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Decision 92-07-080 July 22, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

In the Matter of the Application of Southern California Gas Company (U 904 G) for authority to increase rates charged for gas service based on test year 1990 and to include an attrition allowance for 1991 and 1992.	Application 88-12-047 (Filed December 27, 1988)
And Related Matter.	I.89-03-032 (Filed March 22, 1989)

(Appearances are listed in Appendix D.)

I N D E X

O P I N I O N

I. Summary

On October 7, 1987, Southern California Gas Company (SoCalGas) entered into a 20-year agreement with Maguire Thomas Partners (MTP) to lease space in a new downtown Los Angeles office building. This building, once known as Grand Place, is now named the Gas Company Tower.

In this proceeding, SoCalGas asks the Commission to find that the decision-making process SoCalGas used to select its new headquarters was reasonable. SoCalGas also asks the Commission to approve its proposed revenue requirement for 1991 and 1992. The revenue requirement is intended to reimburse SoCalGas for costs incurred in moving to the new headquarters, including lease payments, operation and maintenance expenses, and capital expenditures.

Based on a thorough review of the record and with due consideration to the evidence and arguments offered by the Division of Ratepayer Advocates (DRA) and SoCalGas, we find that SoCalGas has failed to prove with clear and convincing evidence that the decision-making process it used to select the Gas Company Tower was reasonable. We find that SoCalGas has failed to demonstrate the reasonableness of leasing 50,000 rentable square feet of vacant space for future expansion. We further find that SoCalGas has failed to demonstrate that it was cost-effective to relocate 350 employees from Rosemead/Flair Center to the Gas Company Tower.

SoCalGas requests a net increase in capital expenditures of $21,243,000. We find that SoCalGas has failed to prove the reasonableness of certain tenant improvement and furniture expenditures. We will authorize an increase in capital expenditures of $13,509,000.

SoCalGas has entered into a partnership agreement with the lessor and acquired a 15% equity interest in the Gas Company Tower. We authorize SoCalGas to transfer the equity interest to its shareholders. As consideration for transfer of this asset, we will flow through to the ratepayers the net savings from the equity interest which SoCalGas reasonably projected to receive from this equity interest.

As a result of the aforementioned adjustments, we authorize an increase in 1992 operating revenues of $6,025,000. In addition, SoCalGas is authorized to file an advice letter to recover 1991 expenditures booked into its new headquarters memorandum account, to the extent such expenses are consistent with the terms of this decision.

II. Procedural History

On July 28, 1987, SoCalGas filed Application (A.) 87-07-041 seeking the Commission's authorization to sell its Flower Street Headquarters. In Decision (D.) 87-09-076, issued September 27, 1987, the Commission granted SoCalGas authority to sell. The reasonableness of the sale, all ratemaking consequences flowing from such sale, leaseback, and associated activities, including gain from sale, were deferred to a Phase II proceeding of A.87-07-041 wherein SoCalGas would bear the risk of demonstrating the cost-effectiveness of any sale and leaseback, as well as the reasonableness of leasing a new headquarters facility.

On October 30, 1987, the utility petitioned to modify Interim D.87-09-076, asking to defer review of the cost-effectiveness of the new headquarters to a future rate proceeding wherein SoCalGas would seek to recover in rates its costs associated with the new headquarters. SoCalGas stated that it would be difficult to estimate those costs for ratemaking purposes until it got closer in time to actually incurring them.

By D.88-03-075, issued March 23, 1988, the Commission modified Ordering Paragraph 4 of Interim D.87-09-076 to read as follows:

> "SoCalGas will bear the risk of demonstrating cost-effectiveness of any sale and lease-back in the Phase II Application. SoCalGas must justify in a future general rate case proceeding the cost of its new headquarters facility before the Commission will allow the costs for this facility to be recovered through rates." (D.88-03-075, p. 6.)

Issues relating to SoCalGas' sale of the Flower Street headquarters were resolved in D.90-04-028, as modified by D.90-11-031.

In late 1988, SoCalGas filed its test year 1990 general rate application (A.88-12-047). This application included a request by SoCalGas to recover all costs relating to its planned move to the new headquarters. On April 24, 1989, the Administrative Law Judge (ALJ) issued a ruling which deferred this request to a separate phase of the general rate case.

Fourteen days of hearings were held between July 11, 1990 and March 19, 1991. SoCalGas and DRA were the only active parties in this phase of the proceeding.

III. Background

SoCalGas' principal place of business until 1991 was three interconnected office structures and a parking and vehicle service facility, situated on an approximately 161,000 square foot parcel of land within the block bounded by Flower, Hope, 8th, and 9th Streets in downtown Los Angeles.

During 1985 and early 1986, SoCalGas and its parent company, Pacific Enterprises (PE), actively considered the potential redevelopment of the Flower Street site. In November 1985, the Cushman Realty Corporation (Cushman) was retained by Pacific Center Downtown Inc., a subsidiary of PE, to explore alternative occupancy strategies and to evaluate the development potential on the Flower Street site.

Early in 1986, the firm of Becket and Associates (Becket) examined alternate strategies for retaining all or part of the existing structures at Flower Street in conjunction with a larger feasibility study for possible renovation or redevelopment. Becket concluded that it would not be feasible either technically or economically to bring the existing buildings up to the standards of current building codes, and recommended that the buildings be completely removed.

On February 25, 1986, Cushman submitted a preliminary report which concluded that it might be better for SoCalGas and PE to have separate tenancies in different buildings rather than have a common tenancy in a Flower Street redevelopment or in any single off-site project.

In a July 1986 report, entitled "Downtown Los Angeles Real Estate Study," Cushman confirmed the earlier preliminary report. Cushman concluded that separate off-site locations were superior to redevelopment of Flower Street. According to Cushman, a 19% vacancy rate showed the softness of the then current downtown office market, and created an excellent opportunity for SoCalGas to negotiate favorable lease terms downtown. Cushman foresaw "a window of opportunity for tenants" in the 1989 to 1990 period, since significant amounts of new first class lease space would be added to that market.

Cushman concluded that the strategy resulting in the lowest occupancy costs and least risk involved selling the Flower Street property with a leaseback, and relocating to one of the new downtown projects. Such strategy would avoid a double move for SoCalGas, and if PE were to move out immediately it would also free up some space in the interim leaseback period to allow some consolidation of present off-location SoCalGas headquarters' personnel.

Even before Cushman's July report, SoCalGas and PE (the companies) had initiated discussions with potential developers in downtown Los Angeles. In mid-June, Richard Volpert[1] met with Rob Maguire, of MTP, to discuss Library Tower and Grand Place, which Maguire characterized as "two of the most exceptionally located properties in downtown Los Angeles...with substantial preleasing with other very prestigious tenants." (Exh. 424.) Grand Place, just one block from Library Square, was seen by Maguire as an ideal location for the Gas Company.

In mid-July the companies solicited proposals from third-party developers for new headquarters at Flower Street and at other downtown locations. Proposals for off-site downtown headquarters were received from five off-site development projects. The companies conducted extensive discussions with representatives of these downtown developments between August and November 1986.

By mid-October, the companies had narrowed their choice for headquarters to two off-site downtown projects owned by MTP. PE would occupy Library Tower, and SoCalGas would occupy Grand Place, located one block away. During October and November 1986, the companies engaged in intensive negotiations with MTP. Other downtown locations were considered and rejected.

On December 8, 1986, the companies entered into two letters of intent with MTP. One letter reflected the intent of SoCalGas to lease office space and acquire an equity interest in Grand Place Tower. The second letter reflected the intent of PE to lease space and acquire an equity interest in Library Square.

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1 Richard Volpert, a real estate attorney, is a partner in the Los Angeles office of Strodden, Arps, State, Meagher and Flom. Volpert's service were retained by Pacific lighting.

In anticipation of successfully negotiating two leases with MTP, the companies initiated a comprehensive effort in January 1987 to sell the Flower Street property. Cushman was retained by the companies to sell the property. In August 1987, the companies signed a letter of intent for the sale of the entire Flower Street block.

The companies and MTP concentrated first on finalizing the terms of the Library Square lease. On May 22, 1987, PE and MTP entered into a lease for Library Square and a partnership agreement.

With PE now a partner in Library Square, a lease finalized for PE occupancy at Library Square and a letter of intent signed to sell the Flower Street property, SoCalGas proceeded to finalize the terms of the Grand Place lease. On October 7, 1987, SoCalGas signed the lease and partnership agreement.[2] The lease was amended in August 1988, to increase the space to be leased by SoCalGas.

SoCalGas commenced occupancy of the Gas Company Tower in October 1991.

IV. Discussion

The acquisition of long-term office space for 1,500 to 2,000 employees is a costly, complex and challenging undertaking.

The cost of SoCalGas' new headquarters is significant. SoCalGas estimates the total expenditures for the Gas Company Tower lease (including rent, operation and maintenance, and other expenses) to total $654,026,000 over the 20-year life of the lease.

2 The terms of the lease are summarized in Appendix A to this decision. The partnership agreement is discussed in Section IV.C of this decision.

When adjusted for taxes, depreciation, franchise fees, uncollectibles, and cash flow/sales value of a 15% equity interest in the building, SoCalGas estimates the net expenditure to total $531,204,000.

The transaction is complex. In selecting a building and negotiating a lease or purchase, many different factors must be considered, evaluated and balanced. The factors which should be considered by a prudent utility planning a new headquarters would necessarily include:

- Location of the headquarters,
- Quality of the building,
- Quality of furnishings and capital improvements,
- Amount of space to be occupied,
- Whether to acquire lease or title to the premises, and
- Operation and maintenance costs.

Because of the cost and complexity of the transaction, the task of negotiating acquisition of a new headquarters is a challenging undertaking. To accomplish the task at the lowest reasonable cost consistent with good utility practices, a prudent utility would want to use experienced negotiators who can provide independent and objective judgment and advice on these complex matters.

The question before the Commission is whether SoCalGas has demonstrated by clear and convincing evidence the reasonableness of all expenses associated with the lease and occupancy of its new headquarters in downtown Los Angeles. In many respects, our review is as complex and challenging as the transaction which we are called upon to review. Our job is made even more difficult if the applicant has structured the transaction in a manner which is intended to avoid or impair our review.

According to a SoCalGas memorandum, the extent of regulatory scrutiny was a significant consideration in SoCalGas' search for a new headquarters.[3] SoCalGas sought an arrangement which would "complicate" our scrutiny,[4] "minimize" our review,[5] and "maximize and protect shareholder return from PUC interference and second-guessing."[6]

Notwithstanding SoCalGas' misguided efforts to minimize our "interference," this Commission has an obligation to carefully review those costs which SoCalGas seeks to recover in rates. A utility's effort to complicate our review will be to no avail because the burden rests heavily upon a utility to prove with clear and convincing evidence that it is entitled to the requested rate

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3 Exhibit 459: September 5, 1986 memo from R. L. Ballew to Fred John.

4 "The California PUC will be looking for preferential treatment for PLC by virtue of the SoCalGas tenancy. While we have not been asked to review the companion transaction with PLC and the Library Tower property, we believe the deal is sufficiently dissimilar so as to complicate direct comparison. For example, SoCalGas has no equity contribution, PLC has an equity contribution of perhaps $25 million. SoCalGas' structure is a lease with an equity-kicker, PLC is a 'straight partnership.' SoCalGas has rents lower than current market. PLC has market rent levels. SoCalGas has a 25 percent equity-kicker, PLC has a 50 percent partnership interest. All these things make direct comparison of these related deals by the California PUC more difficult." (Exh. 460, pp. 1-2.)

5 "The Maguire/Thomas proposal has an advantage from a highsight review standpoint. PacBell acted essentially as a general contractor in the construction of their San Ramon headquarters complex. As we have previously summarized for executive management, the Public Staff Division (PSD) (DRA's predecessor) is conducting a review equivalent to a reasonableness review on construction of a large electric generating plant. Utilization of a major developer, such as a Maguire/Thomas, with heavy lease characteristics combine with an equity-kicker would seem to minimize this hindsight regulatory review." (Exh. 459.)

6 Exh. 461: Outline of meeting with L. A. Levifin, 10-16-86.

relief and not upon the Commission, its staff, or any interested party to prove the contrary. (D.90-09-088, at p. 16.)

The principle that the burden of proof rests heavily with the utility is one of six principles summarized in D.90-09-088 which have traditionally defined the standard of review in reasonableness proceedings. Both DRA and SoCalGas express general agreement with these principles. We find these principles to be applicable to our review of the reasonableness of the costs of SoCalGas' new headquarters facility. The other five principles are:

> "1. The act of the utility should comport with what a reasonable manager of sufficient education, training, experience, and skills using the tools and knowledge at his disposal would do when faced with a need to make a decision and act;
>
> "2. The Commission, as the agency charged with oversight and economic regulation of the monopoly utilities, has a legitimate concern not only with the outcomes of the utilities' decisions, but also the process employed to arrive at a particular decision;
>
> "3. The reasonable and prudent act is not limited to the optimum act, but includes a spectrum of possible acts consistent with the utility system need, the interest of the ratepayers, and the requirements of governmental agencies of competent jurisdiction;
>
> "4. The action taken should logically be expected, at the time the decision is made, to accomplish the desired result at the lowest reasonable cost consistent with good utility practices.
>
> "5. The greater the level of money, risk, and uncertainty involved in a decision, the greater the care the utility must take in reaching that decision."

When we apply these six principles to the facts before us, we find that SoCalGas has not met its burden of proving by clear and convincing evidence that it selected a new headquarters at the lowest reasonable cost. Given the significant cost of a 20-year lease of more than 500,000 square feet of office space, we find serious flaws in the process by which SoCalGas arrived at its decision.

Of the various factors which have the greatest influence on the cost of a new headquarters, DRA's testimony focuses on the location and quality of the building selected by SoCalGas. DRA argues vigorously that SoCalGas should have selected a less luxurious, less prestigious and less costly facility. In the following sections of this decision, we will discuss the alternative quality and locations of facilities available to SoCalGas. We will conclude that less costly alternatives were available which would have reasonably met SoCalGas' needs for a new headquarters.

DRA's principal recommendation to the Commission is that the authorized expense for the Gas Company Tower lease should not exceed the lease costs which DRA has calculated for a potential headquarters in West Covina. While DRA's proposal is, in concept, a reasonable yeardstick for measuring the reasonableness of Gas Company Tower expenses, we don't believe it is the best approach to determining the revenue requirement. Instead, we will make specific adjustments to Southern SoCalGas' revenue request to account for excessive space and excessive capital improvements. We will also adjust the revenue requirement to fairly compensate ratepayers for the transfer to shareholders of SoCalGas' equity interest in the building. When these adjustments are made, we believe that the actual cost to ratepayers, over the live of the Gas Company Tower lease, will not exceed the cost of those less costly alternatives which SoCalGas failed to pursue.

A. Quality of The Building

In order to determine the reasonableness of a lease, we must know both the price to be paid and the size and quality of the space to be leased. SoCalGas' direct testimony describes the price to be paid and the amount of space to be leased. However, in Exhibit 35 (Revised), the prepared Direct Testimony of L.K. Harrington, there is scant description of the Gas Company Tower building. The Gas Company Tower is described as a new office tower of about approximately 1,250,000 rentable square feet. Apart from this, SoCalGas offered no description of the type or quality of building to be constructed. Exhibit 275, the Final Executive Report prepared for SoCalGas management prior to execution of the lease, is equally vague in describing the new headquarters.

Within the Los Angeles commercial real estate market, there is a wide range in the quality of office buildings, and this quality can have a significant effect on the cost of a lease. SoCalGas real estate consultant, John Cushman, categorized office buildings in two groups. The higher quality was "institutional grade," the lower group was "investor grade." Either group, institutional or investor grade, is suitable to meet SoCalGas' need for a new headquarters. Cushman further divided each group into three levels. The highest quality category of building is distinguished by the treatments on the architectural features (high ceilings, special finishes, more expensive materials, a larger lobby), lower floor to glass area ratios, and quality and efficiency of mechanical features.

Cushman classified both the Gas Company Tower and Library Square as top level, institutional buildings. The lease itself requires that the building be constructed to the standard of a first class, high-rise, institutional headquarters grade office building located in the Central District of downtown Los Angeles. The lease cites Crocker Center, the Security Pacific Headquarters and California Plaza as examples of the standards to which the Gas Company Tower would be constructed.

Library Square, to be occupied by PE, is variously described by SoCalGas as "the premier building in Los Angeles," "what could be the most prestigious building on the West Coast" and "probably the most expensive space" downtown. As DRA correctly notes, the Gas Company Tower was built one-block away from Library Square by the same builder, and to a comparable standard of quality.

"If, in fact, the gas company were housed in an institutional quality building, paying institutional-quality rents," Harrington testified, "I think that would raise a lot of concern on the part of the Commission." (Tr. 54/5417.) However, Harrington contends there is no need for concern, because SoCalGas "is not paying institutional quality rents." Instead, he argues, SoCalGas was able to lease an institutional-quality building at "investor-grade" rents:

> "...I think what that represents is the fact that utility is going to get all the benefits of being housed in an institutional quality space....without having to pay for it."

We do not find Harrington's testimony to be persuasive. Because SoCalGas is a large, long-term tenant, it may have been able to negotiate rents slightly lower than other, smaller tenants in the same building. However, this leverage would have been the same if applied to lesser grade, less expensive buildings. [7]

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7 Cushman was asked, when he testified about the favorable rents for the Gas Company Tower:

> "Q: And is that because of the leverage SoCalGas had in negotiating?

(Footnote continues on next page)

The fact that SoCalGas had leverage as a large tenant was not a license to shop for the highest grade or most expensive office space. This leverage should have been used to obtain the benefits of an investor-grade building at less than investor-grade rents, thus realizing even greater savings to ratepayers.[8]

In summary, the extremely high quality of the Gas Company Tower does cause us considerable concern. We find the absence of a clear and complete description of the quality of the building to be a serious omission in SoCalGas' direct testimony. SoCalGas has failed to demonstrate by clear and convincing evidence that it gave serious consideration to occupying anything other than the highest grade of office space.

B. <u>Location of The Headquarters</u>

The Gas Company Tower is located at 5th and Grand, in the Central District of downtown Los Angeles.

(Footnote continued from previous page)

A: Yes.

Q: But why wouldn't that leverage be the same in a first-class, low-end institutional building...?

A: It might - - it would be the same." (Tr. 46/4268.)

8 We note Harrington's argument that no investor-grade buildings in the suburbs were big enough to offer the leverage which SoCalGas attained at the Gas Company Tower. (Tr. 54/5419.) The argument is simply false. Several suburban sites, such as Potrero Grande in Monterey Park, were clearly large enough to allow a leveraged lease. It appears however that SoCalGas never gave serious consideration to locating to anything other than an institutional quality building. For example, Cushman commented that SoCalGas would be "pioneering" Monterey Park if it were to relocate to the Potrero Grande site "in institutional quality office space." (Exh. 289.)

Is this the most reasonable, least expensive location for a new headquarters?

Both SoCalGas and DRA agree that SoCalGas had a duty to undertake a thorough investigation and evaluation of all reasonable alternatives, before selecting a particular location for its new headquarters. However, DRA and SoCalGas differ sharply regarding the adequacy of the investigation of alternatives performed by SoCalGas.

SoCalGas characterizes its investigation of alternatives as follows:

> "SoCalGas investigated the costs of refurbishing, building on its own land, joint ventures, and long-term leases, both downtown and in the suburbs. Because of the risks involved in speculative real estate transactions and the problems with a suburban location, SoCalGas decided on a long-term lease arrangement downtown. Many lease arrangements were considered. Hundred of computer runs were done. Many of these potential alternatives were for buildings that were of a lower quality than the Gas Company Tower. SoCalGas seriously considered them. After an exhaustive search and detailed comparative analysis, the Gas Company Tower proved to be the best alternative." (SoCalGas Reply Brief, p. 136.)

DRA believes that SoCalGas' review of options other than Grand Place Tower was confused, superficial, and incomplete. DRA believes that if SoCalGas had more thoroughly evaluated other alternatives, particularly suburban sites, it could have obtained facilities which would have met its headquarters needs at a cost significantly less than the Grand Place lease.

Four general options for locating a new headquarters have been considered in this proceeding:

1. <u>Refurbishment of the Flower Street Buildings</u>

In 1986 SoCalGas carefully evaluated the potential for refurbishing the Flower Street buildings. A feasibility study prepared by the architectural firm of Beckett and Associates concluded that it would not be technically nor economically feasible to bring the Flower Street buildings up to current building codes. Beckett recommended that the buildings be removed. In 1987 and 1988 SoCalGas prepared two additional studies which compared the cost of refurbishing or renovating the Flower Street buildings with the cost of moving to the Gas Company Tower. The 1987 study, which was prepared just prior to the execution of the Gas Company Tower lease, demonstrated that the cost of renovation would be approximately $65 million higher than leasing comparable space in the Gas Company Tower. The 1988 study, while confirming these conclusions, was prepared after the lease was executed.

In D.90-11-031, we found that "the evidence suggests that renovation of the existing buildings would not have been a prudent decision for the gas company." (D.90-11-031, Rev. pp. 18-19.) As SoCalGas notes, the reasonableness of its decision to vacate, rather than refurbish, the Flower Street buildings has already been resolved by D.90-11-031.

2. <u>Redevelopment of the Flower Street Site</u>

SoCalGas also thoroughly studied the potential of building a new headquarters on the Flower Street site. The proposed project, which would have combined a headquarters with other commercial office space, was known as Pacific Center Downtown. The project was given very serious consideration in 1985 and early 1986. However, in a series of reports in the first half of 1986 John Cushman recommended strongly against development of the site. Instead, Cushman recommended relocation of the headquarters to another downtown location as the least expensive alternative.

In mid-1986 the companies decided that Cushman's recommendations should be tested in the marketplace by soliciting actual proposals from developers, both for development of Flower Street and for development at other downtown locations.

The companies solicited proposals for development of the Flower Street property from seven development companies. Proposals for Flower Street projects were received from three developers. Each of the developers proposed a multi-stage development plan in which the companies would contribute the land to the joint venture. Phase I would be an office tower for SoCalGas' headquarters. Phase II would be a second office tower for PE and a mix of retail or hotel facilities. Phase III would be a general office building.

The companies rejected these proposals because none of the developers were willing to commit to the timing of Phase II and Phase III. As we noted in D.90-11-031, "complete redevelopment of a large scale, mixed use project in a speculative market characterized by uncertainty of demand and abundance of competitive developments involved far greater investment and risks than the gas company wanted to undertake." (D.90-11-031, Rev. p. 19.)

While not all of the reasons SoCalGas cites for rejection of the redevelopment alternative are valid,[9] we do accept the ultimate conclusion. In summary, we find that the companies thoroughly reviewed the alternative of redeveloping the Flower Street site, and prudently rejected this alternative.

3. Other Downtown Sites

At the same time that the companies solicited proposals for redevelopment of Flower Street, the companies also solicited proposals from developers at other locations in downtown Los Angeles. Five proposals were submitted: Grand Place, Library

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9 SoCalGas states that Phase I of redevelopment would have met its headquarters needs, but the companies were unwilling to proceed with Phase I alone because it would not yield to PE significant benefits of equity participation. We agree with DRA that the linkage between SoCalGas' needs for a new headquarters and PE's financial ambitions was improper.

Tower, Citicorp Plaza - Tower II, California Plaza - Tower II, and the Manulife Building.[10]

DRA contends that SoCalGas was "transfixed" on the proposals from MTP: Grand Place and Library Tower. However, the record demonstrates that SoCalGas gave serious, thorough consideration to three other downtown proposals. The companies conducted extensive discussions with each of these developers, and actively analyzed and compared the costs and benefits of each proposal. At various times during the course of these discussions, different projects appeared the most promising. At first, Citicorp appeared the most promising to Cushman. (Tr. 46/4295-96.) Later, the California Plaza II project appeared preferable to Harrington. Finally, by November 1986, the MTP package of Library Tower and Grand Place emerged as the front-runner.

The process which SoCalGas used to evaluate alternative downtown proposals generally reflects the type of analysis we expect of a prudent utility. Specific proposals were solicited. The proposals were refined and improved through serious discussions and negotiations with each project's proponent. Comparative analyses were prepared of each proposal. These analyses were thoroughly reviewed by utility management, before SoCalGas proceeded to sign a letter of intent with a specific lessor.

We find that SoCalGas gave thorough, timely, and objective consideration to four downtown proposals. Unfortunately, all five alternatives were high or mid-level institutional quality buildings. SoCalGas did not solicit or receive proposals for lesser quality buildings.

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10 The three alternatives considered by SoCalGas were Citicorp Plaza - Tower II, California Plaza - Tower II, and the Manulife Building. SoCalGas did not give serious consideration to Library Tower, presumably because the companies favored split occupancy and PE desired to occupy this building.

4. Suburban Alternatives

SoCalGas states that over a period of several years "it considered a wide range of alternatives. Each of these were evaluated and analyzed from every conceivable perspective." (SoCalGas Op. Br., p. 1.) SoCalGas knew that it had the responsibility to its ratepayers to evaluate all reasonable alternatives, including suburban sites, in a complete and thorough manner. SoCalGas believes that two studies of suburban alternatives by Cushman satisfy this responsibility.

DRA contends that SoCalGas failed to give any real consideration to suburban headquarters options. DRA believes that SoCalGas' consideration of headquarters options other than the Gas Company Tower was confused, superficial, and incomplete. According to DRA, Cushman's suburban studies were ploys for regulatory purposes, rather than a serious search for a suburban site.

We find that SoCalGas' evaluation of suburban alternatives was not nearly as thorough or timely as its analysis of downtown locations. Throughout 1986 SoCalGas focused its search for a new headquarters in the downtown Los Angeles area. During 1986 SoCalGas did not prepare a list of potential suburban sites that would meet its headquarters needs, as it did for downtown sites. SoCalGas did not solicit proposals from developers of suburban projects, as it did for downtown projects. SoCalGas did not seek to discuss, refine or negotiate the terms of occupancy with suburban developers, as it did with downtown developers.

In July 1986, Cushman Realty Corporation completed a survey of potential headquarters sites for the Carnation Corporation. The survey listed 52 locations. For each site, the Carnation study described summarized such factors as location, project size, available square footage and, for some sites, the estimated rental rates.

SoCalGas argues that the Carnation study was an "exhaustive study" (SoCalGas Op. Br., p. 5) which "produced exactly the kind of extensive knowledge of the suburban real estate market that SoCal Gas needed." (SoCalGas Op. Br., p. 90.) The record does not support SoCalGas' characterization of this study. The Carnation study was neither exhaustive nor extensive, and SoCalGas' consideration of this information was cursory.

The Carnation study was a preliminary survey of potential headquarters sites within a geographic area defined by the Carnation Company. The Carnation study provided no estimate of rental rates for many of the sites surveyed. Moreover, the Carnation study surveyed sites primarily in central, western, and southern Los Angeles County. The study did not survey any sites east of Alhambra. The Carnation study is, at best, illustrative of the type of survey that SoCalGas should have performed of suburban alternatives as the first prudent step in its search for a new headquarters.

Even if the Carnation study had contained information relevant to SoCalGas' headquarters search, there is no evidence that this information was effectively communicated to SoCalGas. Cushman only showed a copy of the Carnation study to Harrington in Cushman's office. John Cushman, President of Cushman Realty Corporation, considered the study to be proprietary and only allowed Harrington to view the document.

Although John Cushman testified that he had extensive discussions with SoCalGas throughout 1986 regarding suburban sites, the only written record of such discussions is Cushman's letter of October 23, 1986 to Harrington, summarizing a meeting between Cushman and Harrington in late September. The letter asserts that Cushman's recent experience with a client, presumably Carnation, provided Cushman with a "comprehensive knowledge of the marketplace and, consequently, a thorough understanding of the options that exist" for SoCalGas. Cushman concluded that there was no building in the suburbs "available in 1986" with sufficient space to handle the interim and expansion requirements" of SoCalGas. However, SoCalGas' search for a new headquarters downtown was not limited to buildings available in 1986. Within the downtown area, SoCalGas was searching for buildings that might become available between 1987 and 1994. SoCalGas considered using Flower Street to meet its interim requirements. Just as SoCalGas' search for a new headquarters downtown encompassed both available buildings and available parcels, we find it imprudent for SoCalGas' evaluation of suburban alternatives in 1986 to be limited to consideration of buildings available in 1986.

Another problem with Cushman's "available in 1986" rationale is that the availability of any project is strongly influenced by the developer's ability to secure a long-term base tenant. Grand Place, for example, was shown in the Carnation report as having an "undetermined" completion date. Yet, the availability of Grand Place, once projected for 1994, was rapidly accelerated when SoCalGas expressed interest in this project.

SoCalGas did not solicit proposals from suburban developers or lessors. Instead, based on Cushman's memo of October 23, SoCalGas assumed that "studies demonstrating the preferability of this transaction [Grand Place] over other downtown and suburban sites are available and suitable to carry this burden." (Exh. 460, p. 2.)

Sometime after SoCalGas received Cushman's letter of October 23, it asked Cushman to perform a further study. SoCalGas offers confusing and contradictory evidence regarding when Cushman was asked to perform the study. Harrington's direct testimony does not indicate when the request was made. In response to a question from the ALJ, Harrington testified that shortly after receiving Cushman's letter of October 23 regarding the Carnation report, he asked Cushman to perform a similar study for SoCalGas that looked beyond the Carnation areas. Cushman testified that the request was made sometime in the fourth quarter of 1986; he could not recall more precisely. However, in Exh. 290, Harrington testified:

> "In early 1987, Lee Harrington asked Cushman Realty to test its hypothesis that downtown Los Angeles offered superior headquarters alternatives for SoCalGas by performing a specific study of suburban relocation alternatives. This assignment resulted in the Cushman Realty study dated May 15, 1987." (Exh. 290, p. 3.)

In a letter dated January 6, 1987, Albert Hunt, Vice President of Pacific Lighting, terminated Cushman's consulting services for Pacific Center Downtown effective December 31, 1986. The letter recites that the companies would look forward to working toward in finalizing the leases with MTP for Library Tower and Grand Place. The letter also recites that the companies would be working with Cushman on the potential sale of the Flower Street properties. The letter does not mention any outstanding request for a study of suburban alternatives. This omission suggests that the request for a suburban study was made after January 6, 1987.[11]

In Exh. 290, Harrington states that Cushman was asked to perform the study to test Cushman's "hypothesis" that downtown alternatives were superior. When the assignment is phrased in this way, it suggests that Cushman was simply asked to look for evidence that would "test" his predetermined position that suburban sites were inferior. This view of the purpose of the report is corroborated by Exh. 482, a memo from Dale Schlather to John Cushman dated May 4, 1987. This memo forwarded a revised analysis of suburban relocation alternatives to Cushman. "The conclusion of this analysis," Schlather reported, "supports your hypothesis that

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11 Cushman's suburban study was not a service performed under the consulting agreement. Instead, Cushman prepared the study in his capacity as the leasing agent for MTP.

the downtown Grand Place alternative is economically superior to suburban alternatives."

The suburban alternatives report was requested, therefore, not to actually search for suburban sites, but to show that suburban sites would be inferior to the Gas Company Tower lease. "[I]n the spring [of 1987]," Harrington testified, 'I felt that we were getting close enough to deciding whether to move forward with Maguire Thomas as we negotiated through the lease that I asked him [Cushman] to finalize that [the Suburban report] - I think I asked him in early May to finalize it - which he did -- actually late April or early May -- so that I could have that information and then to compare with what we were doing with Grand Place." (Tr. 54/5378-79.)

While Cushman certainly had considerable knowledge of the Los Angeles real estate market, he clearly was not motivated or inclined in 1987 to search aggressively for a more cost-effective alternative to the MTP leases. By January of 1987, Cushman had a significant personal financial interest in the success of the MTP leases and a strong fiduciary obligation to MTP not to disrupt the transaction.[12] Cushman's objectivity was further undermined by

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12 As of January 1987, Cushman and the companies anticipated negotiating a successful lease/equity arrangement with MTP at Library Tower and Grand Place. Upon successful execution of these leases, Cushman expected to earn substantial commissions to be paid by MTP. In addition to these commissions, MTP also agreed to pay Cushman substantial sums to discharge financial obligations of MTP to Cushman which resulted from Cushman's sale of his interest in the Engstrom Building, later to be known as Library Tower, to MTP in 1982. These amounts were contingent upon initial funding of the construction loan for the Engstrom Building. This loan was secured only after the lease between MTP and PE was consummated. In addition, Cushman was retained as the listing agent to sell the Flower Street properties. Upon successful sale of the Flower Street property, Cushman expected to earn another significant commission.

the fact that he had clearly expressed his bias, he would call it a hypothesis, that the suburbs were not a viable choice for SoCalGas.

SoCalGas argues that Cushman had no financial incentive to move SoCalGas into the Gas Company Tower because "he would have received a commission from whatever building SoCalGas moved into." This argument is simply wrong. Cushman would be entitled to a commission, to be paid by the seller or lessor, only if he was the procuring cause of the lease. There are many circumstances under which Cushman might not have earned a commission. If another broker was the procuring cause of the lease, if a lessor was represented by an exclusive leasing agent other than Cushman, if SoCalGas had elected to build its own building rather than lease, Cushman would have earned little, if any, commission.

By the time the May 1987 suburban report was presented to SoCalGas, it was too late for SoCalGas to give serious consideration to the information it contained. When SoCalGas signed the letter of intent with MTP in December 1986, SoCalGas agreed that until the letter is terminated, SoCalGas would not "negotiate with the owners or developers of any other office building in the Los Angeles metropolitan area" for the long-term office space requirements for its principal offices. As a result of this agreement, SoCalGas was barred, between December 8, 1986 and when it signed the lease in November 1987, from negotiating with any other owner or developer.

As SoCalGas had learned from its negotiations with MTP and other downtown developers prior to December 8, the true nature and cost of a prospective project can only be understood through serious discussions with the developer. Because SoCalGas did not commission a comprehensive survey of suburban sites before agreeing with MTP not to negotiate with other developers, it imprudently denied itself the opportunity to seriously explore the opportunities presented by suburban sites which the survey identified.

Cushman testified that the letter of intent suspended negotiations with other developers for only one month. Similarly, SoCalGas argues that it agreed not to negotiate with other developers for a short period of time. (SoCalGas Op. Br. p. 5.) These statements misrepresent the letter of intent. Under the terms of the agreement, SoCalGas agreed to suspend negotiations "until the letter was terminated." The letter of intent had a termination provision. This provision allowed either party to terminate the letter of intent upon five days' written notice. However, there is no evidence that either party invoked its right to terminate. Therefore, the prohibition on negotiation with other developers remained in effect until the lease was signed in 1987, and not just a "short period of time."

SoCalGas also implies in its reply brief that it did not consider the prohibition on negotiations with others to be binding. SoCalGas notes correctly that the letter of intent was not a binding commitment to lease space. However, the letter of intent was a binding commitment not to negotiate with others. As the letter of intent clearly states:

> "Except for the foregoing obligation with respect to negotiations with third parties, neither of us intend, by the execution of this letter, to be legally bound to the other or to create legal obligations between us." (Exh. 421.)

Finally, SoCalGas argues that the letter of intent did not preclude serious consideration of other alternatives, if a more attractive option were identified. This argument misses the point. The prohibition on third party negotiations significantly constrained SoCalGas' ability to identify better alternatives by restricting discussions with other developers. Even if an option was identified, the letter of intent discouraged the pursuit of the option by imposing a severe sanction: <u>Before</u> SoCalGas could negotiate with an alternative developer, it was required to terminate the agreement with MTP. By mid-May of 1987, when Cushman finally presented its suburban survey, PE was only a few days away from signing the lease for Library Square. Although the May 1987 survey had identified several promising options, SoCalGas did not terminate the agreement with MTP to give its staff time to study these options.

In summary, we do not consider the May 1987 Report to be a thorough, timely or objective evaluation of alternative suburban sites. Rather than an objective analysis by an impartial expert, it was a report prepared by the agent of the lessor to support his hypothesis that the lease and sales transactions, for which he would receive substantial commissions, were superior to other options that might have been pursued. The report was presented to SoCalGas only when it was ready to finalize the lease with MTP, and only after SoCalGas had legally obligated itself not to negotiate with any other developer. We find that SoCalGas was imprudent in agreeing not to negotiate with third parties during the nine-month period following execution of the letter of intent.
SoCalGas was particularly imprudent in agreeing not to negotiate with other parties before it even conducted a survey of suburban alternatives which could meet its headquarters needs.

Based on MTP's 1989 pro forma financial statements, SoCalGas estimated the net present value of the Gas Company Tower lease to be $242,752,000. This value assumes approximately 550,000 rentable square feet. It further assumes that $34,378,000 will be realized from SoCalGas' 15% equity interest in the Gas Company Tower. Thus, the net present value of Gas Company Tower lease was estimated to range between $242,752,000 (if SoCalGas' equity estimates are realized) and $278,000,000 (if the benefits of equity participation are not realized).

How do those estimates compare to suburban alternatives which were known to SoCalGas? DRA contends that suburban alternatives were clearly less costly than the Gas Company Tower.

SoCalGas, on the other hand, contends that the Gas Company Tower lease was the least costly alternative.

Cushman's May 1987 report contained an economic evaluation of five suburban sites. According to this analysis, the net present value of the 20-year cost of each of the five suburban alternatives would exceed the cost of the Gas Company Tower.

SoCalGas received Cushman's report on May 15, 1987. SoCalGas states that it signed an extension of the letter of intent on June 5, 1987 and went forward with negotiations for a lease with MTP "based on the thorough and complete analysis that both Cushman and SoCalGas performed." However, as of June 5, 1987, when SoCalGas signed the extension of the letter of intent (reaffirming its agreement not to negotiate with other developers), SoCalGas staff had not completed its evaluation of the Cushman Report. On June 30, 1987, W.S. Marshall reported to Harrington that the real estate staff had reviewed the Cushman report and had concluded that Cushman's assumptions of $190 per foot was too high for a low rise development such as Cerritos Town Center and Potrero Grande. To obtain the "institutional quality comparable to that under consideration downtown," they estimated a cost in the range of $160-$170 per foot. Using $165 per foot, they recalculated the data provided in the Cushman study. These recalculations result in projected net rents for Cerritos and Potrero Grande which are approximately 5% lower than Grand Place during the first ten years of the lease. We find that SoCalGas had information before it in June 1987 which showed at least two suburban sites with projected net rents which could be expected to be lower than the Gas Company Tower lease. These net rents were based on the assumption that the same top-level institutional quality building would be built in the suburbs as was planned for the Gas Company Tower. If SoCalGas had considered a lesser quality building, the savings offered by these two suburban sites would have been even greater.[13]

Another site included in Cushman's May 1987 survey was a 21-acre parcel in West Covina to be developed into 580,000 square feet of office space. The site was described by Cushman as follows:

> "Potentially, a build-to-suit could be done on this site. Current zoning allows for a maximum of 660,000 square feet of office space. Amenities in the nearby area are excellent, as are both access and visibility from the San Bernardino (10) Freeway. There are 1,600 linear feet of frontage on Interstate 10.
>
> "This project is East of the geographical boundaries set by the Southern California Gas Company.
>
> "Access to downtown is a straight shot down the San Bernardino (10) Freeway, 20-30 minute drive." (Exh. 289.)

Cushman did not perform an economic analysis of this site. DRA commissioned a consultant, real estate analysts Panell Kerr Foster (PK&F), to perform an analysis of West Covina. Based on this analysis, DRA estimates the net present value of 20-year occupancy costs at West Covina to be $162,954,000. SoCalGas estimates the net present value of occupancy at West Covina to be $247,332,000. The differences between these two estimates arise in

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13 SoCalGas has not offered any plausible reason for its failure to actively pursue these two less costly alternatives. The primary rationale offered in SoCalGas' opening brief is that SoCalGas had negotiated a significant equity interest in the Gas Company Tower, and "because SoCalGas would have occupied virtually all of the building in any of the suburban locations, no equity participation could be anticipated in the suburbs." This explanation is incorrect. Cushman's May 1987 report assumed that SoCalGas would have a 50% equity interest in either the Cerritos Town Center or the Potrero Grande project.

five major areas. These differences are examined in further detail in Appendix B to this Decision. When all of these differences between DRA's and SoCalGas' assessments of West Covina costs are considered, we find the estimated net present value of the West Covina alternative to be approximately $230 million. This is approximately 5% less than SoCalGas' estimated cost of the Gas Company Tower. The West Covina alternative assumes a building of approximately 580,000 rentable square feet (about 5% larger than the space occupied by SoCalGas in the Gas Company Tower). The West Covina alternative also assumes a building of comparable quality to the Gas Company Tower. Thus, the actual cost of the West Covina alternative could be significantly lower than the Gas Company Tower if SoCalGas had negotiated to lease a smaller or less luxurious facility in West Covina.

We note SoCalGas' various non-quantifiable reasons for rejecting suburban sites, but we find none of these reasons to be persuasive. For example, SoCalGas argues that "The real estate risk of a large single use facility located in a distant suburb far outweighed in itself any perceived advantage." (Reply Brief, p. 97.) However, this perceived risk to SoCalGas would arise only if SoCalGas owned the building and if there was a reasonable probability that SoCalGas might exit the building within the next 20 years. These perceived risks are not applicable to the suburban lease options advanced by DRA. Nor has SoCalGas demonstrated the slightest likelihood that it would move in the near or intermediate term. California's regulated utilities, unlike many other corporations, have tended to be very stable tenants. If this were not so, it would be difficult for us to find it prudent for SoCalGas to have executed a 20-year lease at the Gas Company Tower.

In summary, the Gas Company Tower lease was superior to refurbishment or redevelopment of Flower Street, as well as three other downtown institutional quality buildings. On the other hand, there is substantial evidence in this record that a less expensive headquarters could reasonably have been constructed on at least three different suburban sites.

C. <u>SoCalGas' Space Requirements</u>

The lease executed by SoCalGas and MTP on October 7, 1987 (the "original lease") authorized SoCalGas to lease approximately 450,000 rentable square feet of space, consisting of floors 2 and 12 through 29.[14] The actual area of the 19 floors acquired pursuant to the original lease turned out to be 475,000 rentable square feet.

A study prepared by SoCalGas in May 1987 estimated SoCalGas' space needs to be approximately 475,756 rentable square feet. This amount of space was estimated to accommodate 1,976 workstations. These workstations would provide space for relocation of approximately 1,400 downtown employees[15] and 300 suburban employees,[16] 102 workstations for growth through 1996,[17]

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14 The square footage was described in the original lease in approximate terms because the building was only in the preliminary design stages when the lease was executed, and the actual area of each floor had not yet been determined. SoCalGas and MTP variously describe the area of the Gas Company Tower in terms of "rentable square feet" and "usable square feet." Usable square feet is approximately 94% of rentable square feet.

15 Because PE and SoCalGas shared crowded facilities at Flower Street, approximately 250 SoCalGas employees were located at another downtown office in Broadway Plaza. Between 1987 and 1991, SoCalGas gradually moved these employees from Broadway Plaza to Flower Street. The consolidation of SoCalGas' downtown employees was completed when PE vacated Flower Street and moved into Library Square.

16 SoCalGas planned to transfer approximately 25 employees from Sante Fe, 250 employees from Rosemead Springs and a few employees from various Division offices.

(Footnote continues on next page)

and 153 workstations for temporary employees, consultants and visitors. In addition to these 1,976 workstations, SoCalGas projected further expansion within the initial circulation space of 4-5 workstations per floor to meet any unanticipated growth requirements.

Following completion of the May 1987 space study, SoCalGas decided to move an additional 105 employees from Rosemead Springs to the new headquarters, requiring an additional 25,000 square feet of space. Thus, as of October 1987, when SoCalGas executed the original lease, SoCalGas estimated the need for approximately 500,000 rentable square feet.

The original lease provided SoCalGas with three options to modify its space requirements:

(1) An option, prior to initial occupancy, to increase or decrease the amount of space to be occupied by up to two floors (approximately 50,000 square feet). The option to increase space, to be exercised prior to December 31, 1988, applied to floors 10 and 11, and allowed SoCalGas the right to lease this space upon the same terms as the original lease.

(2) A continuing option after December 31, 1988, on a first refusal basis, to expand its occupancy into the 10th and 11th floors. This space would be leased upon the same terms as the original lease.

(3) An option, to be exercised at specific times during the lease, to expand into floors 3 through 9.

(Footnote continued from previous page)

17 The assumed rate of growth was approximately 1% per year. SoCalGas would later increase the assumed growth rate to 2% per year, requiring it to set aside approximately 50,000 rentable square feet for future expansion.

In August 1988, SoCalGas and MTP executed the first amendment to the the lease. In this amendment, SoCalGas exercised its option to lease floors 10 and 11. SoCalGas further added floor 9 to the initial premises. As a result, this amendment expanded the space to be leased by SoCalGas by three full floors, increasing total leased space from 475,000 rentable square feet to 552,877 rentable square feet. This expansion of the lease increased the number of planned workstations from 1,969 to 2,258.

In its prepared direct testimony, SoCalGas did not describe, much less justify, the basis for adding 75,000 rentable square feet to the initial lease. However, in response to questions from DRA and the ALJ, SoCalGas has offered two reasons to support its decision to increase the space to be initially occupied by approximately 75,000 square feet.

First, SoCalGas states that it wanted to provide space for future expansion needs. SoCalGas leased approximately 50,000 rentable square feet to provide space for an estimated 2% employee growth over five years (approximately 200 workstations). SoCalGas hoped that the extra 50,000 rentable square feet would allow it to operate for at least five years without requiring significant relocation of employees within the building.[18] As Harrington explained, SoCalGas wanted to house entire departments or functions on the same floor. According to Harrington, if SoCalGas did not provide vacant space for growth on each floor and if the department grows, SoCalGas would have to either place some department employees on a different floor, or "move that department in toto to

18 For purposes of justifying the added space, SoCalGas assumed that the added space would minimize the need for significant relocations for at least five years. For purposes of justifying the raised floor system, SoCalGas assumed that 20% of the employees would be relocated each year. If significant relocations will occur regardless of the need for expansion, occasional restacking of space would seem to be a comparatively minor inconvenience.

another floor and what's called restack your plan in order to continue to maintain adjacency." (Tr. 54/5406).

It is true that restacking <u>may</u> impose a cost.[19] Dividing a department among several floors <u>may</u> result in lower administrative efficiency.[20] The question is whether these costs outweigh the cost of leasing unused space. The cost of 50,000 rentable square feet of vacant space will be approximately $1,450,000 per year.[21]

SoCalGas has not presented evidence of the cost of restacking floors on an as-needed basis. Nor has SoCalGas offered

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19 SoCalGas has made a substantial investment in measures intended to minimize the costs of reconfiguring the space and relocating employees within the new building. The open office design, the modular furniture and the raised floor system are all designed to reduce the cost and inconvenience of reorganizations within the building. (Tr. 57/5777-5778.) The purpose of the raised floor system, for example, is to provide greater flexibility in floor usage, quicker office relocations, and the ability to make moves during office hours with minor disturbances, and easy connection of computer equipment. (Exh. 282, pp. 3-4.) Given the substantial investment made for the very purpose of minimizing the cost and inconvenience of relocating employees, we are not persuaded that restacking would impose any significant additional cost.

20 We find that it is desirable, but not strictly necessary, to maintain departments and working units on the same floor. While this is a worthy objective, an objective which this Commission has tried to meet within its own headquarters, it is not an objective to be attained without careful consideration of the costs. We could not in good conscience suggest to the taxpayers of California that thousands of dollars should be spent to lease vacant space, simply to avoid housing a department on more than one floor in the same building.

21 SoCalGas had a right of first refusal on two of the three floors added by the first amendment. In other words, these floors could have been by held MTP, without cost to SoCalGas, until SoCalGas actually needed the space or until another party offered to lease the space.

evidence of the cost of housing some departments on different floors. While Harrington testified that the consultants advised that it was more "cost-effective" to lease space for expansion than to add the space as it was needed, we have not been presented with any evidence that an actual study of cost-effectiveness was made by SoCalGas. In addition, SoCalGas has not explained why its estimate of expansion needs grew from 102 workstations in May 1987 to 200 workstations when it signed the first amendment. SoCalGas simply has not met its burden of proving that it is cost-effective to lease and hold vacant space for future expansion, rather than exercise its option to lease the space when it is actually needed.

A second reason cited by SoCalGas as a basis for adding three floors to the original lease relates to its decision to relocate 105 employees from Rosemead Springs/Flair Center to the Gas Company Tower.[22] Prior to executing the original lease SoCalGas had planned to move approximately 250 employees in the engineering department at Rosemead to the Gas Company Tower. It had planned to move the remaining employees (approximately 100) to some other location in Los Angeles. Sometime after execution of the original lease, SoCalGas decided to move all employees at Rosemead Springs to the Gas Company Tower. SoCalGas will require approximately 75,000 rentable square feet in the Gas Company Tower to house these employees.

When SoCalGas was faced with a choice of staying at Flower Street or moving to another location, it prepared a detailed "stay versus move" analysis. All relevant costs and benefits were

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22 SoCalGas' opening brief refers to these employees as the "Purchasing Group." (SoCalGas Op. Br., p. 143.) Harrington described these employees in relation to "information systems projects." (Tr. 57/5704.) It is not clear who exactly these employees are.

carefully weighed and evaluated, before SoCalGas decided to move its employees from Flower Street to the Gas Company Tower.

In contrast to the prudent evaluation of the "stay versus move" options for Flower Street, SoCalGas chose to vacate the Rosemead/Flair facilities and relocate these employees downtown, without performing a "stay versus move" analysis.[23] SoCalGas has failed to offer evidence in this proceeding that the benefits of relocating 350 employees from Rosemead to downtown outweigh the costs.

As Harrington testified,

> "The analysis as to whether to move from a particular facility had to do with, first and primarily, where that operation fit within the function and what the company's need was in terms of being a more efficient, more responsive, more effective organization." (Tr. 54/5408.)
>
> "Q. Did SoCalGas do any assessment of the cost and measure the cost against the benefits before making the determination to move these employees?
>
> A. Well, we knew what the cost was of the lease space at Rosemead, if that's what you're asking.
>
> But in the final analysis, it was the company's view that from a total organizational standpoint that that was overridden clearly by the needs of the

23 In July 20, 1987, SoCalGas prepared a memo on the productivity gains from headquarters consolidation. This analysis estimated direct cost savings of closing Rosemead Springs/Flair Center of $1,339,000. However, this analysis did not consider the overall cost-effectiveness of consolidation. It considered only the benefits and not the cost of consolidation. For example, it properly counted the reduced building operations and maintenance (O&M) at Rosemead as a "savings." However, it did not take into consideration the new, added cost of O&M in the building to which these employees would move.

> organization to function more efficiently in a competitive environment." (Tr. 54, p. 5409.)

The Commission recognizes that there may be benefits from consolidation of administrative functions in a single location, but we reject the proposition that consolidation should be achieved at any cost. Before SoCalGas may prudently conclude that the benefits of consolidation "override" the costs of relocation, it must first clearly determine the costs and benefits of the transaction. SoCalGas' simple assertion that consolidation was more important than the cost does not sustain its burden of proof that it was prudent to relocate these employees from Rosemead to the Gas Company Tower.

In summary, we conclude that SoCalGas has failed to demonstrate the reasonableness of leasing approximately 137,500 square feet in the new headquarters. This is the equivalent of five and 1/2 floors. The space obtained by SoCalGas in the original lease (approximately 475,000 rentable square feet or 1,976 workstations) was more than sufficient to accommodate relocation of all 1,612 downtown employees at the time of the move. In fact, since SoCalGas had the contractual right prior to initial occupancy to reduce its space requirements by up to two floors, SoCalGas could have exercised the option to drop this space and still have accommodated all downtown employes, with more than 100 spaces left for temporary employees, consultants, visitors and short-term growth. SoCalGas' continuing right of first refusal to add two additional floors gave it the flexibility to expand when additional space was actually needed.

We find that SoCalGas has not proven, by clear and convincing evidence, that it required a total of 552,877 rentable square feet at the time of initial occupancy.[24]

We will disallow all costs associated with occupancy of 50,000 rentable square feet for 1991 through 1993. We will disallow a portion of the costs associated with occupancy of 75,000 rentable square feet. The amount of the disallowance will be $3,726,250 in 1992 and 1993, prorated for the term of occupancy in 1991.[25]

SoCalGas' space requirements may be reviewed in the next general rate case for test year 1994, at which time SoCalGas will bear the burden of proving:

(1) The cost-effectiveness of relocating employees from suburban offices to the downtown headquarters,

(2) The incremental revenue requirement, if any, associated with a cost-effective move of employees from suburban offices, and

(3) Cost-effectiveness of leasing vacant space in the new headquarters.

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24 The actual area which SoCalGas has failed to show as prudent and reasonable is 125,000 rentable square feet (rsf), which consists of 50,000 rsf of vacant space and 75,500 rsf for relocation of employees from Rosemead/Flair center. 125,000 rsf is equivalent to 5 floors.

25 The disallowance is calculated by multiplying the estimated gross rent in 1992 ($29.81 per rsf) by 50,000 rsf. In addition, the difference between the costs of the Rosemead lease ($26.54) and the Gas Company Tower Lease ($29.81) is ($3.27), therefore we will disallow 75,000 rsf x $3.27 per rsf.

D. The Equity Interest

Concurrent with the execution of the Gas Company Tower lease, a limited partnership known as Maguire-Thomas Partners - 5th & Grand Ltd., was formed between Maguire Thomas Partners - Grand Place Tower Ltd. (general partner) and Southern California Gas Tower (limited partner). Southern California Gas Tower is a wholly owned subsidiary of SoCalGas.

The sole purpose of the partnership is to acquire and own the Gas Company Tower. Southern California Gas Tower obtained a 15% interest in the partnership, including income or losses from operations, gain or losses from a capital event, net operating cash flow, and net capital proceeds. We will refer to this partnership interest as SoCalGas' equity interest.

SoCalGas recognizes that this equity interest is not being acquired through an investment of shareholder funds. While Southern California Gas Tower will make a small capital contribution of $10,005 (an amount which SoCalGas seeks to recover from ratepayers), it is clear that the principal consideration for this equity interest is SoCalGas' concurrent agreement to execute a long-term lease to occupy approximately 45% of the building. These lease costs, to the extent they are prudently incurred, will be borne by ratepayers. Therefore, SoCalGas proposes to credit ratepayers with any net value of the equity interest.

We agree with SoCalGas that ratepayers are entitled to the benefit of the 15% equity interest in the Gas Company Tower. As we explained in D.90-04-028, as modified by D.90-11-031, the utility investor devotes capital, not specific property, to public use. The utility is guaranteed the opportunity to earn a fair return on the capital so invested. In the case before us, SoCalGas investors do not propose to make any capital contribution. Even if shareholders made the modest capital contribution of $10,005, it would be obviously inequitable for them to retain the equity interest because the value of this interest would far exceed a fair return on the intial investment. Therefore, SoCalGas investors have no basis in law or equity to claim the benefit of the 15% equity interest in the Gas Company Tower.

However, SoCalGas' offer to credit the value of equity interest to ratepayers has an important qualification. If SoCalGas is not allowed to flow through the "full cost" of occupancy, then SoCalGas believes that shareholders should receive the benefits of the equity interest.

We do not agree with SoCalGas' argument that shareholders should receive the equity interest if we deny any portion of SoCalGas' revenue request. We expressly disapprove any ratemaking proposal which makes the allocation of this property interest contingent upon our approval of all incurred costs, regardless of whether such costs were prudently incurred. If we were to award the benefits of the equity interest to shareholders merely because SoCalGas was denied recovery of occupancy costs which were imprudently incurred, then we would unfairly reward shareholders for the imprudence of SoCalGas officers.

For example, later in this decision, we discuss SoCalGas' request to recover $1,000,000 to purchase art for the new headquarters. Had SoCalGas not withdrawn the request for this expenditure, we would have denied it. We would have done so because the expenditure is imprudent. SoCalGas estimates the net present value of the 15% equity interest to be $34,378,000. The fact that we would find that ratepayers should not be charged for a $1,000,000 art collection is certainly not cause for transferring a $34,378,000 asset to shareholders.

The equity interest can be transferred to shareholders only if ratepayers are fairly compensated for the transfer. In light of SoCalGas' desire that shareholders hold the equity interest in Gas Company Tower if we deny a portion of its revenue request, we will assign this interest in a manner which is fair to both parties. SoCalGas will be authorized to retain the equity interest for the benefit of shareholders. At the same time, we will flow through to the ratepayers the estimated savings from the equity interest which SoCalGas reasonably projected at the time it entered into the lease. The amount to be credited to ratepayers is explained in Section V of this decision.

As a result, ratepayers are assured that the reasonably estimated value of the equity interest will, in fact, minimize headquarters costs. And if the equity interest is a prudent investment, as SoCalGas claims it is, and exceeds the estimates of value in the financial pro forms statements, shareholders may realize a reasonable return on their investment.

It our intention by this decision in transferring the 15% equity interest from ratepayers to shareholders at the net present value of $34,378,000 that the issue of any future gain on sale of this asset is resolved. Any future gain or loss from the sale of this asset will clearly accrue to SoCalGas' shareholders.

E. <u>The Quality of Capital Improvements</u>

SoCalGas proposes capital expenditures of $60,543,000.[26]

To finance these costs, SoCalGas received an allowance from MTP of $46 per usable square foot to design and construct basic tenant improvements ($23,920,000). In addition to the specified allowances, the lease also provides SoCalGas the option to borrow from MTP up to $30 per usable square foot for other

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26 SoCalGas initially proposed a capital budget of $61,763,000. Subsequently, DRA has identified $220,000 in capital costs which will be reimbursed to SoCalGas by MTP. SoCalGas acknowledges that these costs should be shown as a reduction in its overall requests for capital costs. SoCalGas has also withdrawn a request for $1,000,000 for art in the new headquarters. When these two adjustments are accounted for, SoCalGas' total capital budget is $60,543,000.

tenant improvements ($15,600,000).[27] SoCalGas proposes to add the balance of the capital costs to rate base.

DRA contests many of SoCalGas' capital expenditures. We will discuss each of the contested categories. Our findings are summarized in Appendix C-4.

1. <u>Consultants</u>

SoCalGas requests $475,000 for project consultants and $103,000 for financial consultants. DRA contends that these requests are unsupported and recommends a disallowance of $538,000. DRA does not explain how its proposed disallowance is derived.

SoCalGas provides a short description of its project management system at pages 43-44 of Exh. 35R. Although the justification for this expenditure is cursory, we find that the expense is reasonable in proportion to the overall capital budget. We will allow the expense for project management consultants.

On the other hand, SoCalGas has not provided any evidence in support of the expenditure for financial consultants. The amount for financial consultants will be disallowed.

2. <u>Tenant Improvements - Design</u>

SoCalGas received an allowance from MTP of $520,000 for design of tenant improvements. However, SoCalGas budgeted $3,000,000 for this purpose. DRA recommends that SoCalGas be allowed just $33,000 for design costs, but DRA has not clearly explained the basis for this disallowance.

SoCalGas correctly notes that DRA has failed to explain the basis for its proposed disallowance of design costs. However, the burden rests on the utility to prove that it is entitled to the requested rate relief, and not on DRA to prove the contrary. In

27 The lease provides that the basic rent would be increased to repay the amount borrowed, by an amount required to amortize the principal and interest over 20 years. SoCalGas exercised the option to borrow the full amount.

this instance, SoCalGas has failed to explain why the budgeted design costs should exceed the allowance provided in the lease. Nor has SoCalGas explained why design costs should equal almost 10% of the total tenant improvement budget. In the absence of such fundamental facts, we cannot find that SoCalGas has met its burden of proving the reasonableness of this expense. We will authorize only the amount of the allowance, $402,000 based on the adopted usable office space.

3. Tenant Improvements - Construction

Under the lease, SoCalGas is responsible for the cost of tenant improvements. Tenant improvements include ceilings, flooring, lighting, interior walls, fixtures and interior electrical, and plumbing systems. The Gas Company Tower lease provides an allowance of $46 per usable square foot for tenant improvements ($23,920,000). SoCalGas has budgeted $31,500,000 or $60.58 per usable square foot for construction of tenant improvements.

The evidence offered by SoCalGas in support of this $31,500,000 is neither clear nor convincing. One of the most significant factors influencing the cost of improvements is the quality of improvements. For example, should the entry halls be linoleum or marble? Should the walls be plaster or teak? Should the plumbing fixtures be aluminum, brass or gold? SoCalGas' direct testimony provides virtually no information regarding the quality of overall improvements. SoCalGas' rebuttal testimony provides a limited description of some particular improvements, but only where DRA has proposed a specific disallowance.

In support of the reasonableness of the tenant improvement costs in the Gas Company Tower, SoCalGas offers two rebuttal exhibits, Exh. 279[28] and Exh. 351,[29] which compare the cost of tenant improvements to be incurred by SoCalGas at the Gas Company Tower with the cost of tenant improvements in similar high rise projects in downtown Los Angeles.[30]

Exh. 279 estimates the average cost of SoCalGas tenant improvements on a "typical floor" to be $50.70 (1989 dollars) per usable square foot as of June 1989. Exh. 351 states that the tenant improvement cost of the "typical floor" of the Gas Company Tower is $54 per usable square foot. Neither exhibit explains how the estimate was derived.[31] SoCalGas does not reconcile the estimate of $50.70 with the estimate of $54.00.

How do the tenant improvement costs of the Gas Company Tower compare to the tenant improvement costs in other downtown office buildings? Exh. 279 looked for costs representing build-out

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28 Exh. 279 is a letter from Fritz Kastner to Lee Harrington, dated February 20, 1990. Kastner is Chairman of Stegeman and Kastner, Inc., project management consultants to SoCalGas for the Gas Company Tower.

29 Exh. 351 is a letter from Gary Considine to Lee Harrington, dated January 25, 1991. Considine is Vice-President of Reel/Grobman and Associates, design consultants for the Gas Company Tower.

30 Neither exhibit was submitted under oath. SoCalGas did not call the author of either exhibit to testify as a witness. DRA objected to the introduction of Exhibit 351. The ALJ received Exhibit 351 into evidence indicating that the objection went to the weight of the evidence, rather than its admissibility.

31 SoCalGas explains the calculation of $54 in a footnote to its reply brief. According to SoCalGas, it divided the $31,500,000 tenant improvement construction budget by 520,000 usable square feet to yield $60.58. SoCalGas then subtracted an unspecified amount for "atypical floors such as" the Executive Floor and the second floor. Even if this explanation had been made on the record, in would be insufficient to explain exactly how $54 was calculated.

costs for major new tenant improvements in Class A office buildings. Exh. 279 states that the cost of tenant improvements of general office space is in the $45-$55 per usable square foot range. While Exh. 279 describes the types of buildings which would be used for cost comparison, it does not provide any of the vital information which would allow the Commission to test the reliability of the information. It does not identify the buildings used for this comparison, explain how the estimated costs were derived, nor even indicate how many structures were used for comparison.

Exh. 351 estimates the cost of tenant improvements in four downtown projects to range from $38 to $68 per usable square foot. While Exh. 351 identifies the specific projects which were used for comparison, it does not explain how these estimates were derived. It is not clear, for example, whether the estimated costs for each of these four buildings are the costs of a "typical floor" or whether these are the average costs of the entire building.

According to Exh. 351, the tenant improvement cost of the new Ronald Reagan State Office Building is $38.00 per usable square foot, and the cost of the Ashton-Tate headquarters in Torrance was $37.50 per usable square foot. Exh. 351 suggests that the lower costs of the Ronald Reagan and Ashton-Tate buildings are not comparable to the Gas Company Tower, because the tenant improvements in these buildings did not include a raised floor, carpet tiles sound masking and telecommunications. According to Exh. 351, these features add $13 per usable square foot to the cost of the Ronald Reagan building.[32] Adding these features would

32 It is not clear why the raised floor system, which is estimated to add approximately $6.00 per usable square foot to the cost of the Gas Company Tower, should add $13 per usable square

(Footnote continues on next page)

bring the cost of improvements in the Ronald Reagan building to $51 per usable square foot.

Assuming, arguendo, that the costs of the Ronald Reagan State Office Building represent a reasonable level of expenditure and is the yardstick by which SoCalGas believes we should measure the reasonableness of its costs, SoCalGas bears the burden of proving by clear and convincing evidence that its method of comparison is accurate. Moreover, where the results of the comparison show the tenant improvement costs of the Gas Company Tower to be $3.00 to $9.00 higher than the State Building,[33] SoCalGas' burden of proof compels it to explain why the higher costs are reasonable.

Given the ambiguities in Exhs. 279 and 351, the absence of supporting detail and the fact that the exhibits are unsworn, we can give them little weight. We agree with DRA that SoCalGas has failed to demonstrate by clear and convincing evidence that its tenant improvement costs are reasonable.

(Footnote continued from previous page)

foot to the cost of the Ronald Reagan building. Nor is it clear what "special telecommunication" costs were added to the estimate of the costs for the Ronald Reagan building, to make these costs comparable to the $54.00 estimated for the typical floor in the Gas Company Tower. According to SoCalGas Exhibit 325, the cost of communication equipment was not included in the $31,500,000 budget for tenant improvement construction costs, upon which the $54.00 average was derived. If this is true, special telecommunication should not have been added to the estimate for the Ronald Reagan building.

33 Assuming the comparable cost of the Ronald Reagan building is $51 per usable square foot ($38 per usable square foot plus $13 for the raised floor system), the cost of the Gas Company Tower is either $54 ($3 higher) or $60.58 ($9.58 higher), depending on whether we compare the cost of a "typical floor" or the average cost of all floors occupied by SoCalGas.

DRA has recommended specific disallowances for such items as coffee counters, sinks in utility rooms, kitchen appliances, and plumbing in the executive dining room, private bathrooms with showers for senior executives, construction of stairways on floors 3 through 8, and general contigencies. These items are included within SoCalGas' overall tenant improvement budget. We will not address DRA's specific disallowances. Instead, we prefer to authorize a reasonable overall tenant improvement budget, and allow SoCalGas the discretion to decide how best to allocate the budget.

Looking at SoCalGas' evidence, in the light most favorable to the company, we find that an allowance of $45 per usable square foot for the Gas Company Tower would provide for improvements comparable to the quality of typical floors of the new Ronald Reagan State Office Building. We conclude, therefore, that the basic tenant allowance of $45 per square foot provided SoCalGas with more than sufficient funds to make basic tenant improvements comparable to the basic improvements in the new Ronald Reagan building.

However, the $45 per usable square foot basic tenant allowance does not entirely account for the tenant improvement costs on two atypical floors in the Gas Company Tower, specifically the second floor cafeteria[34] and the concourse level emergency response center. Based on the figures offered by SoCalGas in Exh. 411, the average cost is $89.72 per usable square foot for the cafeteria and $203.68 per usable square foot for the emergency response center. No party to this proceeding proposed specific construction cost disallowances for either of these two floors. We

34 SoCalGas states that the cafeteria will be used exclusively for SoCalGas employees and will not serve the entire office building. In the event that the cafeteria is opened to other tenants in the building, it would be appropriate for these other tenants to share the costs of cafeteria tenant improvements. This adjustment could be made, if necessary, in a future general rate case.

therefore find the tenant improvement construction costs for the cafeteria and the emergency response center requested by SoCalGas to be reasonable.

As such, given the usable per square foot costs and the 33,000 usable square feet for the cafeteria and 3,000 usable square feet for the emergency response center, $3,571,925 should be accounted for in additional tenant improvement costs[35]. When the $51/usf tenant improvement allowance embedded in the cost estimates for these floors is removed, unaccounted for tenant improvement costs are $1,735,925. Spreading this dollar amount over the authorized usable square feet of 402,433 gives an increase of $4.31 per usable square foot that should be added to authorized tenant improvement construction costs.

DRA also recommends disallowance of $2,982,056 for the raised floor system. The raised floor system consists of removable panels, approximately two feet square, supported six to eight inches above the poured slab. DRA contends that the raised floor system is not cost-effective when compared to the in-duct floor system that would be installed at MTP's expense.

In support of its decision to install a raised floor system, SoCalGas cites a three-page analysis performed by a SoCalGas engineer in 1987. Assuming that 20% of the total office space is reconfigured annually, the study estimated a net annual cost of $89,000 to $134,000. In addition, SoCalGas contends that the system will allow greater flexibility in floor usage and quicker office relocations and will facilitate moves during office hours with minor disturbance.

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35 Cafeteria	33,000usf	x	$89.72/usf	=	$2,960,896
Emergency Response Center	3,000usf	x	$203.68/usf	=	$ 611,029
Total	36,000usf				$3,571,925

We find that that SoCalGas has offered clear and convincing evidence that the advantages of the raised floor system will justify the added cost. We therefore approve this cost item. Adding the raised floor system costs and the $4.31 per usable square foot allowance for the cafeteria and emergency response center to the basic $45 per usable square foot allowance yields $55.31 per usable square foot. We will authorize SoCalGas to recover $22,258,569 for tenant improvements ($55.31 X 402,433 usable square feet). We find that SoCalGas has not demonstrated the reasonableness of expenditures above this level.

4. <u>Furniture</u>

SoCalGas requests $17,500,000 for furniture in the new headquarters. DRA recommends a disallowance of $12,126,000.

All of the furniture in the Gas Company Tower will be new furniture. SoCalGas has chosen not to use any of the Flower Street furniture in the new headquarters. SoCalGas proposes to sell most of the Flower Street furniture. A small portion of the Flower Street furniture will be used at other SoCalGas offices.

We find that SoCalGas has demonstrated the reasonableness of certain new furniture acquisitions:

> Cafeteria furniture: SoCalGas has movable furniture in the Flower Street cafeteria. We agree with SoCalGas that it can maximize the efficiency of space in the Gas Company Tower cafeteria, consistent with City fire code requirements, by using fixed seating. We approve the cost of new cafeteria furniture.
>
> Filing cabinets: SoCalGas will primarily use lateral filing cabinets in the Gas Company Tower because they are more space-efficient. We agree that lateral cabinets will optimize use of wall space around the core of the building, without blocking walkways. This expense is approved.

SoCalGas has not demonstrated the reasonableness of other acquisitions:

Systems furniture: SoCalGas will place approximately 2,030 new, modular workstations in the open space areas of the Gas Company Tower. Many of the employees relocating from Flower Street will be leaving standard office furniture in enclosed offices, and will be moving into open space areas. We agree with SoCalGas that it is not feasible to move standard office furniture into these open space areas.

SoCalGas had some existing systems furniture at Flower Street which could have been refinished and moved to the new headquarters. While SoCalGas recognized that some savings could be realized from refinishing this furniture, SoCalGas found that the modular size of the existing systems furniture did not work as efficiently in the new space. SoCalGas was also concerned that the reconditioning process would impose a productivity cost and impair a smooth move. We find that SoCalGas' reasons for purchasing new systems furniture were legitimate.

While it was reasonable to purchase new systems furniture for the open space areas of the office, we do not find the level of expenditure to be reasonable. Of the 2,030 new workstations, approximately 200 are to be left unused for 1 to 5 years to allow for future expansion. In other words, it appears that SoCalGas has prepurchased a five-year supply of furniture. It is possible that the savings from a bulk purchase of 200 extra workstations exceed the cost of carrying this surplus capital over the next five years. However, SoCalGas has the burden of showing that it was prudent to buy these units now, rather than later when they would actually be needed. SoCalGas has not met this burden. We will disallow 10% of the systems furniture budget ($648,743).

SoCalGas put the modular furniture out to bid. Two bids met the bid specifications. SoCalGas chose the higher of the two bids. One bid was for $6,403,078 and the other bid was for $7,039,021, a difference of $636,193. This difference is reduced because the lower bidder required a greater downpayment, creating a bottom-line difference of $461,593 to $551,593. SoCalGas chose the higher bid because it believed that the more expensive furniture would "provide the most satisfying work environment" and that the "additional first cost is not significant when considered over the anticipated life of these furnishings."

SoCalGas' explanation for choosing the more expensive bid is not persuasive. Every added cost to the ratepayers is significant, whether it is $5.00, $500,000 or $500,000,000. In this instance, both bids met the primary bid specifications and both bids offered a high quality fabric. Minor aesthetic preferences do not justify selecting the higher bid. We will disallow $551,593.

Nonsystem furniture: SoCalGas also proposes to purchase new furniture for all individual offices, as well as new furniture for the board room and executive dining room. SoCalGas offers various reasons for replacing this nonsystem furniture. Some of the existing furniture would be too large for some new offices. Some furniture might need to be refinished. Some furniture might not make a good "ensemble." In designing its offices and in purchasing new office furniture, SoCalGas focused on using space efficiently, and in a manner that would minimize costs due to future changes. This is in part because SoCalGas planned to reduce the average space of individual offices in the Gas Company Tower as compared to the old building, and to reduce the total number of offices in the Gas Company Tower as compared to the old building. More importantly, however, SoCalGas sought the benefits in the ability to interchange individual office furniture between offices to accommodate changes. SoCalGas coordinated a concept of furniture interchangeability and uniform office sizes at the various employee working levels. For instance, certain management-level offices are all the same size. The vice-president's offices are all the same size. On the executive floor, all of the senior vice-president's offices are the same size. SoCalGas, therefore, wanted the ability to move furniture from one manager's office to another; from one senior vice-president's office to another, etc. with the minimum impact.

With this in mind, SoCalGas decided on furniture that was based on a work station concept, somewhat modular. The office furniture is not composed of stand-alone, individual components; it is designed in complete units that are affixed to the walls and floors of the offices. In all of the individual offices, SoCalGas implemented this work station concept. SoCalGas, therefore, did not use any of the furniture from the old building.

The coordinated design of uniform offices and work station furniture for private offices precluded SoCalGas from using furniture from the old building. SoCalGas testified that creating good furniture "ensembles" was not its primary objective. Rather, functionality and efficiency guided its decision. SoCalGas explained that, "...it was a question of the functionality, the interchangeability of the furniture with future moves and, to some extent, uniformity of look in the headquarters." (Tr. 57/5736.)

Uniform office sizes and compatible furniture allows SoCalGas to interchange furniture readily between offices without reducing or at all impacting functionality, and efficient space use. SoCalGas can minimize costs associated with office moves and employee changes without redesigning offices, or purchasing additional furniture. These are benefits that do not accompany the individual furniture components from the old office furniture that may or may not even fit into the new space. Certainly the old furniture would not maximize space use efficiency, functionality, or meet the need for flexibility required for future changes.

We conclude therefore that SoCalGas' purchase of new nonsystem furniture was prudent. However, we expect in SoCalGas' next general rate case application a complete and detailed accounting of the use or disposition of all furniture not moved to the new headquarters from the Flower Street offices.

5. Artwork

SoCalGas has budgeted $1,000,000 for art in the new headquarters. DRA recommends disallowance of the entire amount. After submission of the case, SoCalGas withdrew its request for this budgeted item. We believe that SoCalGas' decision to withdraw this request was correct.

6. Communication Equipment

SoCalGas requests $3,214,000, which is the estimated cost of a new ROLM CBX telecommunications system in the Gas Company Tower.

DRA proposes that the entire cost of the new telecommunications system be disallowed because;

> "SoCalGas did not perform a complete cost/benefit analysis of alternative telecommunication systems. Most, specifically, the only analysis it performed compared the system at the old locations with a new ROLM CBX system at Grand Place Tower. SoCalGas did not consider purchasing end-use equipment with Pacific Bell Centrex." (Exh. 409, p. 40.)

SoCalGas responds that it did compare the costs of ROLM CBX and Centrex in a 1988 study. This study used SoCalGas' current Centrex costs at Flower Street and Rosemead as a proxy for the costs of a Centrex system at the Gas Company Tower. According to this study, the net present value savings of the ROLM CBX system is estimated to be $2,875,000 over ten years. Thus, SoCalGas concludes, it is clearly cost-effective over a ten-year period to install a purchased ROLM CBX system in the Gas Company Tower. (Exh. 329.)

We have carefully reviewed the 1988 study. We are satisfied with the thoroughness and objectivity of the study. We will authorize recovery of the costs of the new telecommunications system. We also expect the projected savings from this investment to be clearly reflected in SoCalGas' next general rate application.

F. Other Issues

1. O&M Costs

DRA disputes SoCalGas' proposed operating and maintenance (O&M) costs in several accounts. We will discuss each of the disputed accounts.

a. Account 921

DRA proposes that the following O&M expenses be disallowed in Account 921:

Moving consultant
Furniture assemblers
Bottled water
Plant rental
Cleaning material
Executive Dining room

SoCalGas defends the first of these expenses, the moving consultant, as an ordinary and reasonable expense which is typically undertaken by businesses engaged in a move of this nature. We agree with SoCalGas that the use of a consultant is a reasonable expense. As with other aspects of SoCalGas' showing, we are disappointed that SoCalGas has not offered any evidence as to how this amount was determined, or why SoCalGas believes it to be reasonable. We will, with some reservations regarding the adequacy of the applicants' showing, allow the expense.

We find the budget for furniture assemblers to be reasonable. We agree with SoCalGas that once it begins operation in the new building it will identify additional requirements to make the work area more functional that will require floor plan modifications and furniture reconfigurations.

The other expense items which DRA proposes to disallow are similar, if not identical to, expenses which were authorized at the Flower Street headquarters. To the extent that such expenses were prudently incurred at Flower Street, they continue to be reasonable in the new building. The appropriate forum for DRA to contest these expenses is the next general rate case.

In summary, we will not adopt any of the specific O&M disallowances proposed by DRA in account 921.

b. Account 926

DRA has proposed a disallowance of $9,000, but has provided no explanation of the basis for the disallowance. DRA's proposal will not be adopted.

c. Account 930

We will authorize a fire safety expense of $23,000 for 1991 and $22,000 for 1992. This is the expense for existing buildings, other than Gas Company Tower, which will continue to be occupied by SoCalGas. (See Exh. 267(a) Line 15, Acct. 9967.000.)

SoCalGas has proposed to expense in Acct. 930 the $10,005 equity contribution it made to the Gas Company Tower. Since we find elsewhere in this decision that the equity interest will be transferred to shareholders, it is not appropriate to expense this contribution.

d. Account 932

DRA proposes the disallowance of some minor cabling and craft shop expenses. We recognize that additions and modifications to cables for computers, telecommunication, lighting and electrical systems will be an ongoing activity. We find SoCalGas' cable expense to be reasonable.

2. Credit Union

The Gas Company Credit Union will occupy a portion of the 552,000 rentable square feet which SoCalGas is leasing from MTP.[36]

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36 It is not clear how much space the Credit Union will occupy. Harrington testified at Exh. 274, p. 50, that the Credit Union will have a build-out of 7,835 square feet, without indicating whether

(Footnote continues on next page)

The "construction budget" for the credit union was estimated in June 1989 to be $463,235. (Exh. 411, MRL-20.) DRA recommends that this amount be disallowed. SoCalGas contends that none of the credit union's capital costs are included in SoCalGas' net capital requirements. (Exh. 274, p. 50-51.)

SoCalGas' contention that the credit union's capital costs are excluded from SoCalGas' net capital requirements is not supported by documented evidence. As set forth in Exh. 511, the estimated construction cost of the credit union space was included "as part of the overall preliminary design budget." SoCalGas has not shown that the credit union costs were explicitly excluded in its final design budget. (Exh. 325.) In addition, Exh. 325 indicates a budget for 520,000 square feet of rentable office space. Assuming that the reference to "rentable space" is incorrect, and that the reference is actually to usable space, 520,000 usable square feet includes the space occupied by the credit union.

Finally, it is not clear how the credit union will make separate lease payments. As DRA correctly observes, SoCalGas has made no showing of a sub-lease with the credit union. SoCalGas has offered no evidence of a clear division of costs. In the absence of such information, we have no basis for finding that the credit union will in fact bear the full costs of its occupancy.

We will not disallow the estimated construction costs for the credit union. However, we will require SoCalGas to file a

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this is rentable or usable space. Exh. 342 indicates that the Credit Union will occupy 8,800 square feet, which equates to about 8,184 rentable square feet.

compliance report with the Commission which includes the following information:

1. A fully executed sub-lease between SoCalGas and the credit union,

2. A complete accounting of all costs of credit union occupancy, including estimated annual operation and maintenance expenses, tenant improvement costs (design and construction), furniture and artwork, moving expenses and a pro-rata share of all project consultant expenses (to the extent the credit union benefited directly or indirectly from these services),

3. A detailed showing of how all credit union capital costs were deducted from the capital budgets prepared by SoCalGas, and

4. A detailed showing of how SoCalGas ratepayers will not be burdened by any of the costs identified in Paragraph (2) and (3) above.

This compliance report shall be filed with within 60 days of the effective date of this decision.

3. <u>Construction and Furniture Inflation</u>

DRA's comparison exhibit proposes a disallowance of $4,178,420. However, DRA has not explained the basis for a disallowance of $4,178,420 in either its testimony or comparison exhibit. Absent such explanation, DRA's proposal is rejected.

4. <u>Affiliate Relations</u>

A primary theme of DRA's case in this proceeding is that PE dominated the decision-making process which led to the Gas Company Tower lease between SoCalGas and MTP. DRA contends that concern for shareholder benefits overshadowed ratepayer interests. DRA argues that SoCalGas should have hired its own attorneys, consultants and financial advisors, rather than rely upon personnel provided by PE.

SoCalGas dismisses DRA's contentions as a "conspiracy theory." SoCalGas insists that SoCalGas' search for a new headquarters was headed by Harrington and that SoCalGas did not assume a subordinate role. SoCalGas contends that it and PE were scrupulous in negotiating separate, independent transactions.

Harrington has testified that the negotiations with MTP by SoCalGas and PE were separately conducted. Harrington also testifies that SoCalGas did not assume a subordinate role in those negotiations. Despite the apparent sincerity of these assertions, there is considerable evidence which leads us to question their accuracy.

Cushman served as principal real estate consultant to both PE (Pacific Lighting) and SoCalGas. Cushman's services were contracted and paid by Pacific Downtown Inc., a subsidiary of Pacific Lighting. The services were terminated by letter of January 7, 1987, from Al Hunt, Vice President of Pacific Lighting. Perhaps most significantly, many important communications from Cushman to SoCalGas were routed through Albert Hunt or John Reddy, employees of PE. For example, when Cushman prepared the SoCalGas relocation study, it also prepared a cover letter, addressed to Harrington, summarizing the report. A draft of the cover letter was first sent to Hunt for "changes or corrections" before it was formally transmitted to Harrington. SoCalGas' decision-making process, therefore, relied almost exclusively on financial, legal and real estate experts provided by PE. Moreover, because Pacific Lighting employed these individuals, most significant communications from these consultants were routed through PE for review and approval. We find compelling evidence that SoCalGas played a subordinate role to PE in these processes which led to the execution of the Gas Company Tower lease.

Because SoCalGas and PE jointly owned the Flower Street property, coordination between these two companies using a joint consultant for Flower Street was certainly reasonable. However, at the point that SoCalGas determined that it and PE would occupy different offices, SoCalGas should have taken steps to receive reliable, independent counsel and advice. Although SoCalGas characterized Cushman as an "independent" consultant, the terms of his employment, the careful orchestration of the two leases and the substantial documentary record indicate that he did not act independently of PE on matters pertaining to the SoCalGas headquarters.

The Commission will continue to monitor the ongoing business relationship between SoCalGas and PE. In particular, we will examine more closely in future proceedings, such as the next general rate case, whether it is prudent for SoCalGas to rely on PE for legal and financial services. These matters will also be examined in the ongoing management audit of SoCalGas.

V. Revenue Requirements

On April 10, 1991, in D.91-04-028, the Commission authorized SoCalGas to record in a memorandum account the expenses, other than capital costs, which were included in A.88-12-047.

By this decision, we now authorize SoCalGas to recover in rates those costs which have accumulated in the memorandum account, less those costs which are expressly disallowed by this decision. Upon the effective date of this decision, we suspend the continued operation of the new headquarters memorandum account.

The tables in Appendix C summarize the revenue requirement authorized by this decision.

As shown in Table C-1, we authorize an incremental increase in operating revenues for 1991 of $5,691,000. The authorized increase, following SoCalGas' request, assumes that SoCalGas began occupancy of the Gas Company Tower in June 1991. SoCalGas' actual date of occupancy is not a matter of record. The actual authorized revenue requirement must be adjusted to reflect the actual date of occupancy. SoCalGas shall file an advice letter, within 10 days of the effective date of this decision, which sets forth the actual authorized revenue requirement for 1991. This amount shall be derived from the following components:

(1) Actual year-end balance of expenditures and capital costs booked into the account through December 31, 1991;

(2) Less any expenses, such as the art collection, which have been withdrawn or reduced by SoCalGas,

(3) Less any amount expressly reduced or disallowed by this decision, and

(4) Less those amount expressly credited for the equity interest.

As shown in Table C-2, we adopt a net operating revenue requirement increase of $6,025,000 for 1992.

Table C-3 summarizes the adopted administrative and general expenses. Rent is reduced to account for a reduction in lease payments of $29.81 per year X 125,000 rentable square feet. This disallowance should be pro-rated for part-year occupancy in 1991. Rent is also reduced to pass through to ratepayers the value of the equity interest. This value has two parts:

(1) The annual reduction for sales values of the equity interest shall be 1/20 of the total value in SoCalGas Exhibit 300 and reflects the time value over 20 years.[37] The reduction in 1991 shall be pro-rated for part-year occupancy.

(2) The annual reduction for cash flow from the equity income shall be as set forth in 1Exhibit 300; except that the

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37 We use the adopted interest rate for long-term debt in SoCalGas' 1992 cost of capital application (D.91-11-059) in consideration of time value.

reduction for 1991 shall be corrected for part-year occupancy.

We make only one adjustment to "other headquarters expenses." SoCalGas' O&M charge of $10,005, for capital contribution to the partnership, is eliminated.

Table C-4 shows the capital expenditures as requested by SoCalGas, and as adopted in this decision. The adopted capital expenditures result in the calculation of rate base, as shown in Table C-5.

The authorized increase in the revenue requirement may be recovered by SoCalGas, with interest, as part of its 1993 attrition adjustment.

In addition to the costs associated with the new headquarters, SoCalGas and DRA agree that a refund of $175,247 is due to ratepayers which represents the difference between (1) an overcollection in the memo account authorized by D.87-09-076 ($617,247) and (2) the undercollection in the memo account authorized by D.90-01-016. This refund should be made, with interest, as part of SoCalGas' 1992 attrition adjustment.

Findings of Fact

1. On October 7, 1987, SoCalGas entered into a 20-year agreement with MTP to lease space in a new downtown Los Angeles office building. This building, once known as Grand Place, is now named the Gas Company Tower.

2. SoCalGas will occupy approximately 550,000 rentable square feet (21 floors) in the Gas Company Tower.

3. In addition to its lease agreement with MTP, SoCalGas also entered into a partnership agreement with MTP and acquired a 15% equity interest in the Gas Company Tower. SoCalGas assigned the partnership interest to a separate subsidiary of SoCalGas.

4. In November 1985, Cushman was retained by Pacific Center Downtown Inc., a subsidiary of PE, to explore alternative occupancy

strategies and to evaluate the development potential on the Flower Street site.

5. On February 25, 1986, Cushman submitted a preliminary report which concluded that it might be better for SoCalGas and PE to have separate tenancies in different buildings rather than have a common tenancy in a Flower Street redevelopment or in any single off-site project.

6. The architectural firm of Becket and Associates concluded that it would not be feasible either technically or economically to bring the existing Flower Street buildings up to the standards of current building codes, and recommended that the buildings be completely removed.

7. In a July 1986 report, entitled "Downtown Los Angeles Real Estate Study," Cushman concluded that separate off-site locations were superior to redevelopment of Flower Street.

8. In mid-July the companies solicited proposals from third-party developers for new headquarters at Flower Street and at other downtown locations. Proposals for off-site downtown headquarters were received from several off-site development projects. The companies conducted extensive discussion with representatives of these downtown developments between August and November 1986.

9. During October and November 1986, the companies engaged in intensive negotiations with MTP. Other downtown locations were considered and rejected.

10. On December 8, 1986, the companies entered into two letters of intent with MTP. One letter reflected the intent of SoCalGas to lease office space and acquire an equity interest in Grand Place Tower. The second letter reflected the intent of PE to lease space and acquire an equity interest in Library Tower.

11. Effective December 31, 1986, the companies cancelled their consulting contract with Cushman. At the same time, Cushman entered into two Commission agreements with MTP. Thereafter,

Cushman proceeded in these transactions as a broker, to be compensated by the lessor if and when the transactions between MTP and the companies were completed.

12. In anticipation of successfully negotiating two leases with MTP, the companies initiated a comprehensive effort in January 1987 to sell the Flower Street property. Cushman was retained by the companies as listing broker to sell the property.

13. The companies and MTP concentrated first on finalizing the terms of the Library Square lease. On May 22, 1987, PE and MTP entered into a lease for Library Square and a partnership agreement.

14. SoCalGas and PE, on August 13, 1987, signed a letter of intent with Shuwa for the sale of the entire Flower Street block.

15. On October 7, 1987, SoCalGas signed a lease and partnership agreement for Gas Company Tower.

16. SoCalGas commenced occupancy of the Gas Company Tower in October 1991.

17. SoCalGas is requesting an increase in rates in 1991 and 1992 to cover the costs of its new headquarters in the Gas Company Tower.

18. SoCalGas contends that the Gas Company Tower lease is the most reasonable and cost-effective option to meet SoCalGas' headquarters needs.

19. DRA recommends that SoCalGas' rates be reduced by $976,000 in 1992, and approximately $9.7 million in years 3 through 20 of the Gas Company Tower lease. DRA's recommendation is based on its contention that SoCalGas could have obtained reasonable headquarters at a less costly location in West Covina.

20. The lease executed by SoCalGas and MTP on October 7, 1987 (the "original lease") authorized SoCalGas to lease approximately 450,000 rentable square feet of space, consisting of floors 2 and 12 through 29. The actual area of the nineteen floors acquired

pursuant to the original lease turned out to be 475,000 rentable square feet.

21. A study prepared by SoCalGas in May 1987 estimated SoCalGas' space needs to be approximately 475,756 rentable square feet. This amount of space was estimated to accommodate 1976 workstations. These workstations would provide space for relocation of approximately 1400 downtown employees and 300 suburban employees, 102 workstations for growth through 1996, and 153 workstations for temporary employees, consultants and visitors.

22. Following completion of the May 1987 study, SoCalGas decided to move an additional 105 employees from Rosemead to the new headquarters, requiring an additional 25,000 square feet of space.

23. The original lease provided SoCalGas with several options to increase or decrease its space requirements.

24. In August 1988, SoCalGas and MTP executed the first amendment to the the lease. This amendment expanded the space to be leased by SoCalGas by three full floors, increasing total leased space from 475,000 to 552,877 rentable square feet.

25. SoCalGas leased approximately 50,000 rentable square feet to provide space for an estimated 2% employee growth over five years (approximately 200 workstations). SoCalGas hoped that the extra 50,000 rentable square feet would allow it to operate for at least five years without requiring significant relocation of employees within the building. The cost of 50,000 square feet of vacant space will be approximately $1,490,500 per year.

26. SoCalGas has not presented evidence of the cost of restacking floors on an as-needed basis, nor has it offered evidence of the cost of housing some departments on different floors.

27. SoCalGas has not explained why its estimate of expansion needs grew from 102 workstations in the May 1987 study to 200 workstations when it signed the first amendment.

28. SoCalGas has not met its burden of proving that it is cost-effective to lease 50,000 square feet of vacant space for future expansion, rather than exercise its option to lease the space if, and when, it was actually needed.

29. SoCalGas will require approximately 75,000 rentable square feet in the Gas Company Tower to house 350 employees relocated from Rosemead/Flair Center.

30. SoCalGas chose to vacate the Rosemead/Flair facilities and relocate these employees downtown, without performing an objective "stay versus move" analysis.

31. SoCalGas has failed to offer evidence in this proceeding that the benefits of relocating 350 employees from Rosemead to downtown outweigh the costs.

32. The space obtained by SoCalGas in the original lease (approximately 475,000 rentable square feet or 1,976 workstations) was more than sufficient to accommodate relocation of all 1,612 downtown employees at the time of the move.

33. Since SoCalGas had the contractual right prior to initial occupancy to reduce its space requirements by up to two floors, SoCalGas could have exercised the option to drop this space and still have accommodated all downtown employees, with more than 100 spaces left for temporary employees, consultants, visitors and short-term growth.

34. SoCalGas' continuing right of first refusal to add two additional floors gives it the flexibility to expand when additional space is actually needed.

35. Concurrent with the execution of the Gas Company Tower lease, a limited partnership known as Maguire-Thomas Partners - 5th & Grand Ltd., was formed between Maguire Thomas Partners - Grand Place Tower Ltd. (general partner) and Southern California Gas Tower (limited partner). Southern California Gas Tower is a wholly owned subsidiary of SoCalGas.

36. Southern California Gas Tower obtained a 15% interest in the Partnership, including income or losses from operations, gain or losses from a capital event, net operating cash flow and net capital proceeds.

37. The principal consideration for this equity interest is SoCalGas' concurrent agreement to execute a long-term lease to occupy approximately 45% of the building.

38. Ratepayers are entitled to the benefit of the 15% equity interest in the Gas Company Tower. Even if shareholders made the modest capital contribution of $10,005, it would be inequitable for them to retain the equity interest because the value of this interest would far exceed a fair return on the initial investment.

39. SoCalGas proposes capital expenditures of $60,543,000.

40. SoCalGas requests $475,000 for project consultants and $103,000 for financial consultants.

41. The project consultant expense is reasonable in proportion to the overall capital budget.

42. SoCalGas has not provided any evidence in support of the expenditure for financial consultants.

43. SoCalGas received an allowance from MTP of $520,000 for design of tenant improvements. However, SoCalGas budgeted $3,000,000 for this purpose.

44. SoCalGas has failed to explain why the budgeted design costs should exceed the allowance provided in the lease. Nor has SoCalGas explained why design costs should equal almost 10% of the total tenant improvement budget.

45. The Gas Company Tower lease provides an allowance of $45 per usable square foot for tenant improvements ($23,920,000).

46. SoCalGas has budgeted $31,500,000 or $60.58 per usable square foot for construction of tenant improvements. The evidence offered by SoCalGas in support of this $31,500,000 is neither clear nor convincing.

47. SoCalGas offers exhibits with conflicting estimates of the cost of tenant improvements on a typical floor. Neither exhibit explains how the estimate was derived. SoCalGas does not reconcile the estimates.

48. Exh. 279, an unsworn letter from a consultant which compares the tenant improvement costs of unidentified buildings, does not provide any of the vital information which would allow the Commission to test the reliability of the information.

49. Exh. 351, another unsworn letter from a consultant, estimates the cost of tenant improvements in four downtown projects to range from $38 to $68 per usable square foot. Exh. 351 does not explain how these numbers were derived.

50. The basic tenant allowance of $45 per square foot provided SoCalGas with more than sufficient funds to make basic tenant improvements comparable to the basic improvements in the new State office building. An allowance of $38 per usable square foot for the "typical floor" would provide for improvements comparable to the quality of the new State office building.

50a. The tenant improvement construction costs for the cafeteria and the emergency response center requested by SoCalGas are reasonable.

51. SoCalGas has offered clear and convincing evidence that the advantages of the raised floor system will justify the added cost.

52. SoCalGas requests $17,500,000 for furniture in the new headquarters. DRA recommends a disallowance of $12,126,000.

53. All of the furniture in the Gas Company Tower will be new furniture. SoCalGas proposes to sell most of the Flower Street furniture. A small portion of the Flower Street furniture will be used at other SoCalGas offices.

54. SoCalGas has demonstrated the reasonableness of cafeteria furniture and lateral filing cabinets.

55. SoCalGas had prudent reasons for purchasing new systems furniture.

56. SoCalGas has not met its burden of showing that it was prudent to buy 200 units of system furniture for future growth at this time, rather than later when they would actually be needed.

57. SoCalGas put the modular furniture out to bid. Two bids met the bid specifications. SoCalGas chose the higher of the two bids because the more expensive furniture would "provide the most satisfying work environment."

58. Minor aesthetic preferences do not justify selecting the higher bid.

59. SoCalGas had prudent reasons for purchasing new nonsystem furniture.

60. SoCalGas has budgeted $1,000,000 for art in the new headquarters. DRA recommends disallowance of the entire amount. After submission of the case, SoCalGas withdrew its request for this budgeted item.

61. SoCalGas requests $3,214,000, which is the estimated cost of a new ROLM CBX telecommunications system in the Gas Company Tower.

62. DRA proposes that the entire cost of the new telecommunications system be disallowed.

63. The 1988 Arthur Young study is a thorough and objective justification of the new ROLM system. This expenditure is reasonable.

64. All O&M expenditures proposed by SoCalGas are reasonable.

65. The Gas Company Credit Union will occupy a portion of the 552,000 rentable square feet which SoCalGas is leasing from MTP. The "construction budget" for the credit union was estimated in June 1989 to be $463,235. DRA recommends that this amount be disallowed. SoCalGas contends that none of the credit union's capital costs are included in SoCalGas' net capital requirements.

66. SoCalGas' contention that the credit union's capital

costs are excluded from SoCalGas' net capital requirements is not supported by documented evidence.

67. The companies thoroughly reviewed the alternative of redeveloping the Flower Street site, and prudently rejected this alternative.

68. To evaluate alternative downtown sites, specific proposals were solicited, the proposals were refined and improved through serious discussions and negotiations with each project's proponent, comparative analyses were prepared of each proposal, and the analyses were thoroughly reviewed by utility management, before SoCalGas proceeded to sign a letter with a specific lessor.

69. SoCalGas gave thorough, timely, and objective consideration to four of downtown alternatives. SoCalGas' decision to select the Grand Place lease over three other downtown alternatives was prudent.

70. SoCalGas' evaluation of suburban alternatives was not as thorough or timely as its analysis of downtown locations.

71. Throughout 1986 SoCalGas focused its search for a new headquarters in the downtown Los Angeles area. During 1986 SoCalGas did not prepare a list of potential suburban sites that would meet its headquarters needs, as it did for downtown sites. SoCalGas did not solicit proposals from developers of suburban projects, as it did for downtown projects. SoCalGas did not seek to discuss, refine or negotiate the terms of occupancy with suburban developers, as it did with downtown developers.

72. The Carnation study was neither exhaustive nor extensive, and SoCalGas' consideration of this information was cursory.

73. There is no evidence that the Carnation information was effectively communicated to SoCalGas. Cushman only showed a copy of the Carnation study to Harrington in Cushman's office.

74. The second suburban study was requested not to actually search for suburban sites, but to show that suburban sites would be inferior to the Grand Place lease.

75. By January of 1987, Cushman had a significant personal financial interest in the success of the MTP leases and a fiduciary obligation to MTP not to disrupt the transaction.

76. By the time the suburban report was presented to SoCalGas, it was too late for SoCalGas to give serious consideration or evaluation to the information it contained. When SoCalGas signed the letter of intent with MTP in December 1986, SoCalGas agreed that until the letter is terminated, SoCalGas would not "negotiate with the owners or developers of any other office building in the Los Angeles metropolitan area" for the long-term office space requirements for its principal offices.

77. As a result of this agreement, SoCalGas was barred, between December 8, 1986 and when it signed the lease in November 1987, from negotiating with any other owner or developer in the Los Angeles metropolitan area.

78. SoCalGas was imprudent in agreeing not to negotiate with third parties during the nine-month period following execution of the letter of intent, particularly before it even conducted a survey of suburban alternatives which could meet its headquarters needs.

79. The net present value of Gas Company Tower lease was estimated to range between $242,752,000 (if SoCalGas equity estimates are realized) and $278,000,000 (if the benefits of equity participation are not realized).

80. SoCalGas had information before it in June 1987 which showed at least two suburban sites with projected net rents which could be expected to be lower than the Gas Company Tower lease. If SoCalGas had considered a lesser quality building at these sites, the savings offered by these two suburban sites would have been even greater.

81. DRA estimates the net present value of 20-year occupancy costs at West Covina to be $162,954,000. SoCalGas estimates the net present value of occupancy at West Covina to be $247,332,000.

Both DRA's and SoCalGas' estimates of West Covina costs are flawed. When these errors are corrected, the estimated net present value of the West Covina alternative is approximately $230,000,000, approximately 5% less than the SoCalGas' estimated cost of the Gas Company Tower.

82. The West Covina estimate assumes a building of approximately 580,000 rentable square feet (about 5% larger than the space occupied by SoCalGas in the Gas Company Tower). The West Covina alternative also assumes a building of comparable quality to the Gas Company Tower. Thus, the actual cost of the West Covina alternative could be significantly lower than the Gas Company Tower if SoCalGas had negotiated to lease a smaller or less luxurious facility in West Covina.

<u>Conclusions of Law</u>

1. The act of the utility should comport with what a reasonable manager of sufficient education, training, experience, and skills using the tools and knowledge at his disposal would do when faced with a need to make a decision and act.

2. The Commission, as the agency charged with oversight and economic regulation of the monopoly utilities, has a legitimate concern not only with the outcomes of the utilities' decisions, but also the process employed to arrive at a particular decision.

3. The reasonable and prudent act is not limited to the optimum act, but includes a spectrum of possible acts consistent with the utility system need, the interest of the ratepayers, and the requirements of governmental agencies of competent jurisdiction.

4. The action taken should logically be expected, at the time the decision is made, to accomplish the desired result at the lowest reasonable cost consistent with good utility practices.

5. The greater the level of money, risk, and uncertainty involved in a decision, the greater the care the utility must take in reaching that decision;

6. The burden rests heavily upon a utility to prove with clear and convincing evidence, that it is entitled to the requested rate relief and not upon the Commission, its staff, or any interested party to prove the contrary.

7. SoCalGas has failed to demonstrate by clear and convincing evidence the reasonableness of leasing 50,000 rentable square feet of vacant space for future expansion.

8. SoCalGas has failed to demonstrate by clear and convincing evidence that it was cost-effective to relocate 350 employees from Rosemead/Flair Center to the Gas Company Tower.

9. SoCalGas has demonstrated the reasonableness of leasing 427,877 rentable (402,433 usable) square feet of space in the new headquarters for 1991 through 1993.

10. SoCalGas has demonstrated the reasonableness of total capital expenditures of $13,509,000.

11. SoCalGas has failed to prove the reasonableness of a portion of the following capital expenditures:

- tenant improvements,
- furniture, and
- consulting fees.

12. SoCalGas has proven the reasonableness of all O&M expenses in 1991, except a capital contribution of $10,005.

13. SoCalGas gave thorough consideration to four downtown alternatives.

14. SoCalGas has failed to demonstrate that suburban alternatives were adequately evaluated. SoCalGas' consideration of suburban alternatives was neither thorough, timely nor impartial.

15. The equity interest should be assigned in a manner which is fair to both parties.

16. Before SoCalGas may prudently conclude that the benefits of consolidation "override" the costs of relocation, it must first clearly determine the costs and benefits of the transaction.

17. SoCalGas' simple assertion that consolidation was more important than the cost does not sustain its burden of proof that it was prudent to relocate these employees from Rosemead to the Gas Company Tower.

18. The costs associated with occupancy of 125,000 rentable square feet for 1991 through 1993 should be disallowed.

19. SoCalGas investors have no basis in law or equity to claim the benefit of the 15% equity interest in the Gas Company Tower.

20. If the Commission awarded the benefits of the equity interest to shareholders merely because SoCalGas was denied recovery of occupancy costs which were imprudently incurred, then we would unfairly reward shareholders for the imprudence of SoCalGas officers.

21. The equity interest can be transferred to shareholders only if ratepayers are fairly compensated for the transfer.

22. Given the ambiguities in Exhs. 279 and 351, the absence of supporting detail and the fact that the exhibits are unsworn, we can give them little weight.

23. The reasonableness of SoCalGas' decision to vacate, rather than refurbish, the Flower Street buildings has already been resolved by D.90-11-031.

O R D E R

IT IS ORDERED that:

1. Southern California Gas Company (SoCalGas) is authorized to hold the 15% equity interest in the Gas Company Tower for the benefit of its shareholders. In consideration for this asset, SoCalGas shall credit to ratepayers the net savings from the equity interest, as specified in this decision.

2. SoCalGas' space requirements in the Gas Company Tower may be reviewed in the next general rate case for test year 1994, at which time SoCalGas will bear the burden of proving:

a. The cost-effectiveness of relocating employees from suburban offices to the downtown headquarters,

b. The incremental revenue requirement, if any, associated with a cost-effective move of employees from suburban offices, and

c. Cost-effectiveness of leasing vacant space in the new headquarters.

3. SoCalGas shall file a compliance report with the Commission within 60 days of the effective date of this decision. The report shall include the following information:

a. A fully executed sub-lease between SoCalGas and the Gas Company Credit Union,

b. A complete accounting of all costs of credit union occupancy, including estimated annual operation and maintenance expenses, tenant improvement costs (design and construction), furniture and artwork, moving expenses and a pro-rata share of all project consultant expenses (to the extent the credit union benefited directly or indirectly from these services),

c. A detailed showing of how all credit union capital costs were deducted from the capital budgets prepared by SoCalGas, and

d. A detailed showing of how SoCalGas ratepayers will not be burdened by any of the costs identified in Subparagraphs (b) and (c) above.

4. SoCalGas is authorized to recover in rates those costs which have accumulated in the new headquarters memorandum account, less those costs which are expressly disallowed by this decision and those amounts credited for the equity interest. These amounts may be recovered in rates, with interest at the three-month

commercial paper rate, as part of SoCalGas' 1993 attrition rate adjustment. Upon the effective date of this decision, we suspend the continued operation of the new headquarters memorandum account.

5. SoCalGas is authorized to increase its operating revenue requirement in 1992 by $6,025,000.

6. SoCalGas shall refund $175,247 to ratepayers, which represents the difference between (1) an overcollection in the memo account authorized by Decision (D.) 87-09-076 ($617,247) and (2) the undercollection in the memo account authorized by D.90-01-016. This refund should be made, with interest at the three-month commercial paper rate, as part of SoCalGas' 1993 attrition rate adjustment.

This order is effective today.

Dated July 22, 1992, at San Francisco, California.

DANIEL Wm. FESSLER
President
JOHN B. OHANIAN
NORMAN D. SHUMWAY
Commissioners

I will file a written dissent.
/s/ PATRICIA M. ECKERT
Commissioner

I will file a written concurring opinion.
/s/ JOHN B. OHANIAN
Commissioner

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

Neal J. Shulman
NEAL J. SHULMAN, Executive Director
pb

Appendix A
Page 1

Terms of the Gas Company Tower Lease

The basic terms of the initial Grand Place lease are described in an Executive Summary prepared by Harrington in September 1987:

•Lessor	Maguire Thomas Partners (MTP)
•Building Size	Approximately 1,100,000 square feet
•Floors/Area	450,000 square feet (plus minus 50,000 hold/drop space) Floors 2 and 11 through 28[1]

•Rental Rates	Gross	Net (Less expense stop of $8.30)
Yr. 1-5	$29	$20.70
6-10	32	23.70
11-15	35	26.70
16-20	43	34.70

•Lease Term	20 years from date of full occupancy (Between 9/1/90 and 6/1/91)
•Space Options	Right to lease one additional contiguous floor (25,000 square feet) in each of years 5,7,10,13,15,17 (total 150,000 square feet). Also first right to lease other space.
•Renewal Options	Six 5-year options, first two options at 90% of fair market value.
•Right to sublease	To affiliate at any times, also 4 floors not subject to project competition restrictions. Tenant receives 100% profits for up to 50% of initial lease space and 50/50 on remainder.

1 The actual lease, executed in November 1987, granted to SoCalGas floors 2 and 12 through 29. When the building was completed, these floors represented 475,000 rentable square feet.

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"Parking — Up to 2.5 passes per 1,000 square feet of initial lease space (e.g., 1,125 passes for 450,000) 270 passes in building including 300 for fleet in tenant controlled area. 555 passes off-site (adjustable).

	In Building	Off Site
Yr. 1-5	$190	$125
6-10	225	150
11-16	270	185

"Identity — Right to sign/logo, not transferable to other tenant if 300,000 square feet leased.

"Budget/Financing — Right to approve Construction Budget/Permanent Financing.

"Cash Allowance — $1.00 each for space planning and moving; $750,000 for lease takeover.

"Building Management — MTP affiliate; fee - 3% of gross operating receipts.

"Tenant Special Requirements — Landlord to construct tenant improvements $45/square foot allowance plus $30/square foot landlord financed through rent increment; tenant right to select contractor and negotiate fees. SoCalGas has right to make further changes to the building during design/construction at tenant's expense." (Exh. 275.)

(END OF APPENDIX A)

APPENDIX B
Page 1

This appendix discusses the principal differences between DRA's and SoCalGas' estimates of the cost of the West Covina alternative.

1. <u>Relocation Costs</u>

SoCalGas believes it has found a "glaring omission" in DRA's estimate of costs for West Covina. DRA's analysis did not include "relocation costs." Initially, SoCalGas' Rodman assumed that the cost of relocating employees from Flower Street to West Covina would be $30 million. (Exh. 285, p. 29.) Rodman did not explain in his prepared testimony how this assumption was derived.

Following submission of Rodman's testimony containing the assumed $30 million relocation cost, SoCalGas commissioned a study by Moran, Stahl, and Boyer (MS&B). This study estimated an incremental relocation cost of approximately $11 million for a hypothetical 22-mile move to the suburbs. The study designed a program intended to offer the company "the greatest control" over its human resources during the relocation to West Covina. The program included a generous array of bonuses, incentives, counseling, and assistance including project completion bonuses, stay bonuses, outplacement, relocation assistance, and commuting assistance.

While the MS&B study is a sincere attempt at an objective evaluation, it appears to overstate the costs of relocation. It assumes 20% attrition from an employee base of 1,746. However, only 1,600 of these employees would be moving from downtown to West Covina. It also characterizes the costs of recruitment, training, and dual operation as "hard costs." However, we find these types of costs to be highly variable and extremely speculative. Nor do these costs account for potential

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Page 2

salary savings of replacing employees at the top of the salary ranges with employees who enter the company at lower salaries.

We agree with SoCalGas that potential relocation costs should be a part of any prudent comparison of alternative costs. However, in order to objectively compare the costs of West Covina to the Gas Company Tower, we must know the cost of relocating employees to both facilities. Rodman testifies, without any factual support, that "The relocation of SoCalGas' headquarters offices four blocks from its current location to Grand Place Tower necessitates some small but insignificant relocation costs related to employees." (Exh. 285, p. 28.) While it is true that approximately 1,600 employees will be relocated only a few blocks, another 350 employees will be relocated from Rosemead to downtown, a distance of approximately 12 miles. Harrington was asked by the ALJ:

> "Q Will SoCalGas be paying relocation costs for any of the employees moved from Rosemead to downtown?
>
> "A No. We have, over the years, moved employees back and forth between the Rosemead location and downtown on a regular basis depending upon assignments, and it's only 12 miles from downtown headquarters, and so company policies would not result in any costs having to be incurred in terms of those relocations.
>
> That's also the case because it has been known that when we located people in Rosemead and Flair that that was a temporary headquarters move until we resolved the ultimate headquarters.
>
> "Q When were they move there? To Rosemead?
>
> "A Oh, they've been moved there over a period of time.

It would have been about eight year ago, I believe." (Tr. 54/5422-23.)

Clearly, SoCalGas cannot have it both ways. It cannot assume generous relocation assistance for moving employees from downtown to the suburbs, and at the same time, contend that company policies result in no relocation assistance to employees moving from the suburbs to downtown. While it may be company policy not to provide assistance or incentives to employees moving from Rosemead, company policy will not prevent the company from incurring many of the other types of costs analyzed by MS&B, such as recruiting replacements, training new hires, commuter productivity, and new hire productivity.

Based on the record before us, we find that the cost of relocation to West Covina would exceed the cost of relocation to the Gas Company Tower. If SoCalGas applied consistent policies and benefit packages to each relocation, the cost of relocating 1600 employees from downtown to West Covina could be as much as 5 times greater than the cost of relocating 350 - 400 employees from suburban sites to downtown. Therefore, we can fairly conclude from this record that the cost of relocating to West Covina could be up up to $5 million more than the cost of relocating to the Gas Company Tower.

2. <u>Operating Expenses</u>

The actual operating expense of a building is influenced by many factors, including, but not limited to, the size, quality, and location of the facilities. SoCalGas has argued, without citation to the record, that the operating costs for the Gas Company Tower and West Covina should not be substantially different because the buildings are of comparable size and quality. However, DRA has documented clear differences in the size and quality of the two projects.

It is likely that the actual operating expenses for West Covina would fall somewhere between $3.35 and $5.30 per rentable square foot.[1] We believe it is appropriate to place considerable weight on the estimate provided by the West Covina developer. SoCalGas has offered no cogent reason for rejecting it. Mr. Cushman's testimony that suburban and downtown operating expenses should be "nominally the same" can be given little weight, given Cushman's refusal to be more precise in explaining his view of "nominal differences." (Tr. 46/4257.) Taking all of these factors into consideration, we find that Rodman's initial assumption of $4.50 per rentable square foot is a reasonable estimate of the operating expenses of the West Covina project.

3. <u>Escalation of Rents</u>

SoCalGas adjusted PKF 1988 costs for inflation to reflect 1990 occupancy. In SoCalGas' comparison exhibit (Exh. 509B, Sch. F), it accounts for inflation by adjusting the net rents by 10%. DRA notes, in its reply brief, that SoCalGas appears to have adjusted a rent total which includes the carryover rents from Flower Street and Broadway Plaza from 1991 and 1992. If only the West Covina net rents are inflated by 10%, the net present value increases by approximately $8.254 million. (DRA RB, p. 12.)

We accept SoCalGas' adjustment.

---

1 SoCalGas argues that operating expenses of $6.14, which are stated in 1987 dollars, should be restated in 1991 dollars. However, this is a comparative analysis and such restatement should be made only if Gas Company Tower operating expenses are stated in 1991 dollars.

4. Pension and Benefits

For the West Covina option, DRA recommends pension and benefits costs $5,313,000 lower than the Gas Company Tower option. We agree with SoCalGas that DRA has failed to substantiate the basis for this "credit." We accept SoCalGas' adjustment.

5. Capital Costs

SoCalGas' estimate of West Covina costs is higher than DRA's estimate in four categories (property tax, return, taxes, and depreciation) because SoCalGas assumes higher capital costs than assumed by DRA. SoCalGas challenges DRA's capital costs on two grounds: (1) SoCalGas asserts that DRA has used an incorrect capitalization rate for West Covina, (2) SoCal Gas believes that DRA has failed to assume comparable building costs for the Gas Company Tower and West Covina.

We agree with SoCalGas that the comparison of the Gas Company Tower and West Covina should assume comparable quality buildings and improvements. This is not to say that we necessarily find the quality or costs of the core building or improvements to be prudent, but we do agree that the comparison, to be meaningful, must assume equal facilities.

We accept SoCalGas' adjustment.

(END OF APPENDIX B)

APPENDIX C

SOUTHERN CALIFORNIA GAS COMPANY

Revenue Requirements for New Headquarter

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APPENDIX C

SOUTHERN CALIFORNIA GAS COMPANY

Adopted Summary of Earnings for New Headquarters
1991
(Thousands of Dollars)

Description	In Rates 1/	Adopted Incremental	Adopted Total
Operating Revenues	$14,303	$5,691	$19,994
Operating Expenses			
Uncollectibles	55	22	77
Administrative and General	14,007	4,138	18,145
Franchise Requirements	240	95	335
Subtotal	$14,303	$4,255	$18,558
Depreciation	$0	$254	$254
Taxes Other Than On Income			
Payroll	$0	($7)	($7)
Income Taxes			
Federal Income Tax	0	297	297
State Income Tax	0	76	76
Subtotal	$0	$373	$373
Total Operating Expenses	$14,303	$4,874	$19,177
Net Operating Revenues	$0	$817	$817
Rate Base	$0	$7,787	$7,787
Rate of Return 2/	N/A	10.49%	10.49%

1/ Authorized in SoCal Gas's 1990 GRC decision (D.90-01-016). Total admin. & gen. exp. reflects the adopted escalation rates in the GRC decision and company's 1991 & 1992 arrition filings.
2/ As authorized in SoCal Gas's 1992 cost of capital application (D.91-11-059).

APPENDIX C

SOUTHERN CALIFORNIA GAS COMPANY

Adopted Summary of Earnings for New Headquarters
1992
(Thousands of Dollars)

Description	In Rates 1/	Adopted Incremental	Adopted Total
Operating Revenues	$14,691	$6,025	$20,716
Operating Expenses			
Uncollectibles	57	23	80
Administrative and General	14,388	3,658	18,046
Franchise Requirements	246	101	347
Subtotal	$14,691	$3,782	$18,474
Depreciation	$0	$435	$435
Taxes Other Than On Income			
Payroll	0	(98)	(98)
Ad Valorem Tax	0	18	18
Subtotal	$0	($80)	($80)
Income Taxes			
Federal Income Tax	0	438	438
State Income Tax	0	100	100
Subtotal	$0	$537	$537
Total Operating Expenses	$14,691	$4,674	$19,366
Net Operating Revenues	$0	$1,351	$1,351
Rate Base	$0	$12,876	$12,876
Rate of Return 2/	N/A	10.49%	10.49%

1/ Authorized in SoCal Gas's 1990 GRC decision (D.90-01-016). Total admin. & gen. exp. reflects the adopted escalation rates in the GRC decision and company's 1991 & 1992 arrition filings.
2/ As authorized in SoCal Gas's 1992 cost of capital application (D.91-11-059).

APPENDIX C

SOUTHERN CALIFORNIA GAS COMPANY

Adopted Administrative and General Expenses

(Thousands of Dollars)

Description	Adopted 1991 1/	1992
Acct. 931 Rent - New Headquarter 2/	$9,522	$16,499
Acct. 931 Rent - Old headquarters 3/	4,121	2,029
Subtotal	$13,643	$18,527
Acct. 920 to Acct. 930 Other Headquarter O&M Expenses	$6,617	$3,521
Subtotal	$20,260	$22,048
Adjustments:		
Sales Value of Equity Interest	(1,451)	(2,487)
Cash Flow from Equity Income	(664)	(1,515)
Subtotal	($2,115)	($4,002)
Total Admin. & Gen.	$18,145	$18,046

1/ Based on the estimated first date of occupancy as of June 1, 1991.

2/ Include: Office space, opr. exp., & property tax:
($20.7+$6.78+$2.33) x 427,877
Storage: $19.75 x 4,800
Parking fee: $1,573,000
Financed tenant impt.:$1,901,000
Property tax and opr. exp. rates inflate at 5% and 3% annually from 1991.

3/ Rent for 1992 includes Rosemead Springs (75,000 sq.ft.) and Broadway Plaza.

APPENDIX C

SOUTHERN CALIFORNIA GAS COMPANY

Adopted Capital Expenditures for New Headquarters
(Thousands of Dollars)

Description	SoCal Gas Requested	Adopted
Company Labor	$800	$800
Project Management Consultants	475	475
Financial Consultants	103	0
Tenant Improvements 1/		
Design	3,000	402
Construction 2/	31,500	22,259
Base Building Modifications		
Design	200	200
Construction	3,500	3,500
Furnishings	17,500	16,300
Artwork	0	0
General Contingency	0	0
Communication Equipments	3,214	3,214
Subtotal	$60,292	$47,150
Allowances		
Basic Tenant Impt.($45/sq.ft) 1/	(23,400)	(18,109)
Financed Tenant Impt.($30/sq.ft.) 3/	(15,600)	(15,600)
Design ($1/sq.ft.)	(520)	(402)
Subtotal	($39,520)	($34,112)
Reassignments	$471	$471
Total Capital Expenditures	$21,243	$13,509

1/ The adopted tenant improvement & allowances are based on the adopted usable office space (402,433 sq.ft).
2/ The adopted construction for tenant improvement is based on the adopted rate of $55.31/sq.ft. of usable space.
3/ Based on 520,000 sq.ft. of SoCal Gas's requested usable office space.

APPENDIX C

SOUTHERN CALIFORNIA GAS COMPANY

Adopted Rate Base for New Headquarters - Wtd. Avg.
(Thousands of Dollars)

Description	Adopted 1991	Adopted 1992
Plant In Service - Wtd. Avg.	$7,880	$13,509
Deductions for Reserves:		
Wtd. Avg. Depreciation Reserve	(74)	(471)
Taxes Def.- Depreciation	(19)	(161)
Total Depreciated Rate Base: Wtd. Avg.	$7,787	$12,876

(END OF APPENDIX C)

Appendix D
Page 1

List of Appearances

Applicant: Robert B. Keeker, Peter N. Osborn, Jordana Singer, David B. Follett, Attorneys at Law, for Southern California Gas Company.

Interested Parties: W. E. Cameron for City of Glendale; ; Law Offices of Dian M. Grueneich, by Barry H. Epstein, Attorney at Law, for California Institute for Energy Efficiency of the University of California (CIEE); Leslie J. Girard, Attorney at Law, for the City of San Diego; Messrs. Biddle & Hamilton, by Richard L. Hamilton, Attorney at Law, for Western Mobile Home Association; Richard K. Durant, Carol B. Henningson, James M. Lehrer, and Frank McNulty, Attorneys at Law, for Southern California Edison Company; James Hodges, for California/Nevada Community Action Association, The East Los Angeles Community Union, and Association of Southern California Energy Programs; Roger J. Peters and Kermit R. Kubitz, Attorneys at Law, for Pacific Gas and Electric Company; Messrs. Graham & James, by Martin A. Mattes, Attorney at Law, for Trigen Resources Inc.; Leamon W. Murphy, for Imperial Irrigation District; Messrs. Jones, Day, Reavis & Pogue, by Norman A. Pedersen for Southern California Utility Power Pool; Robert L. Pettinato, for Los Angeles Department of Water & Power; David Plumb, for City of Pasadena; Patrick Power, Attorney at Law, for City of Long Beach; Michel Peter Florio and Joel Singer, Attorneys at Law, and Sylvia M. Siegel, for Toward Utility Rate Normalization (TURN); Richard A. Shaw for ASCEP/ASSERT; Shelley I. Smith, Assistant City Attorney, for City of Los Angeles; Ronald V. Stassi, for City of Burbank; Robert Weisenmiller, for Morse Richard Weisenmiller & Associates; Barton M. Myerson, Attorney at Law, and Bruce J. Williams, for San Diego Gas & Electric Company; Randolph Wu, Richard Owen Baish, Michael D. Ferguson, Attorneys at Law, for El Paso Natural Gas Company; Steve Harris, for Enron/Transwestern Pipeline Company; Ronald G. Oechsler for Recon Research Corporation; Gilchrist & Rutter P.C., by Frank Gooch, III, Attorney at Law, for Maguire Thomas Partners; Messrs. Brobeck, Phleger & Harrison, by Dan Woods, Attorney at Law, for Cushman Realty Corporation; Jane Brunner, Attorney at Law, and Tom Dalsell, for Utility Workers Union Local 132 and Coalition California Utility Workers; J. Patrick Costello, Edward Duncan, Manuel Kroman, John Mosely, Messrs. Barakat, Howard & Chamberlin, by Nancy Thompson, and Robert Rohne Associates, by Robert J. Hohne, for themselves.

Public Adivsor's Office: Dorothy Taylor.

California Energy Commission: Caryn Hough, Attorney at Law, and Susan Bakker.

Department of General Services: Matthew V. Brady, Attorney at Law.

Division of Ratepayer Advocates: Philip Scott Weismehl, Izetta C. R. Jackson, Irene K. Moosen, Ida Passamonti, Attorneys at Law, Greg Wilson, and Maurice Monson.

Executive Director's Office, WMBE Program: Helen W. Yee, Attorney at Law.

(END OF APPENDIX D)

A.88-12-047
D.92-07-080

Commissioner Patricia M. Eckert, Dissenting:

The majority opinion in the instant proceeding causes me profound concern. My overriding objection rests with the majority opinion's inappropriate disposition of SoCalGas' equity interest in the Gas Company Tower. The policy implications are far-reaching and the signals the majority flashes to the utilities we regulate are like a video game gone haywire.

I believe SoCalGas made a prudent decision choosing the Gas Company Tower. Ironically, the majority does not find that SoCalGas' choice was imprudent, yet it clearly penalizes the utility. Under the guise of intending to place the risk of speculative real estate investments squarely on utility management, the majority squeamishly hides behind weak rhetoric and inconsistent ratemaking principles. In so doing, the majority harshly and roundly punishes SoCalGas. A grotesque perversity exists here. The Commission's articulated will is to transition utilities into leaner, more responsive and competitive business organizations. Yet, when the majority judges SoCalGas' soundly negotiated "equity kicker," the result is that SoCalGas gets the "kick" in the form of present punishment. No imprudency exists that would form a basis for punishing SoCalGas. The record does not support such action by this Commission.

If the majority's intention were to place the risk of real estate investments on the utility shareholders, the majority opinion should have articulated such intent in no uncertain terms. Moreover, the majority opinion fails to acknowledge policy implications, policy changes, and the Commission's clearest thinking about the matter, again leaving utilities with vague Commission ideas and directions. I am disappointed for the utility and I am disappointed with the majority's execution of its public business.

The majority orders SoCalGas' shareholders to pay, TODAY, for all **future forecast** benefits for the equity interest SoCalGas was able to negotiate in the Gas Company Tower. The forecasted benefits accompanying the equity interest may or may not be fully realized in the future. That, of course, is the nature of forecasting. However, this matter is not a concern over a forecast, for this Commission routinely approves and sets prospective rates based on forecasts. Rather, the concern is about fairness, equity, and policy articulations.

The majority finds that SoCalGas' process for searching for headquarters alternatives in suburban locations was imprudent. Yet, it makes no disallowance. On the other hand, the majority expresses concerns with the choice of the Gas Company Tower, but stops short of finding SoCalGas' choice imprudent. With respect to the equity interest SoCalGas negotiated, the majority opinion argues that because SoCalGas placed an estimated future value on the equity, SoCalGas shareholders should compensate ratepayers at the approximate rate of $4 million per year over the 20-year life of the SoCalGas lease.

What is the basis for this punitive treatment? Penalties promulgated by this Commission are typically premised upon unreasonable and/or imprudent utility actions. The majority opinion provides no answer as to why SoCalGas is penalized for negotiating an equity interest position. With the exception of disallowances for various expenses for the Gas Company Tower, all lease costs are approved, and passed onto ratepayers. The majority indicates only that "there is substantial evidence in this record that a less expensive headquarters could reasonably have been constructed on at least three different suburban locations." Two of the suburban locations referenced are locations proposed by the consultant SoCalGas retained, Cushman Realty Corporation. The third location in suburban West Covina was the preferred site chosen by the Division of Ratepayer Advocates (DRA).

Closer scrutiny of the record indicates that the two Cushman alternatives were less expensive than the SoCalGas Tower for only the first 10 years. Thereafter, the Gas Company Tower is less expensive. A 20-year average shows the Gas Company Tower to be less expensive than one of the two Cushman alternatives. It is, therefore, factually incorrect that "at least three" less expensive alternatives were available to SoCalGas. Further, the third purportedly less expensive alternative, DRA's preferred location, did not meet DRA's own requirements as a reasonable location for SoCalGas' headquarters. The record supports this. It is unclear why DRA's preferred location in West Covina evolved into the preferred location as it failed to meet DRA's own requirements.

Factually, then, it can only reasonably be argued that one alternative to the Gas Company Tower existed for SoCalGas. This is not a reasonable basis on which to penalize SoCalGas, and precisely why no imprudency could be found nor disallowance levied against SoCalGas for its suburban search.

The majority opinion is left without findings of fact, and without conclusions of law to warrant such a penalty for SoCalGas' reasonable actions negotiating its equity interest. The utility is left without direction -- to wend its way through the regulatory obstacle course never knowing whether a shrewd business manuever will clear the prudency hurdle or fall through a policy trapdoor.

Patricia Eckert

Patricia M. Eckert

July 23, 1992
San Francisco, CA

A.88-12-047
D.92-07-080

John B. Ohanian, Commissioner, Concurring.

Today's order resolves many issues concerning the move of Southern California Gas Company to a new headquarters site. I wish to comment on the issue of the equity interest. In today's order we settle all accounts between ratepayers and shareholders concerning the value of the equity interest.

As part of the Commission's ongoing business we regularly review the disposition of the gain on sale of utility assets. One of the very important considerations in gain on sale cases is whether ratepayers or shareholders took the risk on an asset. The allocation of gains then follows the assumption of risk.

In this order, by granting ratepayers the forecasted value of the equity interest, ratepayers will take no risk on the equity value of the Gas Tower building. Shareholders will take the entire risk associated with the company's interest in the building. Accordingly, at such time that Southern California Gas Company sells its equity interest, ratepayers will have no claim on the proceeds of that sale.

In many ways this simplifies the future regulatory review of this matter. Southern California Gas Company will have a true market incentive to maximize the value of its asset free from concerns about ratepayer claims upon the asset. At the same time, ratepayers are free from concerns that the expected future value could exceed the realized value and that ratepayers would be asked to make up the difference.

The alternative of granting the equity ownership to ratepayers would blur the distinction between shareholder investment and claims of ratepayers upon utility assets. Indeed, the debate about any allocation of gain on sale of any gas company asset in the future would be even more complicated than those we review now. Once ratepayers cross over into directly owning utility assets the ratepayers acquire an ownership interest in the firm. In the past this direct ownership has been limited by establishing balancing accounts to isolate ratepayer ownership to those specific assets, such as GEDA and EEDA. No such provision has been proposed here. Since investors do not actually buy individual assets when capital is contributed, I believe granting the equity ownership to ratepayers would require that they become owners of the utility in proportion to their contribution. In this case, over $30 million. I do not believe any party wishes this result.

Therefore, the reasonable way to handle the equity interest is for Southern California Gas Company to buy out the ratepayer interest and take title to the equity. That is what today's order accomplishes.

John Ohanian

John B. Ohanian

San Francisco, California
July 22, 1992