ALJ/RC1 *

Mailed
DEC 12 1995

Decision 95-12-018 December 6, 1995

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas & Electric Company (U 902-M) for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure.	)	Application 94-11-013 (Filed November 7, 1994)

ORIGINAL

INTERIM OPINION

Contents

Summary

San Diego Gas & Electric Company (SDG&E) is an investor-owned public utility subject to our jurisdiction. It has applied to undertake a plan of reorganization whereby it would become a wholly owned subsidiary of a holding company (Parent) to be formed for that purpose by SDG&E. Our interim opinion determined that the acquisition of SDG&E by Parent is not an acquisition activity that is subject to Public Utilities (PU) Code Section 854. (Decision (D.) 95-05-021, CPUC2d ~~prepared~~ (Section 854 Opinion).) We will approve SDG&E's application with conditions, primarily based on terms of a settlement among SDG&E and other parties.

Procedural History

SDG&E filed its application on November 7, 1994. Notice of the application appeared in the Daily Calendar on November 9, 1994. No protests were received. The assigned administrative law judge (ALJ) held a pre-hearing conference (PHC) on January 4, 1995. SDG&E requested that no hearing schedule be set until the parties had an opportunity to conduct settlement negotiations. The ALJ conducted a second PHC on March 17, 1995, and SDG&E and other parties reported that they were continuing to conduct settlement negotiations. SDG&E proposed a schedule that would have resulted in hearings being complete in May 1995. The ALJ, however, set a provisional schedule for evidentiary hearings to be conducted during the last two weeks of June 1995, intended to assure that parties would have the Commission's decision regarding the applicability of PU Code Section 854 before being required to serve prepared testimony.

On June 1, 1995, the date on which the Commission's Division of Ratepayer Advocate's (DRA's) testimony was due, SDG&E, Utility Consumers' Action Network (UCAN), and the Federal Executive Agencies (FEA) served a "Joint Recommendation" on the ALJ and parties. UCAN is a consumer advocacy group supported by

41,000 residential and small customers of SDG&E. (ALJ Ruling Pursuant to Rule 76.71 (Mar. 24, 1995).) FEA represents federal agency customers of SDG&E, including the Department of the Navy. SDG&E, UCAN, and FEA recommended that the Commission approve SDG&E's application, subject to several conditions. (See Appendix B for those conditions.) On June 9, 1995, the assigned ALJ issued a Ruling Pursuant to Rule 51.3 directing that SDG&E file the Joint Recommendation under the settlement rules, and informing parties that the evidentiary hearing set for June 19-30, 1995 would be converted to a PHC on June 19, 1995, since it appeared from the prepared testimony of SDG&E and DRA that all of the issues revolved around policy differences rather than factual matters.

DRA filed comments on the Joint Recommendation, and SDG&E filed reply comments. DRA did not identify any factual issues involving the Joint Recommendation, but it opposes the settlement agreement on the basis that SDG&E has not demonstrated the need for the reorganization and the Joint Recommendation omitted several conditions that DRA considers crucial. The matter was submitted on the prepared testimony and briefs filed August 11 and 25, 1995. DRA, SDG&E, and UCAN[2] filed briefs and reply briefs.

Pursuant to Rules 51.6 and 77.1(f) the ALJ issued a ruling on November 3, 1995 inviting comment on the draft decision. SDG&E and UCAN commented. FEA did not comment, but SDG&E represented that FEA had authorized SDG&E to state that FEA supported the draft decision, including the proposed conditions. DRA did not comment, on the grounds that the draft decision should have been circulated as a proposed decision pursuant to PU Code § 311(d). Without resolving that issue, we accept DRA's comments, filed late, due to the apparent misunderstanding about this stage of the process.

In its reply brief, DRA moved to strike a portion of the UCAN's opening brief. DRA's motion is denied.

Pursuant to Rule 51.1(e), we do not approve a contested settlement such as the Joint Recommendation unless it is "reasonable in light of the whole record, consistent with law, and in the public interest." Our adoption of such a settlement is binding on all parties to the proceeding, but unless we expressly provide otherwise, such adoption does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding. (Rule 51.8.)

In our interim decision in this proceeding, we placed the burden of showing that the proposed transaction is in the public interest on SDG&E. (Section 854 Opinion.) SDG&E retains that burden in the present context of a contested settlement agreement.

Description of the Proposed Reorganization

SDG&E proposes to have Parent and Parent's subsidiary (Merger Company) incorporated under California law. SDG&E would own all of the stock of Parent, and Parent would own all of the stock of Merger Company. SDG&E, Parent, and Merger Company would enter into a merger agreement, by which SDG&E would be merged with and into Merger Company, with SDG&E as the surviving corporation (the Merger). As consideration for the Merger, the holders of SDG&E common stock would receive common stock, on a share-for-share basis, of Parent, and the outstanding shares of Parent held by SDG&E would be canceled. SDG&E's existing holders of preferred and preference stock would be unaffected. As a result of the Merger, SDG&E would become the wholly owned subsidiary of Parent. SDG&E's shareholders authorized the Merger at a shareholders' meeting held in April 1995.

The specific steps for which SDG&E seeks our approval are as follows:

1. to issue 100 shares of common stock of Parent;

2. to issue a number of shares of stock of Parent equal to the number of shares of SDG&E common stock outstanding immediately prior to the effectiveness of the Merger;

3. to reserve for issuance a number of shares of Parent stock equal to the number of shares of SDG&E common stock reserved for issuance by SDG&E's Board of Directors under employee benefit plans and similar arrangements immediately prior to the effectiveness of the Merger; and

4. to issue 100 shares of common stock of Merger Company.

SDG&E has not asked us for approval to sell the shares for which it seeks issuance authorization. SDG&E also intends to transfer its ownership in several non-utility subsidiaries to Parent. It has not asked for any authority to do so pursuant to PU Code Section 851. We have previously stated that any purported transfer of utility property subject to PU Code Section 851 without such authority is void. (See In re Pacific Telesis Group (D.93-11-011) 51 CPUC 2d 728, 745.) We will reach no conclusion in connection with this application as to whether any such subsidiaries constitute utility property.

Reasons for the Holding Company Reorganization

Although the parties all agree on the need to condition any approval of the Merger, DRA does not believe that the transaction is necessary in the first place.

SDG&E's Rationale

SDG&E justifies its desire to reorganize under a holding company pursuant to the Merger on the grounds that both regulation of and the markets for SDG&E's services are changing. SDG&E points to the growth of the independent power producer industry over the past several years as the beginning of a trend that will result in a competitive electrical generation business, especially in light of the Commission's electrical industry restructuring proposals. SDG&E believes that generation dispatch, transmission, and demand-side management may join

electrical generation as competitive businesses. In SDG&E's view, such operations should be conducted by separate business units that are not under the ownership and control of SDG&E as a regulated utility. Separation is required, SDG&E believes, to insulate utility cash flow from volatility and risk of all types of competitive markets. Because the regularity of cash flows strongly influences the credit rating of a utility (and therefore its cost of borrowed capital), SDG&E hopes that keeping competitive ventures and regulated service in different business units will help maintain a steady cash flow for the utility operation.

Also, as non-utility business ventures increase compared to the regulated utility's level of operation, SDG&E points out that the utility has increasing exposure to liabilities of such ventures. At the same time, moreover, the range of financing options for such ventures is limited because of the close ties to a regulated business. SDG&E believes that a holding company structure will address both concerns.

DRA's Critique of SDG&E's Rationale

Among other objections, DRA believes that the proposed holding company structure is unnecessary. DRA points to what it considers a dismal record of failure in unregulated businesses by utilities operating without a holding company, such as SDG&E, and by utility holding companies, such as Pacific Enterprises and DRA doubts that placing a business under a holding company, rather than a utility, will improve the historical performance of SDG&E's unregulated businesses.

DRA gives Pacific Gas and Electric Company as an example of a utility that has been successful in running unregulated businesses without a holding company structure. DRA sees nothing in that utility's experience that suggests a holding company is needed to protect the utility from business risks in unregulated enterprises.

Also, DRA fears that a holding company would hinder electrical restructuring. Nothing, in DRA's view, shows that spinning off generation into a holding company "sister" affiliate is superior to creating a utility "daughter" affiliate. Both types of affiliates, it argues, pose issues that could hinder the emergence of a competitive generation market.

DRA reminds us of the long history of abuse of the holding company form of organization leading up to the passage of the Public Utilities Holding Company Act of 1935 (PUHCA). In 1932, almost half of investor-owned utilities in the United States were controlled by three holding companies. (Stephen Ferrey, Law of Independent Power (1994) § 5.04[1][a].) Those and other large holding companies escaped effective state regulation because of their vast resources and interstate scope of operations. (Id.) Pyramiding of holding companies insulated management from investor control, and management of holding companies soaked utility revenues up the corporate food chain without regard to the capital needs of the utilities. (See id.) Self-dealing through complex schemes of intracompany and affiliate transactions at excessive rates was one of the rampant abuses at that time. (Id.)

PUHCA brought interstate utility holding companies under the jurisdiction of the Securities and Exchange Commission and resulted in the simplification of corporate organization charts by abolishing holding companies more than twice removed from their operating subsidiaries. (Id.) Remaining utility holding companies are either subject to federal jurisdiction, if they have interstate operations, or to their respective states, if they operate only in intrastate commerce. SDG&E intends to establish its exemption from PUHCA on the basis that it qualifies as an intrastate holding company.

Proper Role of the Commission on Matters of Corporate Governance

No statute requires a utility to be organized as a corporation or, if it is, that its ownership be divided among many individual investors. (See PU Code §§ 204 & 205, defining "corporation or person" to include a corporation, a company, an

association, a joint stock association, an individual, a firm, and a copartnership.) We believe that the form of business organization and ownership of a public utility touches upon its public calling, and we will not permit any corporate structural change that necessarily impairs the discharge of that calling. We also believe, however, that the form of organization and ownership of any for-profit venture ought lie, in the first instance, in the sound discretion of management, subject to the rights provided otherwise of the shareholders to consent, and subject to our oversight to the extent necessary to protect the public interest. Pursuant to Rule 51.8 of our Rules of Practice and Procedure, we intend the principle expressed in the preceding sentence to be precedent for future similar proceedings.

Nothing in this record suggests that SDG&E's management has exercised its business judgment to pursue its plan of reorganization other than regularly. Its professed rationale is not implausible. SDG&E's reasons for reorganization are not dissimilar to the reasons it gave in its 1985 application or the reasons that Southern California Edison Company (Edison) gave in its 1987 application. We have found the holding company form of organization and ownership, subject to appropriate safeguards, suitable for major public utilities in the past. (See, e.g., In re Southern California Edison Company (D.88-01-063), 27 CPUC2d 347 (Edison Decision); In re San Diego Gas & Electric Company (D.86-03-090), 20 CPUC2d 660 (1986 Decision).) Nothing has happened in the past several years that necessarily makes the holding company structure less intrinsically suitable today.

DRA argues that SDG&E should be required to show that its reorganization does more than provide a benefit to shareholders -- it should also benefit ratepayers. Had we

determined that the proposed transaction was an acquisition activity subject to PU Code Section 854, we would have required SDG&E to show that the reorganization provides net benefits to the ratepayers in both the short-term and long term. (PU Code § 854(b)(1).) We determined, however, that this is not such an acquisition activity. (See Section 854 Opinion.) Accordingly, we decline to impose that burden on SDG&E now.

SDG&E will undergo no change in its corporate identity as a result of the Merger other than the purely formal change occasioned by its merger with and into Merger Company. Merger Company is a pure legal fiction, which has no operations, no employees, no assets, and no purpose aside from facilitating the change of ownership of SDG&E common stock. We will not substitute our judgment for SDG&E's conclusion that the proposed reorganization is suitable from a corporate governance standpoint. We will, rather, focus on what conditions may be required to protect the public interest.

Conditions Required to Protect the Public Interest

The recent history of utility reorganizations into holding companies has been a history of conditions. SDG&E obtained our consent in 1986 to reorganize in a manner similar to what it now requests (1986 Decision). It declined to accept five of the 20 conditions that we then imposed. We approved a similar transaction for Edison, but imposed 15 conditions (Edison Decision). Edison accepted those conditions. SDG&E's prepared testimony in this application proposed 15 conditions. SDG&E, UCAN, and PBA later agreed on 11 conditions in their Joint Recommendation. DRA's prepared testimony proposed 85 safeguards and guidelines, some of which overlapped the 11 conditions in the Joint Recommendation and corporate policies that SDG&E represented would be adopted by its Parent. In its comments on the Joint Recommendation, DRA approved the 11 conditions, but recommended an additional 25 safeguards, which can be organized

into 10 additional conditions and recommendations for modifications of the Joint Recommendation's proposed conditions.

Obviously, there is no "right" number of conditions that allows us to say "11 is too few, 21 is too many." SDG&E may view additional conditions in terms of its desire for the benefits of flexibility that led it to propose a holding company, while DRA may hope that this Commission suffer no diminution of its regulatory powers as a result of permitting the arrangement.

We are left to strike the balance that will allow easing our oversight of competitive and unregulated enterprises of affiliates while retaining our ability effectively to regulate utility operations. As ever, we remain determined that the utility's remaining powers as a natural monopoly be clearly vested in operating units that we may readily identify and regulate. It only requires mention that in striking such balance, we find ourselves engaged in a quasi-legislative mode, concerned primarily with questions of policy, rather than in a quasi-judicial mode where we would be engaged in the application of law to facts.

We will begin by assessing conditions where the parties are either in agreement or differ only in wording. Then we will examine DRA's proposed additional conditions.

Joint Recommendation Conditions

1. Access to Affiliate Data

DRA recommends that we subject all data of SDG&E affiliates to staff access to the same extent and in the same manner that SDG&E is subject. SDG&E, UCAN, and FEA ask us to handle this issue by reference to PU Code Section 314,[11] which limits access to the records of affiliates to transactions between the utility and affiliate "on any matter that might adversely affect the interests of the ratepayers" of the utility. (PU Code § 314(b).)

We believe that data which would not be subject to access if an affiliate were an SDG&E wholly owned subsidiary should not become subject to access if it were an affiliate of Parent. (See In re Reporting Requirements for Electric, Gas, and Telephone Utilities Regarding Their Affiliate Transactions (D.93-02-019) 48 CPUC2d 163, 177 (Affiliate Transactions Order).) The access provided by PU Code Section 314(b) to affiliate records contains two significant limitations: first, that the data relate to a transaction with a utility, and second, that the transaction be one that might adversely affect ratepayers. The condition proposed by DRA would avoid each of these statutory limitations.

DRA argues that we imposed the substance of this condition in the 1986 Decision, a telephone company decision in 1987[12], and the Edison Decision in 1988. SDG&E agrees that the 1986 Decision contained this condition, but points out that the Edison Decision did not.[13]

At the time of the 1986 Decision, PU Code Section 314(b) applied only to telephone utilities. (See Stats.1985 c.1249 § 1.) When the Legislature later amended PU Code Section 314(b) to apply to electrical and gas utilities, it limited access to transactions involving matters adversely affecting ratepayer interests. (See Stats.1986 c.845 § 1.) We see no compelling reason why SDG&E should be singled out for special treatment in this regard.

Although the settling parties are have agreed to specific burdens of proof with respect to discovery disputes[14], we do not by adopting these standards displace our discovery dispute resolution process, currently ALJ Resolution 164. Our present process provides for a mandatory effort for the parties to meet and confer in good faith, reducing the disputes that are brought before us. Usually utilities and staff have been able to resolve disagreements and balance discovery burdens with the

investigative needs appropriate for our regulatory obligations. We hope this will continue to be the case with SDG&E and affiliate transactions, and remind SDG&E that we will interpret Section 314 broadly, in a matter not necessarily limited by the principle of relevance to an open proceeding.

Parties also differ with respect to whether officers and employees of affiliates should be required to appear and testify in Commission proceedings without subpoena.

DRA is concerned that officers and employees of Parent and its subsidiaries and affiliates may evade Commission jurisdiction if we do not dispense with due process. DRA cites the 1986 Decision, where we required such persons to "be available and appear and testify in Commission proceedings without subpoena." (20 CPUC2d at 690.) DRA argues that the Edison Decision is consistent in its condition that the corresponding Edison individuals "shall appear and testify in Commission proceedings, as necessary or required." (27 CPUC2d at 375.)

In the Edison Decision, Edison's proposal was that officers and employees simply "be available to appear and testify in Commission proceedings." Another party argued that unless "without subpoena" were added, some officers and employees who reside outside California would be unavailable, because they would not be subject to our subpoena power. We added instead the "additional clarifying phrase, 'as necessary or required'" and stated "that it is the utility's burden to prove its contentions in any proceeding before the Commission." (Id. at 365.) We went on to observe: "To fail to produce witnesses as necessary or required on the technicality of non-jurisdiction would be a grave mistake." (Id.)

We hold the power of subpoena by constitutional grant. (Cal. Const. Art. XII, § 6.) Although the power of subpoena in

combination with the power to punish for contempt are important tools, we seldom if ever have had to compel testimony. In the rare occasion on which it were necessary to use those powers to obtain a witness, we doubt we would have any greater power than the courts. Although California litigants may use subpoena processes of other states to obtain attendance in California, California procedures generally limit the obligation of out-of-state witnesses for attendance. (See Cal. Code of Civ. Proc. § 1989.) If we do not have or exercise the power to subpoena an out-of-state witness, we would not, by adding the suggested language, increase the scope of our process. As noted in our Edison Decision, however, if such persons are the agents of a utility or its affiliated entity, we can, and in appropriate cases will, place or shift burdens as to facts to which such persons could testify if the utility does not cause them to appear voluntarily. An omitted witness may give rise to a conclusion on our part that the utility is withholding information adverse to its position, and therefore has failed to meet its burden. (See, e.g., Cal. Evid. Code § 412.)

2. Affiliate Transactions Audit

The parties propose an audit of SDG&E affiliate transactions within three to six years after our decision on this application. The cost of this audit would be borne by shareholders.

DRA also asks that we charge it with selecting and supervising the auditor, which we shall do.

3. Dividend Policy

The parties endorse the principle that SDG&E's dividend policy should be set by its board of directors as if it were a "stand-alone" utility.[15]

To police this principle and the first call on capital principle discussed next, DRA proposes that we require

Parent and each of its subsidiaries to submit projected capital budgets with financing requirements, construction plans, and current-year sources of funding during each of the three calendar years following this decision. DRA believes that knowing the extent to which SDG&E affiliates rely upon the utility for capital needs is key to determining whether SDG&E is actually setting dividend policy on a "stand-alone" basis and giving first priority to the capital needs of the utility.

This was a condition we imposed in the 1986 Decision. However, we found it unnecessary in the Edison Decision (27 CPUC2d at 366.) We expressed our reluctance there to involve ourselves with management functions, such as budgets, of holding companies. (Id.) Guided by the standard of ratepayer indifference, we determined that, in light of the modest increase to be expected in non-utility revenues, the other reporting requirements we imposed would be adequate to support our regulatory function. (Id.) Some of the conditions we relied upon in the Edison Decision are proposed here, but not all. We also have no evidence on this record to indicate that non-utility revenues are likely to remain small in relation to utility operations, especially in light of the uncertainties created by electric restructuring.

We do not usually, of course, mandate particular dividends in the course of our regulation of utilities, although we may consider it important evidence in relation to setting reasonable rates. (See 1986 Decision, 20 CPUC2d at 370 ("we are mindful that (fair returns on) investment, whether in the form of dividends or retained earnings, are rightfully the property of shareholders to dispose of as they see fit, subject only to the constraint that in so doing the operations of the utility and the entitlements of its ratepayers to quality service at reasonable rates should not be jeopardized"); see also In re California American Water Co. (D.86807) (1977) 81 CPUC 204, 239.) As we

move to performance-based ratemaking, and innovation since the 1986 Decision and the Edison Decision, return on investment is [illegible] one way of gauging the impacts of that ratemaking.

We do not believe that we can necessarily measure jeopardy to the ratepayers by the capital demand of SDG&E's affiliates. Accordingly, we see no need for DRA's proposed capital budgets report. When SDG&E comes to us for rate increases in the future, we will consider the pattern of its retained earnings as appropriate to determine if any financing-related component of such increase is justified.

4. First Call on Capital

The parties agree that Parent and SDG&E should give SDG&E's utility needs the highest priority.

5. Balanced Capital Structure

The parties agree that SDG&E should maintain a balanced capital structure.[11]

6. Employee Transfers

The parties agree that SDG&E should receive a percentage of the salary of certain utility employees transferred to affiliates in certain circumstances. They disagree on how much.[12] DRA proposes 25% of the transferred employee's base annual compensation, compared to the Joint Recommendation, which proposes 15%.

DRA argues that if one purpose of the transfer fee is to provide a disincentive to intra-company mobility, a higher transfer fee is superior to a lower. While true, it provides no principled basis on which to prefer 25% to any other amount greater than 15%. DRA also argues that we imposed a 25% transfer fee in two Pacific Bell decisions, and SDG&E ratepayers deserve the same. In the first of those decisions, we did impose a 25% employee transfer fee, stating that the focus should be on approximating the market value of the benefits associated with

such transfers, and received by the affiliates, including an analysis of the costs avoided by them as a result of obtaining employees from the regulated utility. (In re Pacific Bell (D.87-12-067) 27 CPUC2d 1, 137.) We set the fee at 25% based on the evidence in that proceeding. (Id.) Later, Pacific Bell requested a waiver of the 25% employee transfer fee with respect to a mass transfer of employees from a below-the-line department to a below-the-line corporation owned by the utility. (In re Pacific Bell (D.92-07-072) 45 CPUC2d 109, 114, 122.) We accepted DRA's analysis that a going-concern valuation of the operation could substitute for the 25% transfer fee in the case of the mass transfer, but continued to apply the transfer fee to subsequent transfers, to which the utility did not object. (Id. at 122-23.)

However, we did not establish a generic employee transfer fee in the Pacific Bell case. In that case, we made clear that we were not establishing generic affiliate transaction guidelines. (Id. at 113.) Moreover, the fee there was based on substantial evidence on the record as to the costs avoided by the acquiring affiliate in an information services/telecommunications business. No evidence in this record shows what the appropriate transfer fee is in the case of an electric and gas utility. SDG&E's witness Morse testified that "[h]eadhunter fees of 15 to 25% are common depending on the type of employee involved" (Ex. 6, at 18).

SDG&E argues for the lower end on the basis that the purpose of the fee should be to compensate the utility for any costs it might incur to replace an employee. But we have previously used benefit to the transferee, not detriment to the transferor, as the proper measure, and we think the same principle should apply here. We will adopt a transfer fee of 25% (which SDG&E concedes may be appropriate in some cases) as a presumptively reasonable transfer fee for the covered employees, subject to an appropriate showing by SDG&E that some lesser

percentage, down to 15%, is more reasonable based upon the legitimate and verifiable recruitment costs to the transferee involved for specific classes of employees at the time. In the case of mass transfers, if any, the employee transfer fee shall be a line item element in the business valuation.

7. No Diversion of Management Talent

The parties agree that management talent of the utility is a precious resource that should be used wisely and not diverted in ways that would detrimentally affect SDG&E.

8. Interconnection Facilities and Equipment

The parties agree that neither Parent nor its subsidiaries should provide interconnection facilities or related electrical equipment to SDG&E, where third-party power producers are required to purchase such facilities or equipment in conjunction with the sale of electrical energy to SDG&E unless the third party has the option to provide similar facilities and equipment through competitive bidding in which Parent and its non-utility subsidiaries may participate.

9. Costs of Reorganization

The parties agree that the costs of the reorganization should be borne by shareholders.

10. Equal Access to Utility Data

SDG&E, UCAN, and FEA propose that whenever SDG&E provides "valuable customer information, such as market technological or similar data" to a non-utility affiliate, it must make such data available to the public on the same terms. DRA's formulation of the same point is that "affiliate access to property or valuable information must be at the same terms and conditions as being offered to third parties." We view DRA's version as equivalent, although it might suggest that SDG&E would be able to offer data to affiliates only after it had offered it to third parties.

We do not propose to turn SDG&B into an information utility with the duty to provide data on demand. SDG&B's duties as a utility will continue unexpanded by our order in this application. We are concerned here solely with proprietary data of SDG&B, that derives its value, at least in part, from not being generally known, and that is not subject to PU Code Section 851. The purpose of this limitation is to limit undue advantage in competitive markets based on access to such data. (We therefore interpret "the same terms and conditions" to mean access on comparably timely terms when the data has a short-term competitive usefulness.) For that purpose, we prefer the SDG&B, UCAN, and FEA formulation.

11. Affiliate Transaction Guidelines

SDG&B, UCAN, and FEA propose the adoption of certain corporate policies that are intended to govern affiliate transactions. DRA proposes adoption of a competing set of accounting safeguards and transfer pricing guidelines.

Before analyzing the differences, we should note that we view such policies as responsive to the Affiliate Transactions Order, which requires that each utility and controlling corporation have procedures and controls in effect to implement certain safeguards, such as ensuring that recordkeeping practices are sufficient to allow and facilitate reporting and documentation by the Commission of all transactions between the utility and its affiliated entities. (48 CPUC2d at 174-75.) In approving any particular set of such policies, therefore, we do not pass on their adequacy in the abstract. The only way to determine if the procedures and controls are working is to perform an audit. If the audit reveals deficiencies in the policies, it will be no defense that their adoption was a condition here. We are now concerned only to see that the policies are reasonably complete as a response to the Affiliate Transactions Order's requirements. Of course, we may change the

Affiliate Transactions Order in the future, and SDG&E and other utilities would be required to conform their policies with appropriately."

Cost Recovery Principle

DRA proposes that SDG&E should adopt a policy requiring that costs incurred by SDG&E on behalf of any affiliate be fully recovered from the affiliate. SDG&E accepts this proposal. (Ex. 6 at 19.) This is consistent with the requirement that transactions with affiliates have a transfer price and that affiliated entities make timely reimbursement to the utility. (48 CPUC2d at 175.)

Limitation to Critical or Essential Services

DRA proposes that the non-tariffed services that SDG&E provides to its affiliates should be limited to "critical or essential" services, by which it means "a service that the affiliate must have in order to operate in the manner authorized." DRA's definition excludes any services that the affiliate could obtain by existing or additional employees or from a vendor (with an exception where necessary to protect proprietary information). DRA's proposal derives from a 1992 Pacific Bell case, (In re Pacific Bell (D.92-07-072) 45 CPUC2d 109.) In that case, we made clear that we were not establishing generic affiliate transaction guidelines. (45 CPUC2d at 113.) We imposed the "critical or essential" limitation in that case, at least in part, on the utility's failure to timely implement cost allocation procedures for a particular affiliate. (Id. at 125.) We did not require the utility to so limit its services to all affiliates, and we see no reason to do so now.

Fully Loaded Cost With Markup

While the parties agree that non-tariffed services provided by SDG&E to its affiliates should be priced at the higher of market or fully loaded costs with markup, DRA proposes that 10%, rather than 5%, be added to costs as the markup. DRA

views the higher markup as providing a better safeguard to the ratepayers, while SDG&E considers the lower markup adequate to "cover anything that might have inadvertently not been charged directly to the affiliate." (Ex. 6 at 20.) DRA relies on the Pacific Bell case as the source for its recommendation. (In re Pacific Bell (D.92-07-072) 45 CPUC2d 109.) However, we did not intend the result there to be applied generally (45 CPUC2d at 113.) Moreover, the utility in that case attempted to show that the cost of a service plus 10% consistently exceeded the market price of the service. (Id. at 124.) It failed to do so, and we ordered 10% applied in the particular circumstances of that case for the affected affiliate. We do not think that the same result is appropriate for all affiliates in this case.

Higher of Market Value or Net Book Value Threshold

A part of the corporate guidelines that SDG&E, UCAN, and FEA propose as a condition of approval is a policy that would set transfer pricing for "goods or services not produced, purchased, or developed for sale." (Ex. 2, Attachment A, at 8-13.) The policy is responsive to the requirement in the Affiliate Transactions Order that utilities have in place transfer pricing policies. Examples of covered items would include data processing, incidental use of vehicles or office space, use of small tools, and other such items that are incidental to the main business of the provider. (Id.) The policy excludes capital assets. SDG&E's policy would value such transfers at the greater of fully loaded cost or fair market value when SDG&E is the provider and the lesser when SDG&E is the recipient. However, for transactions under $100,000 or where no comparable market data is available, SDG&E proposes an allocation process to determine fully loaded cost.

DRA recommends two changes to this policy: (1) it should also apply to "assets" and "valuable information not produced, purchased, or developed for sale"; and (2) fully loaded

costs should be determined/ whether or not the transaction is greater than $100,000 or a fair market value determinable to ratepayers views

DRA's definition of assets would extend the applicability of this policy to real property and intangible property (such as intellectual property, which presumably encompasses "valuable information"). SDG&B has a different transfer pricing policy applicable to "tangible real or personal property and intangible property used in a trade or business." (Id. at 5-7.)

If the assets are above-the-line, they are presumptively subject to PU Code Section 851 jurisdiction to determine whether they may be transferred in the first place and, if so, at what valuation. If the assets are below-the-line, ratepayers should be indifferent because no reason exists to treat below-the-line assets any differently from retained earnings. At this point, they each represent shareholder property. So no compelling reason appears to extend the applicability of SDG&B's policy beyond goods and services produced for sale by broadening it to "assets."

Definitions of Assets

DRA proposes that the terms used in the Joint Recommendation, including the proposed corporate policies and guidelines for affiliate transactions, all be defined by reference to the corresponding definitions in the Affiliate Transactions Order and the Edison Decision. Again, the purpose of the policies is to conform to the Affiliate Transactions Order. In the event that the policies fail to do so and fail appropriately to treat affiliate transactions, we will deal with such shortcomings in the face of actual data. We are not, therefore, concerned that SDG&B's proposed policies may contain definitions that depart from those in the Affiliate Transactions Order since the final test does not depend on the policies and its definitions.

One definitional matter, however, requires attention. In the Affiliate Transactions Order, we adopted a poor definition of fair market value. We defined fair market value in a way that systematically understates the correct result: "the price offered by a willing purchaser in an arms-length transaction" (48 CPUC2d at 173; compare Edison Decision, 27 CPUC2d at 392 ("consideration offered by a willing purchaser of an asset in an arms length transaction").) The amount offered by a willing purchaser in an arms length transaction is seldom, in common experience, the closing amount. Something closer to the traditional formulation is needed to account for the missing actor, the seller. (See, e.g., Black's Law Dictionary (1990, 6th ed.) at 597 ("amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts").) We will take up this definitional issue when we next revise the Affiliate Transactions Order. We note that SDG&E's proposed policy (which defines "fair market value" as "the price offered by a willing purchaser in an arms-length transaction") conforms to the current Affiliate Transactions Order, but suffers from the same defect. SDG&E is on notice that it should not rely on the definition of fair market value in the Affiliate Transactions Order in cases in which the current definition understates the proper valuation.

Benchmark Payments for Intangible Property

SDG&E's proposed policy for intangible assets, including copyrights, patent rights, trade secrets, royalty interests, licenses, and franchises, requires payment at fair market value plus a royalty to be developed on a case-by-case basis. (Ex. 2, Attachment A, at 6-7.) DRA proposes that the definition of intangible property be expanded to include the benefits that SDG&E affiliates might derive from their association with the utility and that compensation be required in

the form of benchmark payments or other compensation. It was a condition to the 1986 Decision that SDG&E and its proposed holding company in that application appear in a Commission-initiated investigation to determine a system of benchmark payments.

We considered imposing this condition in the Edison Decision and rejected it, saying:

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

(27 CPUC2d at 369.) We see no reason why we should change that conclusion.

Name or Logo

DRA wishes to reserve the right to recommend payment for a name or logo, although it recognizes that this is not our policy. DRA will not be estopped from raising this issue in other proceedings in the future, should our policy change.

Co-location

DRA believes that SDG&E should have a policy specifically governing co-location. The policy would articulate two principles: (1) affiliates that co-lease equipment with an SDG&E facility should pay fair market value for co-location rights; and (2) third parties should have the same rights to co-location as offered to affiliates.

SDG&E does not appear to be troubled by the first principle, requiring payment of fair market value, and its more general policies would have the same result, subject to

alternative valuation in cases in which the fair market value was under $100,000. We see no reason why co-location should be treated differently from other property or why the more general policies are inadequate.

With respect to the equal access principle, however, SDG&E disagrees that it would be required to treat third parties and utilities in the same manner for co-location terms and conditions. Since DRA has another proposed policy regarding equal access, for the same reasons (*i.e.*, that it assures that the utility will obtain the best price while also avoiding potentially anticompetitive transactions with affiliates), there is no reason to treat co-location rights separately on the question of equal access, as discussed next.

Equal Access to Other Property

DRA proposes that affiliate access to property or valuable information must be at the same terms and conditions as being offered to third parties. DRA also urges that complementary third parties should have access to utility goods, services, and valuable information on the same terms and conditions as they are provided to affiliates. The first formulation implies that SDG&E could not provide utility access to property or valuable information without first having established the required terms and conditions by an offer to third parties. The second formulation implies that SDG&E could offer "goods, services, and valuable information" to affiliates without first having offered to third parties, but then third parties would be entitled to the same treatment.

We have already decided to treat valuable information in accordance with the Joint Recommendation formulation. That leaves goods and services which, so far as we know, SDG&E is not generally in the business of manufacturing or dealing in as utility goods. If it were in the business, it naturally would seek to gain customers and market share by whatever means

necessary and would set terms and conditions by bargaining with its customers. But if SDG&E buys a carload of copy paper for its own use and as central stores for its affiliates (who presumably would be allocated their proportionate costs), we see no need to require them to go into competition with paper merchants. A utility has no duty to provide non-utility goods and services.

SDG&E contemplates providing corporate support services to its affiliates for tax, legal, and accounting needs. The same principle applies to these non-utility services.

FCC Part 64

DRA recommends that we require SDG&E to determine fully allocated costs in accordance with Part 64 of the regulations of the Federal Communications Commission (FCC), because we have required telephone utilities to do so. SDG&E's witness testified in prepared testimony that gas and electric utility accounting methods and rules are subject to regulations prescribed by the Federal Energy Regulatory Commission (FERC). (Ex. 6 at 29.) SDG&E allocates costs based on those regulations. (Id.) SDG&E believes that its cost allocation methodologies are similar to the methods required by Part 64, but not intended to comply with them. (Id. at 30.) Imposing Part 64 would require SDG&E to implement and reconcile parallel FERC and FCC cost allocation methodologies. We will not require SDG&E to also implement Part 64 in the absence of evidence that the FERC methodology is inadequate.

DRA's Proposed Additional Conditions

DRA argues that we should take this opportunity to continue the work begun in the Affiliate Transactions Order, because our regulation of utilities is a constantly changing task which requires a continuous commitment to flexibility and change. In light of restructuring of the electric industry, DRA argues, we should consider whether the existing affiliate transaction safeguards and conditions are adequate.

1. Preservation of Regulatory Control

DRA asks that we require SDG&E to preserve the regulatory control which the Commission currently has over SDG&E's activities. We agree that the proposed reorganization transaction should not, and in our view, does not, diminish regulatory control. In order to conclude that this reorganization, with the safeguards adopted, is in the public interest we rely upon an understanding that reorganization, in and of itself, does not diminish our powers over utility activity or render us unable to revise the affiliate transaction guidelines should they prove inadequate to protect ratepayers. A condition neither adds to nor diminishes our regulatory control.

Additionally, if we imposed this condition we could expect an endless litigation in which the condition would be invoked as establishing a "historical" test of utility regulation in 1995 as the standard by which all future regulation of SDG&E and its affiliates would be assessed. Parent, SDG&E, the electric utility industry, and our regulatory role will continue to evolve in the future as we revisit the scope and scale of regulatory interests. Too many scenarios, now speculative, may develop for which the Commission will require flexibility, and a condition wedded to the existing level of control and corporate organization might prove too rigid.

2. Rate Reduction

DRA proposes that we require SDG&E to provide ratepayers with a minimum and quantifiable benefit in the form of an up-front reduction in rates of one percent to offset the added costs and risks incurred by ratepayers as a result of the formation of Parent.

DRA notes that ratepayers can expect no other benefit from the reorganization, the reorganization will lead to increased costs that will be borne by ratepayers, and the

reorganization will pose risks also borne by ratepayers that presumably will lead to yet further increased costs to them.

We are more inclined to apply a standard of ratepayer indifference to these types of reorganizations than to try to find positive ratepayer benefits. But it is unnecessary to decide that issue, as discussed below.

DRA sees costs arising from two sources: cross-subsidies from the utility to its unregulated affiliates and management neglect of the utility or favoritism to the affiliates. The principal danger from both sources that DRA identifies is a possible future massive increase in the level of SDG&E's utility-affiliate transactions since the utility would be purchasing substantial portions of its power from an unregulated affiliate. If this becomes a problem, however, it is not because of a holding company transaction now. It will be a problem only if we signally fail in restructuring electric industry regulation.

As examples of cross-subsidies, DRA points to the abuses leading to the adoption of PUHCA some 60 years ago. DRA then cites more recent examples from other jurisdictions of local exchange telephone companies failing to deal at arms length with their affiliates by failing to bargain for revenues from yellow page publishing and by purchasing goods and services above fair cost. As one example of utility-affiliate abuse, DRA cites the Department of Justice antitrust suit against AT&T that led to the break-up of the national telephone monopoly in 1984. In California, DRA cites a case that it sees as involving disallowance of purchases of gas by a utility from an affiliate and another case involving power purchase payments to an affiliate of another utility.

Because SDG&E and Parent will have, initially at least, common directors and principal officers, DRA foresees management

neglecting the search for cost savings or better utility service in favor of cultivating the businesses of unregulated affiliates. As affiliates thrive, the problem of diversion of management talent can only be expected to grow greater; and, on the other hand, if affiliates wither, diversion grows greater as well. DRA then invokes the prospect of utility management sitting down to bargain with itself for the purchase of electricity from a generation affiliate and deliberately maximizing the price.

The record contains no example of a cost that will necessarily flow to ratepayers from the reorganization. DRA has identified risks without an estimate of the degree to which such risks reasonably can be expected to escape detection. We prefer to address cross-subsidies, managerial neglect, or favoritism when faced with an example before valuing the consequences. Therefore, we will not adopt a one-percent rate reduction as a tax on this transaction.

3. Cash Flow and Benefits Reports

DRA proposes that SDG&E's annual report required by the Affiliate Transactions Order should include a consolidated (excluding SDG&E) cash flow statement of Parent prepared in accordance with generally accepted accounting principles (GAAP) with a line item to summarize all cash transfers from SDG&E to affiliates, whether by way of dividend or payment. DRA believes that knowing the total amount of cash transferred from SDG&E to its affiliates will enable us to determine if SDG&E is sending more cash than it can afford to affiliates.

Even though we are not convinced that such a lump sum is necessarily meaningful, the information is readily determinable from other sources. Under GAAP, affiliate transactions are ordinarily summarized in a note, rather than as a line item in partially consolidated statements of cash flows. SDG&E has represented that Parent will register its shares with the Securities and Exchange Commission. Accordingly, Parent will

be required to publish periodic financial reports in accordance with GAAP that will disclose affiliate transactions in a manner as We will receive such periodic reports pursuant to the Affiliate Transaction Order, which should also include dividends of SDG&E Accordingly, we do not see why creating a new reporting requirement is necessary in this case.

Next, DRA proposes that rights to discounted utility service should be treated as an element of benefits required to be reported pursuant to the Affiliate Transaction Order. DRA argues that although transferred SDG&E employees do not currently retain the right to discounted utility service, that right might be granted in the case of future transfers. Such a right could constitute a cross subsidy to employees of an affiliate. That is not the issue is not ripe. Moreover, we do not see why SDG&E should be singled out for special treatment not applicable to other utilities, some of which are presently holding companies. If discounted utility service is a benefit, it should be reported pursuant to the Affiliate Transaction Order. Whether it is a benefit, however, should be taken up in Rulemaking (R.) 92-08-008, and not this application.

4. Business Referral Fee

DRA proposes that SDG&E should receive compensation for business referrals it makes to affiliates and recommends a "referral rate of 13%." It is undisputed that SDG&E does not now have any formal referral program and SDG&E represents that it does not plan to implement any such program in the future. DRA believes that "(i)f SDG&E refers customers to its affiliates, SDG&E is engaging in a marketing activity on behalf of those affiliates." No evidence exists in the record, however, concerning what kinds of activities might be involved or the nature of the referrals. DRA's concern may be that even if the costs of any such marketing activities are recovered by SDG&E, a cross subsidy could exist if the value of such activities to the affiliate is greater than the cost.

We imposed a 13% referral fee, based on first month's revenues including nonrecurring charges, resulting from a

successful customer referral by Pacific Bell to its information services affiliate. (In re Pacific Bell (D.92-07-072) 45 CPUC2d 109, 123.) We did so because we were concerned that the affiliate would divert ratepayer-funded marketing and customer services from the utility. (Id.) In that case, however, we made clear that we were not establishing generic affiliate transaction guidelines. (Id. at 113.) The non-tariffed services that Pacific provided were order processing by its service representatives, service and repair by its employees, and planning and development of enhanced and nonregulated services prior to public offering of the product, and gateway services. (Id. at 114.) These constituted "joint marketing of regulated and nonregulated services." (Id.) The record has not identified any potential services in this case that would create the same concerns.

5. Affiliate Contact Logs

The parties agree that Parent, SDG&E and all controlled affiliates should retain copies (for five years[21]) of: (1) all correspondence between the utility and controlled affiliates, (2) meeting summaries, phone call summaries or logs and e-mail correspondence between the utility and such affiliates (to the extent prepared in the normal course of business), and (3) marketing material, proposals to customers, and business and strategic plans, in each case to the extent prepared in the normal course of business. DRA would add desk calendars to the list, as a means of detecting clandestine meetings that would otherwise escape scrutiny. We adopt this additional requirement because it seems reasonably likely to lead to additional relevant information on affiliate contacts.

6. Timekeeping Requirements

To promote consistency with timekeeping requirements for Pacific Bell, DRA asks that SDG&E's affiliate cost allocation timekeeping policy be based on a 15-minute, rather than 30-minute, minimum increment. We do not see how being able to compare time entries of this electrical and gas utility with a telephone corporation will be helpful.

7. Annual Adjustment to Rates

DRA proposes that we annually adjust SDG&E's rates for any cross-subsidies from SDG&E to affiliates arising after the date of this order. To avoid retroactive ratemaking, DRA believes we should order that SDG&E's future rates be made subject to refund.

By "cross subsidy," we assume is meant both transactions between SDG&E and one or more of its affiliates that fail to reflect a market price (i.e., SDG&E pays too much or receives too little or both) and to situations in which SDG&E and one or more affiliates share resources (e.g., employees, office space, utility service) and the affiliate does not bear its fair share of the expense.

The connection between cross-subsidies and rates is that for 1994-98, SDG&E's base rates are capped (and primarily determined) by a revenue requirement formula. (In re application of San Diego Gas & Electric Company to establish an experimental performance-based ratemaking mechanism (D.94-08-023) mimeo at 3, CPUC2d (PBR Decision.) That revenue requirement is too high if based on inflated expenses due to affiliate freebooting or freeloading because it would be inconsistent with our primary regulatory ratemaking objective of ensuring that the authorized base (nonfuel) revenue requirement used to set SDG&E's base rates is the lowest reasonable amount consistent with the provision of adequate utility service. (Id. at 18.)

The revenue requirement uses SDG&E's test year general rate case for 1993 as the starting point, escalated by inflation and customer growth, with an offset for productivity. (Id. at 40.) Cross-subsidies, therefore, are not built into SDG&E's present revenue requirement. (Ex. 6 at 11.) Accordingly, cross-subsidies have no more relevance to SDG&E's current rate scheme than any other element of expense that might be unallowable under other schemes. SDG&E should account for affiliate-related expenses and the costs of forming the holding company to assure that they are not included in the historical utility expenses that may be used for future rate case estimates.

8. Holding this Proceeding Open Pending Audit

DRA asks that we hold this proceeding open for 3 to 6 years plus the time required to prepare the audit of affiliate transactions that the parties recommend. SDG&E, UCAN, and FEA argue that the audit results can be presented in SDG&E's 1999 General Rate Case, further proceedings in connection with SDG&E's existing base-rates Performance Based Rates application (Application (A.) 92-10-017), any SDG&E proceeding then open, or, if necessary, an investigation instituted by the Commission. We agree that it is useful to designate the appropriate forum to receive the audit, and we will hold this application open for that limited purpose.

9. Generic Proceeding

DRA proposes that we revisit the terms and conditions imposed in this proceeding "in a generic proceeding if the electric industry restructures such that utility-affiliate dealings increase substantially compared to the present." DRA also believes that we should "explicitly state that . . . approval is subject to re-examination in light of the final outcome of the Commission's industry restructuring proceeding." We will continue the work we began in the Affiliate Transactions Order as our restructuring work progresses. If we uncover

situations that are unique to particular utilities, we will fashion appropriate responses that may apply only to SDG&E or other utilities. That may include superseding terms and conditions we impose in this order. We will not, however, hold this application in a state of suspended animation or hold Parent hostage an indefinite term to be released or executed based on rules to be written later. This in no way impairs our ability to deal with SDG&E as a utility or Parent as a corporation that controls a utility in accordance with our statutory authority and as circumstances require.

10. Re-Opening Base-Rates PBR Proceeding

DRA proposes that we reopen the base rates performance based ratemaking (PBR) proceeding (A.92-10-017) to examine the linkages between the formation of [Parent] and the incentives, goals, and objectives established by the base rates PBR. (See PBR Decision.) That proceeding has not been closed. An interim evaluation will begin with a pre-hearing conference to be scheduled no later than December 15, 1996. (Id. at 107.) Hence, there is no need to re-open it, and DRA may make any proper motion in that proceeding.

Other DRA Arguments Against the Proposed Settlement

In its briefing, DRA advanced several other arguments to show that approving the Joint Recommendation is not in the public interest: (1) unique combination of circumstances related to restructuring, (2) need for a complete separation between SDG&E and its affiliates, (3) risk of stock price manipulation, and (4) past failures to report transactions.

Unique Combination of Circumstances

DRA believes that SDG&E's application is unprecedented because it follows a new ratemaking regime in the base rates performance based ratemaking proceeding and precedes industry

restructuring. The risk that deciding this application poses, DRA believes, is the loss of control by the Commission over policies and actions of the new parent company and their impact on the utility an the emerging competitive generation market. DRA sees SDG&E slipping from our control through the piecemeal incremental dismantling of Commission oversight now emerging through SDG&E's regulatory requests.

We did not grant SDG&E its new ratemaking treatment nor embark upon electric industry restructuring for the purpose of preserving the status quo. We recognize that the holding company structure will allow Parent to make, without our oversight, some decisions on matters that we do not regulate. We recognize that SDG&E now makes some decisions on matters we do not regulate and some of those come to our attention, while others do not. The introduction of Parent will not cause a dramatic departure from how we now regulate SDG&E as a public utility.

Complete Separation

DRA describes self-dealing in terms of sharing officers and directors between SDG&E and affiliates. It cites instances in which an officer of an SDG&E affiliate has "lent himself" money in his capacity as an officer of SDG&E. True separation of personnel, facilities, intellectual property, and administrative and general functions, in DRA's view, minimizes the potential for cross-subsidies and reduces subjective judgments regarding allocation of costs and dedication of financial resources.

We see self-dealing, however, as an objective problem that involves common interests rather than common actors. Outcome counts more than process here. Simply because affiliates are dealing with each other through separate boards of directors and officers does not mean that their decisions are necessarily untainted by self-dealing. If separate boards and officers share a commonality of interests, we must still be alert to issues of self-dealing. We will continue to rely on the Affiliate

Transactions Order and periodic audits to detect and deal with potential problems in this area.

Stock Price Manipulation

DRA argued that one of the potential adverse impacts for ratepayers associated with utility diversification effects includes the incentive to write-up asset values with the intent to stimulate stock movement through inflated values. We do not believe that DRA meant to suggest that management and its independent public accountants intend in such situations deliberately to violate the securities laws. We know of no example of any public utility since PUHCA that has been detected engaging in such manipulation.

Past Failures to Report

DRA argues that the Affiliate Transactions Order is inadequate because SDG&E has failed to report significant transactions between SDG&E and its unregulated affiliates in compliance with the Commission's requirements; therefore, DRA proposes additional safeguards.

The Affiliate Transaction Order reads in part as follows: "Each utility shall submit, in tabular form, a list of all contracts (including written agreements if not otherwise listed under #1 above) between the utility and its affiliated entities that were either signed or in effect during the period covered by the annual report and that involve the provision of greater than $5,000 in goods and/or services." (48 CPUC2d at 175.)

Although the definition of "goods" and "services" for purposes of Section II (Reporting Requirments) did not specifically mention intra-company loans as a "service", loans are clearly of "economic value" to the affiliate (48 CPUC 2d at 176, Section II(C)(3)) and loans are generally one of the so-called banking services obtained from financial institutions. The

accounting safeguards require that all transactions between a utility and its affiliated entities are to be recorded (48 CPUC 2d at 174-175, Section II(B)(1)(w)). Therefore, even assuming SDG&E did violate the reporting requirement of Section II(B)(2)[25], DRA has not persuaded us that its own investigatory powers, combined with the recording or accounting safeguards, are inadequate to any compliance effort the Commission might desire to undertake in the future. If DRA has discovered some harm to ratepayers from non-compliance with reporting requirements, it may make a motion asking the Commission to initiate an enforcement proceeding or seek to clarify the reporting requirements through a petition to modify them. In our judgment, if SDG&E erred in interpretation or application of the guidelines, that is not sufficient reason to reject the holding company reorganization, although it does suggest that audits and regulatory oversight of affiliate transactions are appropriate.

DRA next argues that SDG&E failed properly to bill the time of its officers and employees to affiliates. For example, SDG&E's corporate secretary appointed an SDG&E officer as a director of a subsidiary. Should the officers have charged the time to perform the corporate acts of appointment and acknowledgment of appointment to the subsidiary? We think not. The power to appoint directors is a normal prerogative of ownership of a wholly-owned subsidiary, and it inures to the benefit of the owner, not the subsidiary. If an SDG&E officer were discharging the duties of an employee of the subsidiary and conducting its day-to-day business, that would be another matter. Merely holding office, however, does not seem to be the sort of transaction for the benefit of the subsidiary with which we should be concerned.

Findings of Fact

SDG&E is an investor-owned public utility subject to the jurisdiction of this Commission.

2. SDG&E's board of directors has recommended, and SDG&E's shareholders have authorized, that SDG&E be reorganized into a holding company form of ownership (through a reverse triangular merger with a second-tier subsidiary).

3. SDG&E's principal reason for the proposed restructuring is to respond to what it considers a changing business environment in the electric and gas utility industries, including the possible onset of competition within markets that SDG&E has historically served as a regulated monopoly. SDG&E considers the holding company form of organization suitable because it provides a corporate framework for the separate ownership of unregulated businesses and helps to insulate the credit of SDG&E from the risks of ownership of such businesses.

4. Parent is a California corporation organized by SDG&E. Merger Company is a California corporation organized by SDG&E.

5. SDG&E seeks authority pursuant to PU Code Section 818 to permit Parent to issue 100 shares of common stock initially.

6. SDG&E seeks authority pursuant to PU Code Section 818 to permit Merger Company to issue 100 shares of common stock, to be owned by Parent.

7. SDG&E intends to merge with and into Merger Company and to cause each issued and outstanding share of SDG&E common stock to be exchanged on a one-for-one basis for a share of common stock of Parent.

8. SDG&E seeks authority pursuant to PU Code Section 818 to permit Parent to issue a number of shares of stock equal to the number of shares of SDG&E common stock outstanding immediately prior to the effectiveness of the Merger.

9. SDG&E seeks authority pursuant to PU Code Section 818 for Parent to reserve for issuance a number of shares of common stock equal to the number of shares of SDG&E common stock reserved for issuance by SDG&E's Board of Directors under employee benefit plans and similar arrangements immediately prior to the effectiveness of the Merger.

10. SDG&E intends to transfer the stock of its subsidiary corporations to Parent following the Merger and SDG&E has not asked for authority to do so pursuant to PU Code Section 851.

11. As a result of the Merger, SDG&E would be a wholly owned subsidiary of Parent, and the owners of SDG&E preferred and preference stock would be unaffected.

12. As a result of the Merger, SDG&E, Parent, and SDG&E's former subsidiaries would be affiliated entities within the meaning of the Affiliate Transactions Order.

13. SDG&E has not asked for approval to sell the shares the issuance of which it is seeking.

14. The active parties in this proceeding are SDG&E, UCAN, FEA, and DRA.

15. UCAN is a consumer advocacy group supported by 41,000 residential and small customers of SDG&E. FEA represents federal agency customers of SDG&E, including the Department of the Navy. DRA represents the interests of public utility customers and subscribers.

16. SDG&E, UCAN, and FEA recommended that the Commission approve SDG&E's application, subject to conditions. DRA objected to the recommendation, recommended that the Commission deny the application, and recommended that if the Commission approves the application it should change some and add other conditions.

17. DRA proposed that SDG&E should adopt a policy requiring that costs incurred by SDG&E on behalf of any affiliate be fully recovered from the affiliate. SDG&E accepted this proposal but rejected all other DRA proposals for changes and additions to the conditions contained in the SDG&E, UCAN, and FEA recommendation.

18. DRA proposed an employee transfer fee of 25% in place of the joint SDG&E, UCAN, and FEA recommendation of 15%. The evidence showed that a fee of 15-25% reasonably approximates the cost to the transferee of recruitment that would otherwise be incurred.

Retention of desk calendars (to the extent prepared in the normal course of business) would be likely to lead to other relevant information.

Conclusions of Law

1. The issuance of stock of Parent and Merger Company is subject to the jurisdiction of this Commission pursuant to PU Code Section 818 and prior Commission decisions.

2. SDG&E's choice of business form touches on its public calling and is subject to Commission oversight to determine that changes in its form of organization and ownership will not impair the discharge of its duties.

3. The form of organization and ownership of any for-profit venture subject to the Commission's jurisdiction ought lie, in the first instance, in the sound discretion of management, subject to the rights provided otherwise of the shareholders to consent, and subject to the Commission's oversight to the extent necessary to protect the public interest.

4. SDG&E's business objectives with respect to the proposed reorganization are valid in the absence of any evidence that SDG&E's board of directors acted with lack of due care or good faith.

5. The proposed reorganization is not adverse to the public interest in light of the conditions proposed by SDG&E, UCAN, and FEA, the additional conditions proposed by DRA and adopted by the Commission and in light of the Commission's power to regulate SDG&E and its affiliates in the future to detect and remedy any abuses that may arise.

6. SDG&E should adopt a policy requiring that costs incurred by SDG&E on behalf of any affiliate be fully recovered from the affiliate.

7. An employee transfer fee of 25% is presumptively reasonable, subject to SDG&E's showing that some lesser fee of 15% or greater is reasonable for the specific class of employee involved in the transfer and to the alternative application of business unit valuation in the case of mass transfers.

8. DRA should select and supervise the outside auditor or consultant for the Verification Audit.

9. Except as set forth in Conclusions of Law 6, 7, and 8, above, the different or additional conditions proposed by DRA are not necessary to protect the public interest.

10. Except as set forth in Conclusions of Law 6, 7, and 8, above, the joint recommendation of SDG&E, UCAN, and FEA is reasonable in light of the whole record, consistent with law, and in the public interest.

11. The application of SDG&E for issuance of stock of Parent and Merger Company should be approved subject to the conditions set forth in the joint recommendation of SDG&E, UCAN, and FEA, except as set forth in Conclusions of Law 6, 7, and 8, above.

12. The Commission retains its authority to modify or replace the requirements set forth in the Affiliate Transactions Order. Nothing in this approval precludes the Commission from imposing additional or different regulations upon affiliate transactions applicable to SDG&E and other similarly situated utilities in the future.

13. It can be seen with certainty that the proposed issuance of stock of Parent and Merger Company will not have a significant effect upon the environment.

IT IS ORDERED that:

1. The application of San Diego Gas & Electric Company (SDG&E) for authority pursuant to Public Utilities (PU) Code Section 818 for the issuance of stock by the California corporations SDO Parent Co., Inc. (Parent) and San Diego Merger Company is granted, subject to the conditions set forth in the following Ordering Paragraphs 2 through 12, inclusive.

2. The officers and employees of Parent and its subsidiaries shall be available to appear and testify in Commission proceedings as necessary or required. The Commission shall have access to all books and records of SDG&E, Parent, and any affiliate pursuant to PU Code Section 314. Objections concerning requests for production pursuant to PU Code Section 314 made by Commission staff or agents are to be resolved pursuant to ALJ Resolution 164 or any superceding Commission rules applicable to discovery disputes. SDG&E is placed on notice that the Commission will interpret Section 314 broadly as it applies to transactions between SDG&E and the holding company or its affiliates and subsidiaries in fulfilling its regulatory responsibilities as carried out by the Commission, its staff and its authorized agents. Requests for production pursuant to Section 314 made by Commission staff or agents are deemed presumptively valid, material and relevant. Any objections to such request shall be timely raised by SDG&E, Parent or its affiliates. In making such an objection, respondents shall demonstrate that the request is not reasonably related to any issue that may be properly brought before the Commission and, further, is not reasonably calculated to result in the discovery of admissible evidence in any proceeding.

3. The "SDO Parent Co., Inc. Corporate Policies and Guidelines for Affiliate Transactions" as revised May 3, 1995 and

entered into evidence in this matter (with the addition of any policy requiring that costs incurred by SDG&E on behalf of any affiliate be fully recovered from the affiliate) shall be implemented in its entirety by SDG&E, Parent, and SDG&E affiliates.

4. Within three to six years after the date of this Decision, the Executive Director shall make staff assignments as necessary to conduct an audit of Parent, SDG&E and controlled affiliates, at the expense of shareholders of Parent for an audit of SDG&E's affiliate transactions for the purpose of verifying SDG&E's compliance with its affiliate transactions policies and guidelines, this Decision, and other applicable Commission orders and regulations (Verification Audit). The Division of Ratepayer Advocates (DRA, which, for purposes of this ordering Paragraph shall mean DRA or such other staff organization that the Executive Director designates for the purpose) shall be the designed staff organization having responsibility for the audit unless the Executive Director determines that the needs of the Commission dictate otherwise. Parent shall provide funding for the costs of the audit, including the fees and expenses of an outside auditor or consultant and DRA's incremental travel costs, subject to the following: (a) DRA may contract with the outside auditor or consultant, or Parent may contract directly with the outside auditor or consultant, in which case DRA shall be a third-party beneficiary of the contracted services, for which DRA shall have the ultimate authority and responsibility for selection, direction, monitoring and supervision of the contractor; and (b) prior to the selection of an outside auditor or consultant, DRA shall consult with SDG&E, UCAN, and FBA regarding the identity of potential contractors. SDG&E, Parent, and all controlled affiliates shall retain (for five years (but at least until the completion of the Verification Audit)) (i) all internal and external correspondence between SDG&E and controlled

affiliates, (ii) to the extent prepared in the normal course of business, desk calendars, meeting summaries, phone call summaries or logs and E-mail correspondence between SDG&E and controlled affiliates, and (iii) marketing material, proposals to customers, business and strategic plans. The auditor's report shall then be filed by DRA with the Commission and served on the parties to this Application, which shall remain open solely for such purpose. The assigned Administrative Law Judge (ALJ) is directed to hold a pre-hearing conference during the last quarter of the third, fourth, and fifth years following the date of this order, as necessary to assure that the Verification Audit is scheduled. DRA shall file and serve the results of the Verification Audit in this docket and, at the same time, shall file and serve its motion to consolidate this docket with either SDG&E's 1999 General Rate Case, SDG&E's Application (A.) 92-10-017, any other SDG&E proceeding then pending, or, if none of the foregoing dockets is open, to institute an investigation for such review. The ALJ shall consider DRA's motion, and the responses of other parties, if any, and shall either issue a ruling consolidating this docket into the appropriate existing proceeding or prepare an order for the Commission to institute an investigation for such purpose. After the Verification Audit, SDG&E ratepayers shall continue to fund the normal PU Code Sections 314.5 and 797 audits. However, in no event shall SDG&E ratepayers be required to fund another Verification Audit until at least three years have elapsed since the completion of the first Verification Audit, with the exception of audits performed in connection with PU Code Section 851 proceedings.

5. The dividend policy of SDG&E shall continue to be established by SDG&E's Board of Directors as though SDG&E were a standalone utility company.

6. The capital requirements of SDG&E, as determined to be necessary to meet its obligations to serve, shall be given first priority by the Board of Directors of Parent and SDG&E.

7. SDG&E shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in its most recent decision on SDG&E's capital structure. SDG&E's equity shall be retained such that the Commission's adopted capital structure shall be maintained (adjusted to reflect the imputation of SDG&E's long-term capital leases) on average over the period the capital structure is in effect for ratemaking purposes.

8. When an SDG&E employee is transferred from SDG&E to either Parent or an affiliate, that entity shall make a one-time payment to SDG&E in an amount equivalent to 25% of the employee's base annual compensation, unless SDG&E can demonstrate that some lesser percentage (equal to at least 15%) is appropriate for the class of employee involved. The aggregate of all such fees paid to SDG&E shall be credited to the Electric Revenue Adjustment Mechanism (ERAM) account on an annual basis, or as otherwise necessary to ensure that SDG&E customers receive the fees. This transfer payment provision will not apply to clerical workers. Nor will it apply to the initial transfer of employees to SDG&E's business units at the time of initial separation from SDG&E pursuant to PU Code Section 851 application or other Commission proceeding. However, it will apply to any subsequent transfers between SDG&E and previously separated business units.

9. SDG&E shall avoid a diversion of management talent that would adversely affect the utility.

10. Neither Parent nor any of Parent's subsidiaries shall provide interconnection facilities or related electrical equipment to SDG&E, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities or equipment in conjunction with the sale of electrical energy to SDG&E, unless the third party may obtain and

provide facilities and equipment of like or superior design and quality through competitive bidding. Parent and its non-utility subsidiaries may participate in any competitive bidding for such facilities and equipment.

11. All costs arising from SDG&E's holding company reorganization are and shall be borne by shareholders, and will not be used to determine future rates or sharable earnings under Decision 94-08-023.

12. Valuable customer information, such as market technological or similar data transferred, directly or indirectly, from SDG&E to a non-utility affiliate shall be made available to the public subject to the terms and conditions under which such data was made available to the non-utility affiliate. This condition will not apply to such information that is proprietary to and in the possession of a business unit of SDG&E at the time it is initially separated from SDG&E.

13. To the extent reflected in Ordering Paragraphs 3, 4, and 8, the different and additional conditions proposed by DRA are adopted.

14. SDG&E and Parent shall file a written notice with the Commission, served on all parties to this proceeding, of its agreement, evidenced by a resolution of their respective boards of directors duly authenticated by a secretary or assistant secretary of SDG&E or Parent, as the case may be, to the conditions set forth in Ordering Paragraphs 2 through 12, inclusive. Failure to file such notice within 30 days of the

effective date of this Decision shall result in the lapse of the authority granted by this Decision.

This order is effective immediately.

Dated December 6, 1995, at San Francisco, California.

DANIEL Wm. FESSLER
President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

APPENDIX A

Appearances

Applicant: SDG&E by *Jeffrey M. Parrott*, attorney-at-law, and Lynn G. Van Wagenen.

Interested parties: Barakat & Chamberlin, by Melissa Metzler; California Cogeneration Council, by *Jerry Bloom* and Lynn Haug, attorneys-at-law of Morrison & Foerster; Chevron USA, by Carolyn Baker of Edson & Modisette; Department of the Navy, by Sam De Frawi, attorney-at-law; Division of Ratepayer Advocates, by *Kathleen C. Maloney*, attorney-at-law, Chris Blunt and Tim Kenney; Federal Executive Agencies, by Norman Furuta, attorney-at-law; Henwood Energy Services, Inc., by David R. Branchomb; MRW & Associates, Inc., by Steven C. McClary; Pacific Gas and Electric Company, by *Roger Peters*, Pilar Garcia, and Ann Kozlovsky, attorneys-at-law; Sithe Energies, Inc., by John Wood; Southern California Edison Company, by *Stephen E. Pickett* and Julie A. Miller, attorneys-at-law; Southern California Gas Company, by *Jeffrey E. Jackson* and Daniel G. Clement, attorneys-at-law; State of California Department of General Services, by Dian Grueneich, attorney-at-law; Toward Utility Rate Normalization (TURN), by Theresa Mueller, attorney-at-law; and Utility Consumers' Action Network (UCAN), by *Michael Shames* and Michael Wells, attorneys-at-law.

APPENDIX B A

Conditions Recommended by SDG&E, UCAN, and FEA

1. The officers and employees of SDG&E's holding company and its subsidiaries shall be available to appear and testify in Commission proceedings as necessary or required. The Commission shall have access to all books and records of SDG&E, it holding company, and any affiliate pursuant to PU Code Section 314. Requests for production pursuant to PU Code Section 314 made by Commission staff or agents are deemed presumptively valid, material and relevant. Any objections to request shall be timely raised by SDG&E, its holding company or its affiliates before the administrative law judge or assigned commissioner to the proceedings in which such objections arise. In making such an objection, respondents shall demonstrate that the request is not reasonably related to any issue properly before the Commission and, further, is not reasonably calculated to result in the discovery of admissible evidence in the proceeding.

2. The "SDO Parent Co., Inc. Corporate Policies and Guidelines for Affiliate Transactions" as revised May 3, 1995, will be implemented in its entirety by SDG&E, its holding company, and SDG&E affiliates. (See Ex. 2, Attachment A.)

3. Within three to six years after approval of SDG&E's application to form a holding company, the shareholders of SDG&E's holding company will pay for auditors to audit SDG&E's affiliate transactions for the purpose of verifying SDG&E's compliance with its affiliate transactions policies and guidelines, the Commission Decision approving SDG&E's application to reorganize into a holding company structure, and other applicable Commission orders and regulations (the "Verification Audit"). ([SDG&E, UCAN, and FEA] recommend that the auditor be selected by the Commission from a list of qualified firms submitted by [SDG&E, UCAN, and FEA]. The auditor's report shall then be filed by SDG&E with the Commission and served on the appropriate parties. [SDG&E, UCAN, and FEA] recommend that the most likely forum for any necessary Commission review of the

Verification Audit would be either SDG&E's 1999 General Rate Case, or the evaluation and possible extension of its existing base rate Performance Based Rates ("PBR") experiment (A.92-10-017). This PBR application currently remains open for that evaluation. If either of those forums are not available, SDG&E agrees that it will not contest a motion to have the Verification Audit reviewed in any SDG&E proceeding then existing, or if need be, opening an OII for such review.) Thereafter, SDG&E ratepayers shall continue to fund the normal PU Code Sections 314.5 and 797 audits. However, in no event shall SDG&E ratepayers be required to fund another Verification Audit until at least three years have elapsed since the completion of the first Verification Audit, with the exception of audits performed in connection with PU Code Section 851 proceedings.

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

5. The capital requirements of SDG&E, as determined to be necessary to meet its obligations to serve, shall be given first priority by the Board of Directors of SDG&E's holding company and SDG&E.

6. SDG&E shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in its most recent decision on SDG&E's capital structure. SDG&E's equity shall be retained such that the Commission's adopted capital structure will be maintained (adjusted to reflect the imputation of SDG&E's long-term capital leases) on average over the period the capital structure is in effect for ratemaking purposes.

7. When an SDG&E employee is transferred from SDG&E to either its holding company or an affiliate, that entity will make a one-time payment to SDG&E in an amount equivalent to 15% of the employee's base annual compensation. The aggregate of all such fees paid to SDG&E shall be credited to the ERAM account on an annual basis, or as otherwise necessary to ensure that SDG&E

customers receive the fees. This transfer payment provision will not apply to clerical workers. Nor will it apply to the initial transfer of employees to SDG&E's business units separated from SDG&E pursuant to PU Code Section 851 application or other Commission proceeding. However, it will apply to any subsequent transfers between SDG&E and the newly separated business units.

8. SDG&E shall avoid a diversion of management talent that would adversely affect the utility.

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

10. All costs arising form SDG&E's holding company reorganization are and will be the responsibility of shareholders, and will not be used to determine future rates or sharable earnings under D.94-08-023.

11. Valuable customer information, such as market technological or similar data transferred, directly or indirectly, from SDG&E to a non-utility affiliate shall be made available to the public subject to the terms and conditions under which such data was made available to the non-utility affiliate. This condition will not apply to such information that is proprietary to and in the possession of a business unit of SDG&E at the time it is separated from SDG&E

Appendix C-A
Glossary of Defined Terms

Abbreviation	Definition
1986 Decision	*In re San Diego Gas & Electric Company* (D.86-03-090) 20 CPUC2d 660
Affiliate Transactions Order	*In re Reporting Requirements for Electric, Gas, and Telephone Utilities Regarding Their Affiliate Transactions* (D.93-02-019) 48 CPUC2d 163
ALJ	Administrative Law Judge
D.	Decision
DRA	Division of Ratepayer Advocates
Edison Decision	*In re Southern California Edison Company* (D.88-01-063) 27 CPUC2d 347
FBA	Federal Executive Agencies
GAAP	Generally accepted accounting principles
Merger	The merger of SDG&E with and into Merger Company, as described in the section titled "Description of the Proposed Reorganization."
Merger Company	A California corporation to be formed for the purpose of facilitating the reorganization of SDG&E, as described in the section titled "Description of the Proposed Reorganization."
Parent	A California corporation to be formed for the purpose of owning the outstanding common stock of SDG&E, as described in the section titled "Description of the Proposed Reorganization."
PHC	Prehearing Conference
PU Code	Public Utilities Code
PUHCA	Public Utilities Holding Company Act of 1935
SDG&E	San Diego Gas & Electric Company
Section 854 Opinion	*In re San Diego Gas & Electric Company* (D.95-05-021) ___ CPUC2d ___
UCAN	Utility Consumers' Action Network
Verification Audit	An audit to be performed 3-6 years following the date of the decision in this application.

APPENDIX D

Endnotes

[1] To be initially known as "SDO Parent Co., Inc."

[2] FEA did not file a brief, but wrote the assigned ALJ to indicate its continued support of the Joint Recommendation.

[3] SDG&E noted a transcription error in Appendix B concerning whether "base" compensation or "gross" compensation should serve as the basis for calculating certain payments. That error has been corrected, and the conforming change has been made to the text of the decision. SDG&E suggested that the Commission make a finding concerning the lack of environmental effect of the proposed reorganization, which has also been done. SDG&E requested that the Commission's order be made effective immediately, rather than upon 30 days.

[4] UCAN commented that it generally supports the draft decision, but finds an ambiguity in the discussion of fair market value. UCAN quotes a definition of fair market value from SDG&E's proposed corporate guidelines that appears to be consistent with the example definition quoted from Black's. In prepared testimony, however, SDG&E withdrew that definition and substituted a definition that conforms to the current Affiliate Transactions Order. The draft decision has been revised to clarify this issue. UCAN is also uncertain as to the precedent established in the section "Proper Role of the Commission on Matters of Corporate Governance." An editorial change has been made that may relieve UCAN's uncertainty.

[5] DRA stated its position in a letter to the assigned ALJ. DRA set forth its position regarding the applicability of Section 311, but made no motion on which action can be taken.

[6] See Rule 3(b). We do not address the merits of DRA's motion, which involves a claimed violation of the settlement rules, because we have not relied upon the reference sought to be struck in making our decision in this application.

[7] To be known as "San Diego Merger Company."

[8] The term "the parties" refers to SDG&E, UCAN, FEA, and DRA for purposes of this discussion.

[9] In the 1986 Decision we said: "Insofar as is consistent with the public interest, we prefer to leave management of the utility to the managers chosen by the utility's shareholders. Otherwise, private ownership of public utilities would be pointless. Among the decisions that would ordinarily be management's prerogative, with the consent of shareholders, are the nature and extent of diversification and the form of corporate organization best suited to carry out that diversification." (20 CPUC2d at 670.) Although diversification into non-utility lines of business was contemplated at that time, our ability to find an appropriate level of safeguards and protect ratepayers on a continuing basis is also sufficient for affiliates in the same line of business.

[10] "Provide complete access to ALL books & records of all affiliates. The definition of affiliates is the same as that in R.92-08-008."

[11] "The officers and employees of SDG&E's holding company and its subsidiaries shall be available to appear and testify in Commission proceedings [DRA: without subpoena] as necessary or required. The Commission shall have access to all books and records of SDG&E, its holding company, and any affiliate pursuant to PU Code Section 314."

[17]In re Pacific Bell (D.87-12-067) 27 CPUC2d 1, 99. However, that decision did not adopt the condition. (See id. at 138.)

[18]"Edison shall ensure that the Commission has access to books and records of the holding company and each of its affiliates and their joint ventures consistent with the requirements of Public Utilities Code section 314." 27 CPUC2d at 374.

[19]"Requests for production (SDG&E, UCAN, and FEA: pursuant to PU Code section 314) made by Commission staff or agents are deemed presumptively valid, material and relevant. Any objections to such requests shall be timely raised by SDG&E (its holding company) or its affiliates (before the administrative law judge or assigned commissioner to the proceedings in which such objections arise). In making such an objection, respondents shall demonstrate that the request is not reasonably related to any issue properly before the Commission and, further, is not reasonably calculated to result in the discovery of admissible evidence in the proceeding."

[20]DRA: "Dividend policy is to be set as if utility is stand alone." SDG&E, UCAN, and FEA: "The dividend policy of SDG&E shall continue to be established by SDG&E's Board of Directors as though SDG&E were a comparable, stand-alone utility company."

[21]DRA: "[Parent] is to give capital requirements of utility first priority." SDG&E, UCAN, and FEA: "The capital requirements of SDG&E, as determined to be necessary to meet its obligations to serve, shall be given first priority by the Board of Directors of [Parent] and SDG&E."

[22]DRA: "A balanced capital structure is to be maintained, and equity is to be retained such as to maintain capital structure."
SDG&E, UCAN, and FEA: "SDG&E shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in its most recent decision on SDG&E's capital structure. SDG&E's equity shall be retained such that the Commission's adopted capital structure will be maintained (adjusted to reflect the imputation of SDG&E's long-term capital leases) on average over the period the capital structure is in effect for ratemaking purposes."

[23]DRA: "SDG&E will receive from affiliate 25% of transferred employee's 1st year base annual compensation as a transfer fee for affiliate's avoided cost."
SDG&E, UCAN, and FEA: "When an SDG&E employee is transferred from SDG&E to either [Parent] or an affiliate, that entity will make a one-time payment to SDG&E in an amount equivalent to 15 percent of the employee's base annual compensation. The aggregate of all such fees paid to SDG&E shall be credited to the ERAM account on an annual basis, or as otherwise necessary to ensure that SDG&E customers receive the fees. This transfer payment provision will not apply to clerical workers. Nor will it apply to the initial transfer of employees to SDG&E's business units separated from SDG&E pursuant to a PU Code Section 851 application or other Commission proceeding. However, it will apply to any subsequent transfers between SDG&E and the newly separated business units."

[24]Such changes may affect one or more utilities as circumstances dictate.

[25]That policy values the asset solely by fair market value. But for administrative convenience, if both the estimated fair market value and net book value are each $100,000 or under, the transferor may select either fair market value or net book value.

[26]SDG&E should retain such copies until the completion of the Verification Audit, whether or not the Verification Audit is undertaken within 5 years.

"Originally, DRA proposed that we require SDG&E to remove all costs incurred by SDG&E related to its affiliates from rates (and order SDG&E) to file an annual Advice Letter to remove these costs from rates. This annual adjustment to rates should remain in effect until SDG&E's next general rate case." (Ex. 4, at 1-3.)

"SDG&E's reports pursuant to the Affiliate Transactions Order were not introduced into evidence so it is not possible to determine whether SDG&E failed to report the matters alleged, but the nature of the transactions clearly falls outside the reporting requirements.

24. Affiliates are required to make "timely reimbursement" to the utility for any outstanding balances due. (48 CPUC.2d at 175.)

25. We do not reach this conclusion today; as we would need additional information concerning the utility's cash management system in order to determine whether these loan transactions were exempt from reporting under section II(3) and (4) ("Financial Transactions", 48 CPUC.2d at 179) which may be more germane to these particular loans. Although concerned that reporting requirements of such large loan amounts may be covered in two different and possibly inconsistent sections of our guidelines, this proceeding is not the appropriate forum for pursuing penalties or revising the guidelines.