact on the operations of their unregulated subsidiaries.

79. By (i) increasing opportunities for direct and indirect self-dealing in Edison's current service territory and in the new merged utility's larger service territory, (ii) increasing ratepayer costs due to such self-dealing opportunities, and (iii) disadvantaging nonaffiliated QFs as set forth in the relevant findings of fact, the proposed vertical integration of SDG&E's electric and gas distribution facilities and SCEcorp's unregulated Mission Group subsidiary will have adverse competitive impacts.

80. In addition to considering the proposal's effects in each individual market under review, consistent with the May 7, 1990 Advisory Opinion, we also have the discretion to consider the merger's combined competitive impacts and to determine, based on an assessment of such aggregate effects, whether there will be net adverse effects on competition which militate against approval under § 854(b)(2).

81. We balance the adverse impacts on transmission, bulk power, and affiliate relationships against the pro-competitive impacts of the merger in these areas.

82. We will not explicitly consider within § 854(b)(2) other factors considered in § 854(b)(1) or (c) which may be arguably relevant to an assessment of competition; the statute does not explicitly indicate that factors considered under § 854(b)(1) or (c) may be balanced against the findings made under § 854 (b)(2). Since the evidentiary record in this particular proceeding was developed in a manner consistent with a separate consideration of the § 854(b)(1), (b)(2), and (c) factors, we adhere more closely to this analysis.

83. Whether viewed under the approach taken in the PD, consistent with Attorney General Van de Kamp's Advisory Opinion, or under the "balancing" approach suggested by Attorney General Lungren, this proposed acquisition will adversely affect competition under § 854(b)(2).

84. The legal standard for reviewing proposed mitigation of the merger's adverse impacts on competition pursuant to § 854(b)(2) is avoidance of adverse impacts. Anything short of avoidance is statutorily insufficient and will preclude authorization of the proposed merger.

85. There is no nexus between 150 MW of transmission service and the merger-related impacts identified in the PNW and SW wholesale transmission markets. Yet, adoption of applicants' proposal would implicitly accept the availability of 150 MW transmission service for seven years as effective mitigation of the proposed merger's adverse impacts, including its long-term effect of separating two regional markets (SW and PNW) that may otherwise be eventually unified through removal of existing barriers to transmission accessibility.

86. To constitute effective mitigation under § 854(b)(2), DRA's auction proposal must avoid adverse impacts of the merger, meaning that the proposal must be presently feasible, so that the Commission can put it in place with the knowledge and assurance that it will work effectively at the time the merger is authorized.

87. Authorization of the proposed merger contingent upon further development of DRA's auction proposal, or refinement of its crucial missing variables in a subsequent proceeding, is legally impermissible, for we cannot ensure at the time of approval that the mitigation measures ultimately adopted will be sufficient. Nonetheless, once authorization is given, the merger cannot be undone, and the decision to proceed without definitively resolving major mitigation details will have irreversible consequences.

88. Even if § 854(b)(2) permitted a phased approval process under the set of facts this application poses, thereby allowing us to approve the merger now subject to development of effective mitigation measures in an implementation phase, there is no assurance that DRA's proposal would work, given the jurisdictional and feasibility questions that have been raised.

89. Even if the terms of DRA's proposal could be tightened and mechanisms provided to arbitrate or adjudicate conflicting claims to transmission service, this is a cumbersome arrangement and it is unclear that it would be effective given the dynamism of the bulk power markets, where purchase and sale opportunities arise without advance notice and expire within minutes or hours. Thus, the problems go beyond mere implementation, to fundamental issues of whether or not DRA's proposal is feasible. Therefore, we conclude that the proposed merger's adverse competitive impacts cannot be avoided through adoption of DRA's auction mechanism at the present time.

90. DRA's transmission proposal is preferable to all other measures presented for consideration. However, it requires additional development, and it is uncertain that even then outstanding jurisdictional and feasibility questions could be resolved in a manner consistent with the applicable statutory mitigation requirements (§ 854(b)(2)).

91. Since the holding company structure (1) provides the Commission with less direct ratemaking control over parent/subsidiary interactions than it currently possesses in its regulation of stand-alone SDG&E and (2) exposes SDG&E ratepayers to the impacts of existing unregulated affiliate transactions, the Commission is required to review its current SCEcorp holding company protections to ensure that they will shield ratepayers from the increased costs which may accompany the merger.

92. The Commission must look beyond existing regulatory mechanisms and applicants' proposals to determine whether other proposed measures will adequately mitigate the merger's identified adverse impacts related to vertical integration of SDG&E and the Mission Group.

93. The only measures that could effectively mitigate adverse competitive effects of the merger related to affiliate issues are (1) divestiture of SCEcorp's Mission Energy projects which operate in the WSCC area, coupled with (2) a comprehensive ban against such subsidiary's, or a successor's, future involvement in the WSCC market.

94. With partial divestiture of Mission Energy, the post-merger jurisdiction of the Commission and its ability to effectively regulate and audit public utility operations in California can be preserved.

95. Section 854(b)(2) does not permit authorization of the merger subject to further implementation of conditions designed to avoid adverse competitive impacts. Rather, it requires that the proposed merger be approved only when such impacts can be avoided at the time of approval; since only the adverse impacts associated with vertical integration of SDG&E and the Mission Group can be avoided, the proposed merger cannot be authorized.

96. Section 854(b)(2) requires avoidance of adverse competitive impacts, but today there is no proposal before us which avoids the proposed merger's adverse competitive impacts on the defined wholesale transmission and bulk power markets.

97. The question of rivalry between Edison and SDG&E is more properly analyzed as an aspect of the public interest determination under § 854(c), rather than under the competitive analysis stemming from § 854(b)(2).

98. On balance, applicants have not demonstrated that the proposed merger is in the public interest.

ORDER

IT IS ORDERED that:

1. DRA's March 26, 1991 Motion to Strike Applicants' Response to the Attorney General's Supplemental Brief and Southern Cities' April 10, 1991 Motion to Strike Attachment A to Applicants' Supplemental Brief on SB 52, are denied.

2. Since the proposed merger's adverse impacts on competition in the defined wholesale transmission and bulk power markets, as set forth in the preceding findings of fact and conclusions of law, cannot be avoided through adoption of mitigation measures, the acquisition is not authorized.

3. Because applicants have not proved by a preponderance of the evidence that the proposed merger will provide net benefits to ratepayers in the long term, the acquisition is not authorized.

4. Because applicants' proposal does not include a ratemaking method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted benefits of the proposed merger, the acquisition is not authorized.

5. Because the evidence does not support a finding that, on balance, the proposed merger is in the public interest, the acquisition is not authorized.

6. The application of SCEcorp, SCE and SDG&E for authority to merge SDG&E into SCE is denied.

7. SDG&E shall file a modified attrition allowance application on March 2, 1992, for rates to be effective January 1, 1993.

8. SDG&E's next general rate case will be for test year 1994.

This order becomes effective 30 days from today.

Dated May 8, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
G. MITCHELL WILK
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

I will file a written concurring opinion.
/s/ G. MITCHELL WILK
Commissioner

I will file a written concurring opinion.
/s/ JOHN B. OHANIAN
Commissioner

I will file a written concurring opinion.
/s/ DANIEL Wm. FESSLER
Commissioner

I will file a written concurring opinion.
/s/ NORMAN D. SHUMWAY
Commissioner

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

NEAL J. SHULMAN, Executive Director

APPENDIX A
Page 1

LIST OF APPEARANCES

Applicant: William L. Reed, Timothy W. Taylor, Jeffrey Guttero and E. Gregory Barnes, Attorneys at Law; Messrs. Covington & Burling, by Nicholas W. Fels, Attorney at Law; for San Diego Gas & Electric Company.

Applicants: Stephen E. Pickett, Attorney at Law; Messrs. O'Melveny & Myers, by Joseph M. Malkin, Cheryl W. Mason, Patricia A. Schmiege, Julie A. McMillan, Charles C. Read, Kim Wardlaw, David P. Enzminger, Kenneth R. O'Rourke, Mark A. Samuels, and Richard Goetz, Attorneys at Law; Newman & Holtzinger, by J. A. Bouknight, Jr., Edward J. Twomey, Jane I. Ryan, and Richard L. Roberts, Attorneys at Law; for SCEcorp and Southern California Edison Company.

Interested Parties: Ater, Wynne, Hewitt, Dodson & Skerritt by Michael P. Alcantar and Paul J. Kaufman, Attorneys at Law, for Texaco Producing Inc.; Barbara Bamberger, for Sierra Club; Mark Mead, Attorney at Law, for San Diego County Air Pollution Control District; Philip Presber, for California Association of Utility Shareholders; Chester and Schmidt Consultants, by Reed V. Schmidt, for California City-County Street Lighting Association (CAL-SLA); Sylvia M. Siegel and Joel R. Singer, Attorney at Law, for Toward Utility Rate Normalization (TURN); C. Hayden Ames, Attorney at Law, for Chickery & Gregory; Barbara Baird, Attorney at Law, for South Coast Air Quality Management District; Barry H. Epstein and Dian M. Grueneich, Attorneys at Law, for California Department of General Services, Inc.; David Branchcomb, for Henwood Energy Services, Inc.; Messrs. Goldberg, Fieldman & Letham, by Arnold Fieldman, Channing D. Strother, Jr., and David Brearley, Attorneys at Law, and Messrs. Hjelmfelt and Larson, by David C. Hjelmfelt, Attorney at Law, for City of Vernon; Jan Michael Whitacre and Charles Chambers, Attorneys at Law, and Maurice Brubaker, for Federal Executive Agencies; W. E. Cameron, for City of Glendale; Steven M. Cohn and Patrick J. Bittner, Attorneys at Law, for the California Energy Commission; William H. Cullviner, Attorney at Law, for Kelco Division of Merck & Company, Inc.; Adams & Broadwell, by Marc D. Joseph, Attorney at Law, Paul Crost, Attorney at Law, and Dean Cofer, for IBEW Local Union 47; David A. Moore, for IBEW Local 465; David B. Follett, Attorney at Law, for Southern California Gas Company; Norman Furuta and David W. La Croix, Attorneys at Law, for Department of the Navy; Thomas Dalzell, Attorney at Law, and Carl Wood, Bernie Garcia, and John Chabot,

APPENDIX A
Page 2

for Utility Workers Union of America, Local 246; Steven Geringer, Attorney at Law, for California Farm Bureau Federation; Howard V. Golub, Peter Hanschen, Roger Peters, Shirley Woo, and Kermit R. Kubitz, Attorneys at Law, for Pacific Gas and Electric Company; Lee Grissom, for Greater San Diego Chamber of Commerce; Biddle & Hamilton, by Richard L. Hamilton, Attorney at Law, for Western Mobilehome Association; Lloyd M. Harmon, Jr., Attorney at Law, for County of San Diego; Donald Klein, for Rate Watchers; Donald La Croix, for Citizens for Action and Reform by Education; Duncan, Weinberg, Miller & Pembroke, by Barry F. Mc Carthy, Attorney at Law, for M-S-R Public Power Agency; Hanna & Morton, by Keven R. Mc Spadden and Douglas K. Kerner, Attorneys at Law, for Hanna & Morton; William B. Marcus, for JBS Energy, Inc.; Donald H. Maynor, Attorney at Law, for NCPA; Leamon W. Murphy, for Imperial Irrigation District; Jones, Day, Reavis & Pogue, by Norman A. Pedersen, Attorney at Law, for Southern California Utility Power Pool; James K. Hahn, City Attorney, by Edward J. Perez, Assistant City Attorney, for City of Los Angeles; Robert L. Pettinato, for Los Angeles Department of Water & Power; Scott D. Rasmussen, Attorney at Law, for City of Pasadena; John Robinson, for Dames & Moore; David G. Salow, for Association of California Water Agencies; Michael J. Schilmoeller, for Salt River Project; John W. Witt, City Attorney, by William S. Shaffran, Curtis M. Fitzpatrick, Leslie J. Girard, Nina B. Deane, and Deborah L. Berger, Deputy City Attorneys, for City of San Diego; Michael Shames and Frank J. Dorsey, Attorneys at Law, for Utility Consumers' Action Network (UCAN); William C. Schurr, for Rancho Bernardo Community Council; Messrs. Roberts & Kerner, by Douglas K. Kerner, Attorney at Law, and Jan Smutny Jones, Attorney at Law, for Independent Energy Producers Association; Louise Renne, City Attorney, by Leonard Snaider, Deputy City Attorney, for City and County of San Francisco; Ronald V. Stassi, for City of Burbank; Nancy Thompson, for Barakat, Howard & Chamberlin; Siva Tufono, for Samoan Development Services Center; John K. Van de Kamp, California Attorney General, by Mark J. Urban, Peter H. Kaufman, H. Chester Horn, Jr. and Susan L. Durbin, Deputy Attorneys General, and Daniel E. Lungren, Attorney General, by Thomas E. Gede, Special Assistant Attorney General, for California Attorney General; Messrs. Spiegel & McDiarmid, by Sandra J. Strebel, Peter K. Matt, Bonnie S. Blair, and Russell Smith, Attorneys at Law, and Rourke & Woodriff by David A. DeBerry, Attorney at Law, for Cities of Anaheim, Azusa, Banning, Colton, and Riverside; Wright & L'Estrange, by Robert C. Wright, Attorney at Law, for Wright & L'Estrange; Karen Young and Jean Brunkow, for Childcare Resource Service; Harry Winters, for Regents, University of California; Richard O. Baish, Michael D. Ferguson, and Randolph L. Wu, Attorneys at Law, for El Paso Natural Gas Company; David R. Chapman, City Attorney, for City of Escondido; Leboeuf, Lamb, Leiby & Macrae, by Aaron Gundzik, Attorney at Law, for Tucson Electric Power Company; Thomas Harron, Attorney at Law, for City of Chula Vista; James Hodges, for South Bay Community Development Consortium; Graham & James, by Peter W. Hanschen and Martin A. Mattes, Attorneys at Law, for Santa Margarita Company; P. R. Mann & Associates, by Philip Mann, Attorney at Law, for P. R. Mann & Associates, and MEI Group; Richard H. Baldwin, for Ventura County Air Pollution Control District; Pat Baggerly, for Environmental Coalition of Ventura County; and Peter Navarro, Edward J. Neuner, Barbara Schutze, and Edward Duncan, for themselves.

Division of Ratepayer Advocates: James S. Rood, Philip Scott Weismehl, Helen W. Yee, Robert C. Cagen, Irene K. Moosen, Jean M. Vieth, and Hallie S. Yacknin, Attorneys at Law, and Thomas Pulsifer, and Erik B. Jacobson.

(END OF APPENDIX A)

APPENDIX B
Page 1

ABBREVIATIONS AND ACRONYMS

A.	- Application
Advisory Committee	- Joint Utility Advisory Committee
AEPCO	- Arizona Electric Power Cooperative
ALJ	- Administrative Law Judge
APMC	- Additional Proposed Merger Conditions
APS	- Arizona Public Service Company
BRPU	- Biennial Resource Plan Update Proceeding (I.89-07-004)
CEC	- California Energy Commission
CFE	- Comision Federal de Electricidad
COTP	- California-Oregon Transmission Project
CPP	- California Power Pool
CPUC	- California Public Utilities Commission
D.	- Decision
DCF	- Discounted Cash Flow
DEIR	- Draft Environmental Impact Report
DRA	- Division of Ratepayer Advocates
DVP2	- Devers-Palo Verde 2 transmission line
ECAC	- Energy Cost Adjustment Clause
EIR	- Environmental Impact Report
FERC	- Federal Energy Regulatory Commission
Fn.	- Footnote
GRC	- General Rate Case

APPENDIX B
Page 2

HHI	- Herfindahl-Herschman Index
IBEW	- International Brotherhood of Electrical Workers
IDBs	- Industrial Development Bonds
IEP	- Independent Energy Producers
IFAs	- Incremental Facility Additions
IID	- Imperial Irrigation District
IOAs	- Integrated Operation Agreements
IPP	- Intermountain Power Project
ITS	- Interruptible Transmission Service
KRCC	- Kern River Cogeneration Company
kV	- Kilovolt
kWh	- Kilowatt-Hour
LADWP	- Los Angeles Department of Water and Power
MEC	- Mission Energy Company
MFFC	- Mission First Financial Company
MG	- The Mission Group
MLC	- Mission Land Company
MPEC	- Mission Power Engineering Company
MSR	- Modesto Irrigation District/City of Santa Clara/City of Redding
MW	- Megawatt
NBR	- New Business Relationship
NCPA	- Northern California Power Agency
NLRB	- National Labor Relations Board

APPENDIX B
Page 3

NOB	- Nevada-Oregon Border
NPC	- Nevada Power Company
NRC	- Nuclear Regulatory Commission
NW	- Northwest
OB	- Opening Brief
PDCC	- Pacific Diversified Capital Company
PEA	- Proponents Environmental Assessment
PG&E	- Pacific Gas & Electric Company
PHC	- Prehearing Conference
PMAL	- Phoenix-Mead/Mead-Adelanto/Adelanto-Lugo
PNW	- Pacific Northwest
PPAs	- Power Purchase Agreements
PU Code	- Public Utilities Code
PURPA	- Public Utility Regulatory Policies Act of 1978
QF	- Qualifying Facility
RB	- Reply Brief
SCAQMD	- South Coast Air Quality Management District
SCE	- Southern California Edison Company
SDAPCD	- San Diego Air Pollution Control District
SDG&E	- San Diego Gas & Electric Company
SERAM	- Model that forecasts availability of SW economy energy for sale in California
SONGS	- San Onofre Nuclear Generating Station

SW	- Southwest
SWPL	- Southwest Power Link
UCAN	- Utility Consumer Action Network
UP&L	- Utah Power & Light
USDOJ	- U.S. Department of Justice
WSCC	- Western Systems Coordinating Council
WSPP	- Western Systems Power Pool

(END OF APPENDIX B)

A.88-12-035
D.91-05-028

G. MITCHELL WILK, Commissioner, concurring in part:

Much will be said and speculated, both publicly and privately, about this proceeding, our process for deciding it, the decision itself, as well as those who decided it. For the record, I will take this opportunity to briefly share the rationale and emotion that underlies my support of today's decision.

I would first like to acknowledge the extraordinary efforts of my colleagues in carefully considering this decision and the voluminous record on which it is based. As one of the Assigned Commissioners in this proceeding since its inception, I know how overwhelming it is given my experience to-date. In particular, our two new colleagues, Dan Fessler and Norm Shumway, have demonstrated their dedication by taking on these issues and this record as new appointees. Their hard work helped enormously in reaching a decision.

I am in an unusual position on this decision. While I agree with the result, I do not agree with a substantial portion of the rationale employed by the majority in reaching the result.

Denial of the merger is warranted under the competitive provisions of PU Code 854(b)(2). I believe, however, that the record does not support the majority opinion's further findings of denial based on PU Code Sections 854(b)(1) and 854(c). Because of the potential wide-ranging precedential value of this decision, I am concerned that the Commission preserve its flexibility to act in a quasi-legislative manner with regard to utility mergers. I think that we must have the ability to approve mergers that satisfy the overall public interest, and I believe that this decision could be seen to limit that ability.

In short, the competitive problems that this merger would cause, and the lack of available mitigation for their impacts, constitute sufficient cause for denial given the standards established by S.B. 52. In other respects this merger would benefit ratepayers, and those benefits have been demonstrated on the record. Because this is an important case of first impression as a result of the enactment of S.B. 52, I am concerned that the ramifications of the majority opinion could extend beyond today's decision.

I am furthermore disappointed that the Commission may not have fully captured this important opportunity to more affirmatively clarify its philosophical direction on the issues raised by this application, and to provide guidance in those areas where the Commission could have exercised its legitimate discretion: It is appropriate for the Commission to establish what would have been acceptable, not just what wasn't.

<u>Competition: The Sole Basis for Denial</u>

Those who know me know by action and deed, not rhetoric, that I believe in harnessing competitive market forces as they continue to emerge in our regulated utility industries; we should not avoid or stifle them.

At a time when this Commission is working in all its regulated industries to increase competition and open up more markets and alternatives for consumers, we simply could not approve this merger given its adverse impacts on transmission access and competition. Further, PU Code Section 854 as modified by S.B. 52 requires that there be adequate mitigation measures in hand at the time we approve a merger in order to avoid, not just reduce, such impacts. At this time, we do not.

With regard to the presence of adverse competitive impacts, the record is clear that the merger would have caused many: This point is simply not debatable. While DRA's presentation was insightful and potentially workable as a means to mitigate the adverse impacts, it is hardly ready for implementation. We may spend much of the rest of this decade resolving the issues raised by DRA's proposals as we move more and more towards open access and greater competition in the electric industry.

But what the CPUC itself can do in the transmission access arena is arguably limited, and it is clear that the Federal Energy Regulatory Commission (FERC) has considerable jurisdiction over many important transmission access issues, not the least of which is wholesale pricing, on both an interstate and intrastate basis. Therefore, it is abundantly reasonable to conclude that adequate mitigation measures would have required coordinated and complementary efforts on the part of both Commissions. I am aware of no such proceeding before FERC, and we are certainly in no position to predict its commencement, much less rely on its potential outcome.

Now would simply not have been the time to take the chance that transmission access and wheeling rules would ultimately have been promulgated, much less promulgated acceptably to encourage competition and lower costs. Other mitigation measures suggested either failed to provide adequate protection, or would have required further evidentiary proceedings, the outcome of which would have been unknown. Given the consequences of this merger, faith and hope simply are not sufficient to counterbalance these concerns and meet the legal standards imposed by S.B. 52's amendments to PU Code Section 854.

The basic reason for the existence of the Commission is to protect consumers from monopoly abuse. By promoting competition, the Commission has reduced costs, expanded alternatives and thereby limited the possibility for abuse of customers, large and small, in telecommunications, transportation, and, to an increasing extent, in energy. In my judgment, the fundamental inconsistency of this merger with those principles and that direction is the sole appropriate reason for its disapproval. Under S.B. 52, this impact compels disapproval, and in my judgment the decision needed to go no farther.

<u>The Record on Long-Term Benefits</u>

Contrary to the majority opinion, I find that the applicants did meet their burden of proof to demonstrate long-term benefits, and that those benefits would have been substantial and easily passed through to ratepayers by usual Commission ratemaking procedures. However, my concern is not whether a billion dollars over ten years is "large" or "small"; instead, it is with the determination by the majority that the applicants' showing was insufficient to show that these benefits would exist. For that reason I will discuss in some detail what our decision today omitted, that is the showing made by the applicants that net benefits of the aforementioned scale are indeed very real. In addition, I do not believe that the majority appreciates fully the inherent uncertainty present in all such analyses or forecasts, and the fact that the Commission must often make important decisions based on uncertain predictions because that is all an applicant can possibly provide. If this showing was insufficient, then I am uncertain what showing could be deemed sufficient and the decision offers little guidance to answer this question for these or any other merger applicants.

While we agree that "short term" corresponds to something like a three-year ratemaking cycle, I am disappointed at the decision's treatment of a definition of "long term". Rather than relying on common business sense, the majority defines long term as "at least several years into the next century" (Section 4C). The basis for this conclusion is somewhat unclear. But even at that, I believe the applicants met their burden of proof.

The applicants made a convincing showing of net benefits that would continue specifically to the year 2000, along with straightforward reasoning to demonstrate that those benefits would continue into the foreseeable future. No party offered any credible showing to the contrary. It is worth recounting some detail from the record to review what was shown.

In their proposed decision, the ALJs found specifically that the labor cost savings overwhelmed the other savings attributed to the merger, and were the most reliable (page 46 of the ALJ proposed decision). The net labor savings start out at \$59 million in 1991, and increase to \$177 million annually by 2000 (Appendix D, page 4 of the ALJ proposed decision). These numbers are based primarily on a unit-by-unit review of what staffing levels would be needed post-merger; for the most part, DRA's re-creation of the applicants' analysis yielded virtually identical results. The only theory advanced as to why these savings would not continue indefinitely came from DRA, which argued that "bureaucratic costs" would offset other labor savings. The ALJs found DRA's theory to be unsubstantiated, as well as inconsistent with the results of DRA's own economic studies (ALJ proposed decision, pages 165-66). In this regard, DRA's evidence about comparable large corporations did <u>not</u> show that diseconomies of scale would occur as Edison grew larger. Thus, the record shows that there is no reason to expect that these savings would not continue indefinitely.

As for long-term benefits associated with resource planning, we need to look at the utilities' own expenses, and what they must pay independent generators (QFs) for purchased power. Here again, the evidence points to a convincing showing by the applicants.

With regard to the utilities, the ALJs' conclusion of modest but positive benefits is fully consistent with the basics of resource planning as a discipline. Without the merger, Edison and SDG&E would separately attempt to minimize generation costs subject to the various constraints they face (such as air pollution restrictions). With the merger, the combined utility would have additional options available to it <u>as well as the option of doing exactly what the independent utilities would have done anyway</u>. Such flexibility might bring few benefits, but surely it cannot bring additional costs. Further, the ALJs found that there are continuing benefits to any significant resource deferrals for the indefinite future because each subsequent plant is needed that much later, and would be cheaper in present value terms (as well as potentially improved due to intervening technological advances).

Also, DRA and other parties argued that Edison and SDG&E should be able to obtain the benefits of generation resource coordination through contracts or other arrangements without merging. If they are correct and the merger would not have changed the coordination that would have occurred anyway, then the merger offers neither costs nor benefits for resource planning, and the issue is moot.

On the QF side, the projected merged operations would increase the incremental energy rate (IER), an important factor that determines what QFs are paid under Interim Standard Offer 4 (ISO4) contracts signed in the middle 1980s. Accordingly, there is an additional expense that amounts to about $290 million, in total, from 1991 to 2000. This is why the ALJs show net year-to-year costs for resource planning by the later 1990s. However, this expense is forecasted by DRA to peak at $83 million in 2001 and decline thereafter. Although it is unclear at what date net resource plan benefits turn positive again, this effect is not enough to overcome the labor savings in those years that the resource plan shows net costs.

On top of the foregoing, one must also bear in mind that resource planning is among the most uncertain and complicated of modeling efforts. The record offers as much specific information as can be known about the resource-planning future; however, the basic point that additional flexibility cannot increase costs is true indefinitely, a point overlooked in today's decision.

If one looks beyond this evidence to some distant period (2010? 2020?), there appears to be no basis to draw any specific conclusions. This does not surprise me; indeed, I would be suspicious of the opposite situation, had a party claimed to produce a precise 30-year forecast as a purported basis for our decision. Beyond some point, no one's best efforts can tell the future.

Considering the above discussion of the evidence, it is my judgment that a showing of net benefits was made for years 4 through 10, and the factors that produce these benefits will continue indefinitely. These combine to satisfy the statutory requirement for a finding of net long-term benefits. In order to reach the contrary conclusion, the majority opinion embraces DRA's argument regarding eventual diseconomies of scale despite the proof to the contrary contained in DRA's own economic studies. The majority notes that SDG&E will grow and achieve certain economies for itself eventually; however, that possibility would produce no net costs, only the potential end, at some ill-defined time, of a source of benefits. The majority opinion quibbles with the applicants' reliance on a set of assumptions for forecasting resource plan impacts; the majority would have preferred "a detailed analysis of expected events and a consideration of unforeseen circumstances" (Section 4D.2). I am unfamiliar with how one forecasts the unforeseen, or for that matter with any systematic gap in the complicated resource planning presentations made by the applicants. In the end we must always amend resource planning analyses to fit the assumptions we find most supportable, but the scope of resource plan presentations in this case was entirely adequate to prove the required point, that long-term benefits do exist.

In my opinion the majority has not identified any substantial gap in the applicants' demonstration of net long-term benefits. In part, this is reflected by the failure of the majority opinion to identify clearly what the purported deficiencies were, or to spell out in any detail what showing would have been required to address them. The applicants deserve this accounting, and, despite the appropriateness of case-specific decisions, future applicants require it to know what is expected from them, especially considering that we are implementing the amendments imposed by S.B. 52 for the first time. I fear the posture taken by today's decision may create an unreasonably high burden that is entirely too convenient for the Commission's staff and other parties to use against all mergers that come before us, despite their potential advantages for ratepayers.

When we are dealing with forecasts, especially those more than ten years into the future, there is tremendous uncertainty. It is inherent in the effort to forecast. I am concerned that the majority opinion either overstates the extent to which additional scenarios or analyses could realistically have made the future any more precise from today's vantage, or interprets the applicants' burden as being obliged to eliminate more uncertainty than anyone realistically could. In either case the result may be a "burden of proof" that requires what no applicant can today supply, a precise vision of the first decade of the twenty-first century.

As the Commissioner most involved in the enactment of S.B. 52 which established the new standards we implement for the first time today, I cannot believe that the Legislature intended to establish an evidentiary burden that is incapable of being met. There is no legislative history to support that interpretation, nor have any Members said so. I do not want this Commission to be perceived as having achieved the same result implicitly through the assignment of an overwhelming administrative burden to an applicant.

Affiliate Relationships

The decision would require a partial divestiture of Mission Energy as mitigation were the merger to go forward. By requiring this I believe that the majority may have suggested that the Commission does not believe itself fully capable of controlling potential affiliate abuses, and must instead sever affiliate relationships.

Based on available evidence and experience to-date, I disagree. The Commission has the means to control affiliate abuses, and they are contained in the Edison holding company decision (D.88-01-063) as well as our general statutory and constitutional authority. As evidenced by the KRCC decision (D.90-09-088) and other pending proceedings regarding similar allegations, we can and will investigate and remedy such abuses.

I supported substantial disallowances for Edison and other utilities that have harmed ratepayers through affiliate abuses, and I will continue to do so when appropriate. While the potential for such problems may always exist, so will our fully adequate authority to correct them.

"Retail Competition"

The decision today reflects my opinion that retail competition should be more properly considered an issue related to PU Code Section 854(c) rather than the more restrictive Section 854(b)(2). The recharacterization of this issue as "across-the-fence rivalry" is consistent with its genuine character, which is not "competition" as the word is customarily and properly used. The importance of this interpretation cannot be overstated given the consequences of such rivalry if considered "competition" under S.B. 52's amendments to PU Code Section 854. Thus, I am disappointed that the majority opinion still falls short by failing to go beyond the instant case to clarify that this interpretation is a matter of broad, and thus predictable regulatory policy given the nature of our regulated entities as franchise monopoly utilities.

Furthermore, by shifting the former "retail competition" issue to Section 854(c) the majority finds, on balance, that the merger shifts from in the public interest to contrary to the public interest. Based on the record, this result gives far too much weight to what now is referred to as case-specific rivalry.

For competition to exist there must be current or potential customers with the ability to choose between competing providers. For retail franchise monopoly customers this is clearly not the case, and even for those occasional commercial customers who might relocate to avoid high-cost utility service, such instances are rarely justified solely on the basis of utility bills, and thus are few in number and exert little influence over the market behavior of others.

Therefore, the beneficial or harmful effects of a rivalry between monopoly utilities with respect to retail rates cannot be called "competition", and we should have said so once and for all.

In addition, I believe that the attribution, explicit or subtle, of any substantial dollar amount in the instant case to past benefits of rivalry is inaccurate, and, furthermore, that no showing has been made as to how or by what mechanism this "benefit" would "disappear" were the merger to be approved. For the Section 854(c) analysis to have been reversed from a positive finding in the ALJ proposed decision to a negative in the final decision after the inclusion of this issue suggests that the majority has given both the size and influence of this rivalry far too much weight. I agree that the loss of this rivalry is an adverse impact, but in my view the majority expands its influence unreasonably given the record in this case.

There is no question that ten years ago SDG&E was a high-cost utility. From about that time until the present, its rates have gradually decreased to the point where they fall slightly below Edison's. But for what reasons?

Rather than point to the whole host of factors that were involved, I will note that the Commission routinely makes findings about why rates are set at a given level, and in that manner identifies particular rate-reducing factors in each decision. In reviewing the Findings of Fact and Conclusions of Law of 48 significant Commission decisions that affected SDG&E's electric rates from 1980 to the present, my staff found exactly four findings that were in any way related to inter-utility rate comparisons, none of which was tied to Edison alone, and none of which changed rates. Those decisions contain over 1000 findings of fact! While this does not exclude comparisons as a possible influence on rates, it would seem to eliminate them conclusively as a primary, much less a determining factor upon which the Commission should rely to balance the factors included in PU Code Section 854(c), as it appears to have done in today's decision.

The loss of rivalry is a negative, but not one of the magnitude implied by the decision's balancing results.

S.B. 52 and the Overall Public Interest

The majority opinion undertakes the public interest balancing called for by PU Code Section 854(c), and finds that the merger is not in the public interest. As I indicated above, the treatment of rivalry appears to tip the balance against the public interest for the majority, and I disagree with that analysis and result; given the genuine adverse competitive impacts, we did not need to reach this rather unjustified conclusion. However, the majority also cites the more traditional competitive impacts on transmission access as a substantial negative factor in the overall balance, and I agree that those impacts are negative, important, and cannot be mitigated currently.

If S.B. 52 had not been enacted, I would have approached this application with the same standards of review regarding competition as I have used in other, unrelated proceedings before this Commission. S.B. 52's amendments to PU Code Section 854, however, had an unforeseen and substantial impact on today's decision, and one that needs to be understood by all parties.

These amendments have served to limit the Commission's ability to consider mergers. If my colleagues ever desire to have an example of why the Commission should vigorously oppose codification of Commission practice, this is it.

Under S.B. 52, we must undertake three balances: Short and long term benefits; competition; and the overall public interest. A merger failing any one of these must be rejected. Further, PU Code Section 854(e) contains unprecedented and somewhat ambiguous language regarding the "burden of proof" applicants must surmount with regard to these tests. Additionally, PU Code Section 854(d) suggests a role for intervenor participation, such as by our own Division of Ratepayer Advocates, that is unclear given subsection (e).

I know that S.B. 52's author intended only to codify a public interest view at least somewhat akin to that which the Commission generally employs under our broad authority to review mergers and acquisitions. However, in practice this legislation has proven far more problematic than any of us anticipated at the time the bill was signed into law, and it requires revision in at least two areas.

First, I believe that the standard for reviewing mergers and acquisitions should be the overall public interest rather than the public interest as segmented into a number of independent pieces. In addition to the principles of consistency and predictability, I know of no more important test of proper regulation than achieving a balance between often conflicting facts, interests, and circumstances, particularly in the increasingly competitive environment that all our utility industries face. S.B. 52's provisions regarding competition and ratepayer interests must be amended to allow for an overall balancing. This is not to suggest that had this standard been pursued in this case that a different result would necessarily have occurred. But some of my colleagues and I were greatly troubled by the inflexibility of the statute despite Attorney General Dan Lungren's more reasonable interpretation of S.B. 52's application. Such statutory constraints have little place in these competitive times; neither ratepayers nor shareholders are benefited by them.

Second, the language in subsection (e) regarding "burden of proof" is troubling as well as vague. For example, does it suggest that mitigation suggested by DRA or other intervenors cannot be considered, and that the Commission is limited to the proof and evidence submitted by the applicants? This ambiguity should be addressed by amendment.

In short, our experience in this case demonstrates the need for S.B. 52's amendments to be revised to assure that they will never mandate disapproval of a merger that is in the overall public interest, and to clarify that the Commission may examine the record as a whole to determine whether the public interest is advanced.

Conclusion

Many have expressed disappointment that this case has taken so long to conclude. I share in this frustration: No one wanted an earlier decision than I. It must be observed, however, that in many ways this case deserved the time and attention it has received given its potential impact. It has been my experience that those who would be fast to criticize our process often do so as a means to get attention or shift blame.

Many will read entirely too much into this decision and the philosophies that may underlie it. I would again urge caution. Personal philosophy indeed played an important part for all of us, as it should, but the complexity of the issues in this case goes far beyond the convenience and simplicity implied by broad generalizations. While I am not in agreement with all that is said and concluded in this decision, I believe that the denial of this application is consistent with the evidence and applicable statutes.

This proceeding tested the mettle of all those who were involved or affected. When this case began, as Commission President I pledged to the parties and the public that we would pursue this application openly, deliberately, and fairly, and that the final decision would reflect our commitment to the best interests of the ratepayers, shareholders, and California, including its worldwide competitive strength. With today's decision, regardless of its flaws, I believe we have met this challenge and commitment.

G. MITCHELL WILK
Commissioner

May 8, 1991
San Francisco, California

A.88-12-035
D.91-05-028

Concurring Opinion of Commissioner John B. Ohanian

America has long been known as the land of opportunity. California, with its moniker "The Golden State," has come to symbolize the opportunity available in America. Millions of people have come to America and this State because of the opportunity for a better life -- and I was among them. In these troubled times, opportunities are more limited, and the cost of losing them high.

Today's decision represents a lost opportunity. Denied to California's ratepayers is the opportunity to have their rates reduced by a cumulative one-billion dollars through the end of the decade. Lost are significant environmental benefits, most notably reduced emissions of air pollutants. Left unrealized is the opportunity to recast bulk power and transmission markets for the benefit of producers and consumers alike. So, too, will many other opportunities be lost because of our action today.

Foremost among the opportunities lost is a savings to ratepayers of over one-billion dollars through the year 2000. The one-billion dollars in merger-related savings would have flowed back into California's economy to create new jobs, investments, and additional tax revenues for financially-strapped State and local governments. Lower utility bills would have enhanced California's competitive position in global markets well into the next century.

Foregone is the opportunity to realize significant environmental benefits. The San Diego air basin would have seen a permanent merger-related decrease in emissions of NOx and SOx. For the Southeast Desert Air Basin, the mitigation plan contained in the EIR would have reduced NOx emissions relative to a no-merger scenario by 5,438 tons through the year 2000, SOx by 16 tons, and PM10 and its precursors by 5,612 tons. For the South Coast Air Basin, NOx emissions would have been reduced by 8,391 tons, and PM10 and its precursors by 8,132 tons. For the South Central Coast Air Basin, NOx would have fallen by 4,995 tons, PM10 and its precursors by 4,303 tons. In total, through 2007, compared with a no-merger scenario, approval of the merger would have reduced NOx emissions by 48,051 tons, SOx emissions by 9,030 tons, and PM10 and its precursors by 62,727 tons. All other environmental impacts were eliminated entirely or reduced to less than significant.

Perhaps the greatest opportunity lost is widespread access to the merged utility's transmission network by third-party buyers and sellers of electrical power. We could have replaced the two insular and provincial "service territories" of Edison and SDG&E with one larger, open, and free-wheeling market for electrical power. On a grander scale, we could have forged the separate power markets of the Southwest, California, and the Pacific Northwest into one large, integrated market for bulk power. With the larger market, a greater number of buyers and sellers could have competed among themselves. The resulting efficiencies and savings clearly would have been enormous. Potential benefits to California's businesses and ratepayers are incalculable. California's competitive position in global markets would have been greatly enhanced. But with denial of the merger, realization of such benefits will have to wait another day.

Finally, there are a host of other benefits that could have been realized had we approved the merger. For instance, Edison's progressive and far reaching policies on affirmative action would have extended into San Diego had we approved the merger. Lost, too, is Edison's commitment to expand its philanthropic activity. Numerous strategic benefits including operating flexibility, geographic diversity of resources, reduced bypass risk, etc., will remain unrealized due our actions of today.

Let there be no doubt that I concur in today's decision. I agree that the merger creates substantial adverse impacts in the transmission and bulk power markets. I recognize that net benefits were not assured beyond the year 2000. Nor was there a clear regulatory mechanism identified to guarantee the flow through of forecasted long-term benefits from the merger. Lastly, I concur that the public interest would have been substantially harmed by the loss of rivalry between Edison and SDG&E.

But I must confess my disappointment in the loss of the many opportunities inherent in the merger between SCEcorp and San Diego Gas and Electric. My career in public service has been dedicated to finding solutions to problems. Accordingly, my preference would have been to craft solutions to the merger's flaws in order to achieve it's many benefits. Solutions based on expanding and strengthening the forces of competition to offset the merger-related adverse impacts on markets. Solutions that not only fully mitigated anticompetitive impacts, but created significant and beneficial opportunities for the ratepayers and California as a whole.

In the case of transmission and bulk power markets, a pro-competitive solution to mitigate merger-related anticompetitive impacts would have been to open up the merged entity's transmission network; and create a larger bulk power and transmission market buy tying together the separate Southwest, California, and Northwest markets into a single, unified market. The first step would have enabled existing buyers and sellers of bulk power within the merged entity's service territory to better compete with the merged entity. The latter step would expand the geographical boundaries of the market, allowing a greater number of buyers and sellers to compete with one another. The larger market with more participants would have correspondingly diminished the merged entity's market power. Further, by bringing to the market a greater array of buyers and sellers of wholesale transmission and bulk power, we could have created a more efficient market with lower costs.

The parties to this proceeding provided us with much of the raw material we needed to realize this opportunity. For example, the applicants pledged to provide transmission facilities in their service territory of sufficient capacity to meet the transmission needs of other utilities (both within and outside its service territory) and QFs seeking to sell power to outside utilities. The applicants also committed to provide 250 megawatts (MW) of transmission service to the Southwest and 150 MW to the the Pacific Northwest. I believe that with additional effort, the Commission could have used the parties' proposals to craft a transmission access plan that would not only have mitigated adverse impacts on competition, but created an entirely new environment for transmission access that would have fundamentally recast and expanded the competitive landscape for bulk power and transmission markets.

A visionary transmission access plan would also have provided a market-based solution to the problem of lost rivalry between Edison and SDG&E. Such a plan would have replaced the lost rivalry with new and strengthened rivalry from municipal utilities. As today's decision recognizes, the threat of potential municipalization is an important spur to utilities such as SDG&E and Edison to operate efficiently and reduce costs. Greater access to buyers and sellers of bulk power besides Edison would not only have strengthened the Resale Cities relative the merged entity, but would have strengthened the threat of municipalization if the merged entity's rates were to get out of line.

I must express my reluctant concurrence in regards to the finding that the applicants did not meet their burden of demonstrating net long-term benefits (i.e., benefits beyond the year 2000). This is in stark contrast to the finding by the ALJs in the proposed decision that there are indeed net benefits after the year 2000. Anyway, I find the whole task of proving anything beyond the year 2000 to be problematic. As the proposed decision pointed out, forecasts for three-year general ratecases have often proved well off the mark. I note that in ECACs, where we forecast for one year the costs to produce or buy power, our crystal balls have often proved to be cloudy or even cracked. And I remind my fellow Commissioners of the havoc that was wrought to our forecasts by recent events in the Middle East. The proposed decision accepted the fact that forecasts grow increasingly speculative with the progression of time, and accordingly, gave greater weight to near-term forecasts (i.e., pre-2000) of merger-related costs and benefits than it did to forecasts of more distant periods. To conclude that the applicants did not meet their burden of showing net benefits over some undefined, long-term horizon may be setting a standard subject to considerable discretion and impossibly high to meet.

I must also express my reluctant concurrence of our rejection of the merger based upon it not meeting the statutory test of providing an adequate regulatory mechanism to flow through to ratepayers both short and long-term benefits. The proposed decision found no such inadequacy. Now, we decide that no mechanism was presented by the parties which could guarantee the flow through of benefits. I agree, but I'm not convinced that there ever could be such an assurance. How does one guarantee that labor savings from positions eliminated in year one of the merger are explicitly flowed through to rates in year 20?

Switching gears, I want to express strong concurrence with the finding in today's decision that rivalry between Edison and SDG&E is most appropriately considered under PU Code Section 854(c), not 854(b)(2) as in the proposed decision. The lack of a common geographic market at retail precludes the sort of head-to-head competition that was the focus of the conventional antitrust analysis we performed in carrying out our duties under PU Code

Section 854(b)(2). On the other hand, the loss of rivalry between Edison and SDG&E certainly affects the public interests and is properly analyzed as an aspect of the public interest determination required under 854(c).

I want to conclude by emphasizing that we are not denying the proposed merger because of general hostility to such transactions. Rather, our hands were tied by the inadequate mitigation proposals put forth by the parties (particularly the applicants, considering their burden of proof). The lack of details on the record simply precluded us from crafting a visionary transmission access plan. Tightening the knot around our hands was the vague and restrictive language of PU Code Section 854. The law forced us to deny the merger because long-term net benefits that would accrue in the next century could not be assured. The law forced us to reject the merger because there is no ratemaking mechanism in existence that could guarantee the flow-through of merger-related benefits well into the next century. In short, the law prevented the Commission from taking advantage of a golden opportunity to achieve benefits for all of California.

John B. Ohanian, Commissioner

May 8, 1991
San Francisco, California

A.88-12-035
D.91-05-028

Daniel Wm. Fessler, Commissioner, Concurring:

I join both the result and rationale articulated in the Commission's decision. Too much has been said today for me to feel it appropriate to add but the briefest of thoughts. I join the sentiments expressed by COMMISSIONER SHUMWAY respecting the challenge presented by the 1989 amendments to a statute obviously intended to control our direction but lacking in a definition of critical terms. I also concur that the interpretation suggested by Attorney General Lungren affords the Commission needed flexibility to pursue the public advantage when faced with proposed mergers, consolidations or control acquisitions involving large utilities in our state.

I am not without sympathy for the views set forth by COMMISSIONER OHANIAN respecting the opportunities presented by the proposed merger. However, it is my belief that many of the advantages which he identifies may be attained through the enlightened cooperation of what we now have determined are to remain independent utilities. The challenge for the future is to identify and pursue advantages which might have been attained as a result of the merger in circumstances which do not exact the anti-competitive consequences which we have clearly identified.

It is difficult to respond to COMMISSIONER WILK'S statement of individual views and abide with the pledge to be brief. I will limit myself to the § 854(b)(1) issue of long-term benefits and the burden of proof.

I respectfully disagree that the Commission is to be faulted for declining to set in concrete a definition of a term made pivotal by the provisions of the statute. Of necessity, the flexibility which we all seek suggests that this concept must be determined with respect to the nature and dynamics of the constituent entities, a factor which will vary with each proposed combination.

In this case, the application would have created for what may well be the balance of time the largest investor owned utility in the world. Given the enormity and permanence of this organic change, the "common business sense" to which my colleague appeals urges caution. One need not go beyond common sense to realize that the ingredients in an omelet are difficult to repackage in their original containers. Before approving such an irretrievable step we should be convinced of "long-term" benefits which exceed a decade.

There is no doubt that § 854 places the burden of establishing the long-term benefits upon the applicants. On this record I join the majority in concluding that the applicants' showing failed to withdraw the issue of long-term benefits from the realm of speculation and to establish that, more likely than not, such benefits exist.

/s/ Daniel Wm. Fessler

DANIEL WM. FESSLER, COMMISSIONER

May 8, 1991
San Francisco, California

4-1

NORMAN D. SHUMWAY, Commissioner, Concurring:

Today I join in both the result and the rationale of the majority opinion denying the merger of San Diego Gas and Electric (SDG&E) with Southern California Edison (SCE). This decision is founded upon the Commission's interpretation and application of a new statute governing large utility mergers.

In the forging of this Order, the Commission was confronted with two major challenges. The first dealt with an assessment of the evidence contained in the record, as to whether it did satisfy statutory objectives which were clearly enunciated in Public Utilities Code Section 854. The second challenge, however, was more difficult. The Commission was obligated to give meaning to provisions of the statute which were indeed unclear, and then evaluate the evidence in light of such interpretations.

In adopting the 1989 amendments to Public Utilities Code Section 854, the Legislature probably intended to provide the Commission with standardized criteria to apply in cases of large utility mergers. To be sure, the statute thus provided useful guidelines. But in doing so, it denied the Commission much of the flexibility it had previously utilized in such applications. This inflexible approach, together with the ambiguous provisions of the statute, lead me to hope that this Commission will recommend, and the Legislature will seek to accomplish, suitable reform to Section 854.

One immediate area of concern to this Commission is the design of the statute under Section 854(b)(1) and (2) which requires the applicant to prove both net benefits and the avoidance of adverse effects upon competition. This two-fold requirement could require the Commission to deny a merger which delivers large net benefits, but which cannot completely avoid adverse effects upon competition, however small. The requirement that both tests must be passed denies to the Commission the ability to accord different weights to the accumulated evidence in each area, and to balance the two against each other.

In addition, Section 854(b)(2) creates as the standard for approval of a merger the requirement to avoid adverse effects upon competition. If the Commission adopts mitigation measures, these measures cannot simply allay adverse effects but must avoid them altogether. This standard is strict, and seems to conflict with the meaning of the word "mitigate". According to Webster's Dictionary, "mitigate" means "to make or become milder, less severe, less rigorous, or less painful; to moderate." The statute rejects the notion that the anti-competitive effects of a merger could be softened or moderated, in favor of the more rigorous standard of total avoidance. A literal application of this provision could defeat virtually every proposed merger to be considered under the statute.

The avoidance requirement restricts the Commission's latitude to determine what best serves the public interest. If avoidance cannot be achieved, the Commission cannot approve a merger even when mitigation measures are available which, in the Commission's judgment, would soften adverse impacts to an acceptable level.

In deciding this case, the Commission faced uncertainty over the correct implementation of Section 854(d). The subsection suffers from a lack of precision in its meaning. The Legislature intended to place the burden of proof for a merger, through a preponderance of the evidence, upon the applicants and so provided in Section 854(e). Yet in Section 854(d), the statute allows the Commission to "consider reasonable options to the proposal recommended by other parties". This language raises the question of whether the Commission could approve a merger proposal put forth by an intervening party, even if the case-in-chief presented by the applicants did not meet the burden of proof required in Subsection 854(e).

Another area of interpretation of this statute which will remain to be tested in future merger cases is the selection of a proper standard to measure the "adverse" effects on competition. In the course of this case, two different attorneys general rendered their opinions on the term "adverse". Attorney General Van de Kamp adopted a strict interpretation that any adverse effect upon competition which could not be avoided, even in a market where commerce was limited, would require a denial of the merger (a "per se" test).

Attorney General Lungren disagreed, preferring that adverse impacts on any given market should be examined in the context of all the positive and negative effects of the merger on all affected markets. Only after such a broad examination resulted in a finding of net adverse effects would the Commission then seek to avoid (by mitigation) the negative effects. Under the Lungren approach, the statute would require a denial only if such net negative effects could not be avoided.

In the case before us, the Commission was not obligated to choose which interpretation should control the outcome. The application failed under both interpretations. However, the fact that two able attorneys general and their competent and highly trained staffs should differ on this issue is disturbing. The difference between the application of a narrow or broad standard could determine the outcome of future applications to merge with billions of dollars at stake for both ratepayers and shareholders. Public policy considerations demand that merging parties who plan to apply for approval from this Commission must know to which standard they will be held. In the interest of creating a consistent climate for businesses in California, the interpretation of any new statute should not be subject to such wide variations from one attorney general to the next.

Although the two opinions regarding "adverse" effects on competition do not alter the decision in this case, it is appropriate to provide guidance for future merger applicants as to which standard is preferred by this Commission. The Lungren approach supplies the Commission with more latitude to review the total competitive picture and to weigh the positive and negative aspects of a merger application against one another. This approach better preserves the Commission's ability to tailor a final judgment suitable to each case. If a more narrow test were to be applied, the Commission would be forced to reject mergers which do not comply with the specific language of the statute even when the Commission may feel the merger to be procompetitive on balance.

In the final analysis, the application of Section 854 leads to a general observation. Certainly it is entirely appropriate and useful for the Legislature to exercise its mandate by enacting laws to set forth policy criteria which the Commission must consider. However, the Legislature should also recognize the advantage of granting the CPUC adequate discretion in applying the criteria from case to case and year to year, without requiring periodic changes to the statutes as individual circumstances develop. In this era of changing telecommunication and energy markets, it is in everyone's best interest to foster a thoughtful, deliberative, and independent CPUC which should and will be guided by consistent principles, but which is able to react to new circumstances with a maximum of flexibility.

Norman D. Shumway

Norman D. Shumway, Commissioner

May 8, 1991
San Francisco, California