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Decision 96-07-059 July 17, 1996

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of	)	
Roseville Telephone Company	)	Application 95-05-031
(U 1015 C) for Authorization to	)	(Filed May 9, 1995)
Implement a Plan of Reorganization	)	
Which Will Result in a Holding	)	
Company Structure.	)	

INTERIM OPINION

Contents

Summary

Roseville Telephone Company (Roseville) 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 Roseville.[1] We will approve Roseville's application with conditions.

Procedural History

Roseville filed its application on May 9, 1995. Notice of the application appeared in the Daily Calendar on May 16, 1995. The Division of Ratepayer Advocates (DRA) and Comtech Mobile Telephone Company (Comtech) each filed a protest.[2] The assigned administrative law judge (ALJ) held a pre-hearing conference (PHC) on July 19, 1995. Roseville and DRA served prepared testimony and stipulated that no material issues of fact in connection with the application exist. No evidentiary hearing was held. On November 9, 1995, the ALJ issued a ruling pursuant to Rules of Practice and Procedure 63 and 77.1, ruling that in the absence of evidence taken at a hearing, Public Utilities (PU) Code Section 311(d) and Rule 77.1 would not apply to the draft opinion to be set before the Commission for action. However, the ruling stated that a draft decision would be made available to the parties for comment pursuant to the same procedures set forth in Rule 77.1 for a proposed decision pursuant to PU Code Section 311(d), including a comment period. Accordingly, the parties comments on the draft decision form part of the record of this matter.

Description of the Proposed Reorganization

Roseville has had Parent and Parent's subsidiary RTC Reorganization Sub (Merger Company) incorporated under California law. Roseville would own all of the stock of Parent, and Parent would own all of the stock of Merger Company. Roseville, Parent and Merger Company would enter into a merger agreement, by which

Roseville would be merged with and into Merger Company, with Roseville as the surviving corporation (the Merger). As consideration for the Merger, the holders of Roseville common stock would receive common stock, on a share-for-share basis, of Parent, and the outstanding shares of Parent held by Roseville would be canceled. Roseville's existing debt securities would be unaffected. As a result of the Merger, Roseville would become the wholly owned subsidiary of Parent. Roseville's shareholders authorized the Merger at a shareholders' meeting held on June 16, 1995.[3]

The specific steps for which Roseville 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 Roseville 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 Roseville common stock reserved for issuance by Roseville'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.

Roseville has not asked us for approval to sell the shares for which it seeks issuance authorization. It has not asked for any authority to transfer any business unit to Parent or any affiliate 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 (1993) 51 CPUC 2d 728, 745.) We will reach no conclusion in connection with this application as to whether any such business units constitute utility property.

Governing Statutes

In a recent opinion, we determined that the acquisition of San Diego Gas & Electric Company by a similarly formed holding company was not an acquisition activity that is subject to Public Utilities (PU) Code Section 854.[4] PU Code Section 854 has since been amended. (Stats. 1995 ch. 622, § 1 (AB 119).) Section 854 now applies expressly to mergers as well as acquisition or control activities. Section 854(b), which applies to certain activities involving very large electric, gas, or telephone utilities, was also amended with respect to the analysis of short-term and long-term benefits to ratepayers. However, a new Section 854(g) excludes the formation of a holding company from such tests.

The addition of Section 854(g) thus calls into question our continued authority to exempt the formation of a holding company, generally, from Section 854 pursuant to the authority granted in Section 854(a), which permits us to establish "the definitions of what constitute merger, acquisition, or control activities." It is clear that the legislature considered the formation of a holding company to be subject to Section 854, because otherwise it would not have found it necessary to exempt such an activity from the provisions of paragraphs (1) and (2) of Section 854(b). Accordingly, we conclude that the proposed transaction is subject to Section 854. Roseville concedes the jurisdiction of the Commission pursuant to Sections 701, 818 and 854(a) of the PU Code.

Reasons for the Holding Company Reorganization

The parties[5] agree on the need to condition any approval of the Merger, and they disagree on what conditions should be imposed. However, there does not appear to be any remaining disagreement on whether Roseville first needs to show that reorganization is necessary in some way to its continued operation as a public utility.

Roseville's Rationale

Roseville justifies its desire to reorganize under a holding company pursuant to the Merger on the grounds that Parent could own other subsidiaries (than Roseville) that could engage in unregulated businesses on a structurally separate basis from the regulated utility, thereby protecting utility ratepayers from the risks associated with the new businesses, simplifying regulation of the telephone utility and permitting [Parent] to pursue new, unregulated business opportunities with the optimum corporate structure in place. The reason that Roseville believes it will be desirable to engage in such unregulated businesses is that its historical role as a monopoly provider of telecommunications is changing. Aspects of its present operations may become competitive businesses in the short-term future, and engaging in competition carries with it the risk of business failure. The potential for such failure carries with it, in Roseville's view, the potential of affecting its ability to discharge its remaining, noncompetitive, regulated, monopoly utility obligations. By keeping competitive and regulated enterprises in separate operating companies, Roseville reasons, the utility, and consequently its ratepayers, will be better insulated from market risk. Roseville acknowledges that a component of its proposal is that it will facilitate the future divestiture to affiliates of business units of the utility that become deregulated.

Evolution of DRA's Critique of Roseville's Rationale

In its protest, DRA took the position that Roseville's application failed to show why the reorganization was necessary. In particular, DRA argued, Roseville did not show why its current corporate structure is inadequate to permit it to participate in other telecommunications businesses or why a holding company structure would be superior. In its Report on Roseville Telephone Company Application for Authorization to Implement a

Plan of Reorganization Which Will Result in a Holding Company Structure, DRA's position was that it supports "utilities' forming a holding company if there are (1) tangible and quantifiable ratepayer benefits, and (2) sufficient safeguards in place to adequately protect the utility and its ratepayers from the activities of unregulated affiliates." (Ex. 2 at 1-1.) In its briefs, DRA focuses its attention solely on the conditions of approval, including conditions relating to ratepayer benefits and affiliate transactions safeguards.

The recent amendments to Section 854 show that the Legislature intended to exclude considerations of ratepayer benefit from our review of holding company formation involving utilities.[7]

Role of the Commission on Matters of Corporate Governance

We recently held 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. (In re San Diego Gas & Electric Company (1995) ___ CPUC2d ___ (D.95-12-018) (SDG&E Holding Company Decision).) In so holding, we adopted a standard of ratepayer indifference to the effects of a holding company reorganization. Accordingly, when a utility seeks to reorganize under a holding company structure under PU Code Section 818 or Section 854, we do not require it to demonstrate more than that (1) a valid business purpose exists, and (2) the reorganization may be accomplished and future operations conducted pursuant to conditions that will be adequate to protect the public interest.

Conditions Required to Protect the Public Interest

As noted in the SDG&E Holding Company Decision, the recent history of utility reorganizations into holding companies has been a history of conditions. DRA has proposed 76 conditions be required as a condition of our approval of this application. (Ex. 2.) Roseville accepts some of these conditions but rejects others.

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.

DRA's Proposed Conditions

When DRA submitted its prepared testimony, we had not yet issued the SDG&E Holding Company Decision. However, "to avoid the need to re-litigate so soon after [that case], DRA is willing to accept the following package of safeguards and conditions: [(1)] safeguards and conditions that the Commission adopts [in the SDG&E Holding Company Decision,] (2) safeguards and conditions previously adopted by the Commission for telephone utilities, particularly those set forth in D.92-07-072[,] and (3) safeguards and conditions agreed to by Roseville in its direct testimony." (Ex. 22 at 4-1.) The Commission commends DRA for its proposal to refer many of the policy issues to the outcome of the SDG&E Holding Company Decision. This will allow us to focus on those areas of difference between DRA and Roseville that are germane to telephone utilities or unique to Roseville's situation.

1. Testimony of Officers and Employees of Affiliates

In the SDG&E Holding Company Decision, we required that the officers and employees of the holding company and its subsidiaries shall be available to appear and testify in Commission proceedings as necessary or required. We adopt that condition here.

2. Affiliate Transactions Order to Apply as Reporting Standard

Roseville agrees that our decision In re Reporting Requirements for Electric, Gas, and Telephone Utilities Regarding Their Affiliate Transactions (1993) 48 CPUC2d 163, 177 (Affiliate Transactions Order) should be the standard for reporting of affiliate transactions. Because Roseville is, and Parent will be*, already subject to the Affiliate Transactions Order, however, and because Roseville has not requested any deviation from those requirements, it is not necessary to impose adherence to the Affiliate Transactions Order as a condition of approval of the application.

3. Annual Statements on Affiliate Transactions

Roseville agrees that annual statements on the nature of affiliate transactions and the bases of allocations and transfer pricing should be required. As a condition, however, this requirement is simply declarative of PU Code Section 587 and the Affiliate Transactions Order.

4. Accounting Standards

DRA proposes that Parent, subsidiaries[8], and joint ventures[9] keep books consistent with generally accepted accounting principles (GAAP) and the Uniform System of Accounts (USOA). Roseville foresees businesses, such as cable television,

* In its comments on the draft decision, Roseville is concerned that this phrase could be read to subject Parent to regulation as a utility. We mean no more than that Parent would be classified under the Affiliate Transactions Order as an "affiliated entity" and "controlling corporation" in relation to Roseville.

in which it would be inappropriate to require application of USOA. Roseville suggest that USOA be required only "where appropriate." DRA does not address this suggestion in its reply brief, and in its direct testimony addresses it only by reference to a previous decision in which we required an electric utility's holding company, any of its subsidiaries, and the joint ventures of the holding company and/or its subsidiaries, to keep books in a manner consistent with GAAP "and, where feasible, with" USOA. (In re Southern California Edison Company (1988) 27 CPUC2d 347, 375 (Edison Decision).)

We did not define "where feasible" in the Edison Decision, and Roseville does not define "where appropriate" here. Nevertheless, we consider "where appropriate" preferable. USOA was developed for the specific purpose of reporting accounts of regulated utilities. When a regulated utility is substantially involved in affiliate transactions in an unregulated business, either directly or through or with an affiliate or joint venturer, applying USOA may be indicated under GAAP to assist in proper accounting and reporting by the utility. On the other hand, when the utility is only a passive investor (assuming that to be otherwise proper), no useful purpose can be served by imposing USOA. The appropriateness of applying USOA in such situations, accordingly, will vary with the applicable facts and circumstances, and a decision on appropriateness will require the sound application of accounting judgment, subject to our review in particular cases in which we may direct a specific treatment for purposes of a given proceeding or series of transactions.

5. Notification for Transfer of Certain Assets

Roseville agrees that it should be required to notify the Commission before transferring any asset greater than $100,000 to Parent or an affiliate. We will adopt the formulation contained in Ordering Paragraph 7 of the Edison Decision.

6. Ledgers for Affiliate Transactions

Roseville agrees that it should be required to maintain ledgers to track affiliate transactions through separate accounts receivable and payable, with separate sub-accounts for each affiliate.

7. Cash Flow Statement

In the SDG&E Holding Company Decision we considered requiring a statement of cash flow including the holding company and affiliates other than the utility. We concluded that the information that such a requirement would elicit is already provided by GAAP's notes requirement and decided against it.

8. Reporting on Benefits to Former Employees

Roseville agrees that the Affiliate Transactions Order's requirements concerning reporting on pensions and benefits retained by transferred employees should apply. However, for the same reasons given above, requiring adherence to that requirement as a condition of approval of the application is not necessary. DRA also suggests that the Affiliate Transactions Order be supplemented, in Roseville's case, with a provision defining benefits to include any rights to discounted utility services. Roseville argues that discounted service is rendered solely pursuant to tariff, and so the Commission retains full control over how it may be applied. Moreover, in the SDG&E Holding Company Decision, we expressed our preference that this issue be addressed as part of future work on the Affiliate Transactions Order, and there is no need to adopt this condition.

9. Annual Reporting of Affiliate Transactions

Roseville agrees that it should be required to annually report all intercompany transactions, but it is not necessary to impose adherence to the Affiliate Transactions Order as a condition of approval of the application.

10. Annual Reporting of Capital Budgets

In the SDG&E Holding Company Decision, we considered this requirement for projected capital budgets of affiliates and decided not to impose it.

11. Annual Reporting of Organizational Changes

Roseville agrees that it should be required to include in its annual reports pursuant to the Affiliate Transactions Order a description of organizational changes, such as changes to Parent's structure.

12. Annual Reporting of Changes to Affiliate Transactions Corporate Guidelines

Roseville agrees that it should be required to include in its annual reports pursuant to the Affiliate Transactions Order a description of changes to its corporate guidelines for affiliate transactions.

13. Tracking and Reconciliation of Business Referrals

DRA recommends that Roseville should be required to track business referrals from Roseville to affiliates, with "totals reconciled on a monthly basis" once it has established a formal referral program. (Ex. 2, at A-3.) Roseville argues that the program is unnecessary either to achieve ratepayer indifference or to promote fair competition, on the theory that the small size of Roseville's customer base relative to potential future competitors, such as AT&T, eliminates any possibility that Roseville will favor its affiliates in a way that would be anticompetitive. DRA counters that whatever the future may hold, Roseville remains today a monopolist within its market, and tracking referrals is necessary to assure a fair start to competition.

In the SDG&E Holding Company Decision, we looked at this issue from the perspective of indirect ratepayer funding of nonregulated ventures in which the utility was involved rather than from the perspective of concerns with competition. On the evidence in this record, we cannot dismiss DRA's concern that a potential for abuse may exist that could be monitored by tracking. Accordingly, we will require Roseville to notify the Commission in the event that it establishes any formal referral program involving a course of regular and repeated referrals of customers of Roseville to one or more affiliates. We will also require that Roseville track, on a monthly basis, referrals of customers to affiliates, for a period of one year thereafter. This should be sufficient time so that competitors may bring complaints before us for any allegedly anticompetitive activities involved in such referrals during the opening stages of competitive markets.[10] In any such proceeding, for good cause shown, the presiding officer may direct that Roseville continue such tracking through the end of any discovery period.

14. Affiliate Revenue Accounts for Referrals

DRA recommends that Roseville's affiliates be required to maintain revenue accounts to track amounts received from customers that might be referred by Roseville in the future. The purpose of this condition is not to monitor anticompetitive activities, but rather to establish facts that might be useful in calculating the value of such referrals. Roseville argues that the precedent which DRA cites for this condition was not intended to apply to utilities or telephone companies generally, but solely to Pacific Bell (Pacific). DRA argues that in our previous decision In re Pacific Bell ((1992) 45 CPUC2d 109 (the ISG Decision), we were affirming existing Commission rules for utility/affiliate transactions.

The ISG Decision involved an application pursuant to PU Code Section 851, to transfer the personnel and assets of Pacific's Information Services Group (ISG). (Id. at 113.) We approved the application, "subject to Pacific's compliance with the Commission's existing affiliate transaction guidelines and our interpretation of those guidelines herein." (Id.) The following year, however, we adopted the Affiliate Transactions Order in its present form, after considering several changes specifically directed toward telephone utilities. We there required disclosure by the utility of any "activity of economic value" (a service) provided by the utility to an affiliated entity. (Affiliate Transactions Order, 48 CPUC2d at 176.) We also required reporting of the value of such activities based on cost to the utility, using USOA accounts. (Id.)

By its terms, the Affiliate Transactions Order applies to referrals by Roseville to an affiliate, provided that the referral constitutes an "activity of economic value." We think, therefore, that the Affiliate Transactions Order is a better source than the ISG Decision to determine what constitutes existing Commission rules for utility/affiliate transactions.[11]

DRA also argues that the 13% referral fee which it recommends (and to which the revenue tracking condition relates) is necessary to prevent diversion of ratepayer-funded marketing and customer services from the utility. Roseville argues that its small size, compared to Pacific, makes the risk of "significant" referrals remote. Neither of these arguments, however, was the issue at hand when we first adopted that referral fee for Pacific.

When a utility provides a referral service to an affiliate, at least two approaches can be taken to the question of how much the affiliate should pay: (a) compensate the utility for its costs; or (b) compensate the utility at the market price for the value of the referral. Assuming that costs and market price can be ascertained, market price should generally exceed costs, because if it costs more to provide a service than its market price, the utility would cease providing the service.

If the proper measure is cost, we are not concerned with how much revenue the affiliate realizes that is traceable to the initial referral. Similarly, if the proper measure is market price, and the market price is determined by an objective standard of the "going rate," we have no need to examine affiliate accounts relating to business developed from referrals. It is only when the proper measure is different from both cost and market that we need to be concerned with such accounts.

In the rate case that set a referral fee for Pacific, DRA argued that, in the absence of a market study, the proper measure of the value of referrals was the excess of the profit earned from those referrals over the profit that would be earned from such referrals if made to a non-affiliate. (In re Pacific Bell (1986) 27 CPUC2d 1, 112-13, 132.) We approved, on that record, a calculation of profits that rested on an allocation of certain costs for advertising, made necessary by the fact that no study of a market-based price was in the record. (Id. at 132, 138.) In doing so, we were using 13% of affiliate sales revenue from Pacific referrals as a proxy for market value. (Id. at 138.)

We would prefer in Roseville's case, if necessary for ratemaking purposes, to use the market-based price. We will not speculate here on when, whether, or how such a price should be determined. We will not require Roseville to track affiliate sales revenues from referrals as a condition of this application. If transfer pricing becomes an issue in a Roseville general rate case, Roseville could find itself with the burden of producing an appropriate market price study and if it were unable to do so, could find itself with the burden of demonstrating an appropriate referral fee. Whether or not it would benefit from historical affiliate revenue data tied to referrals in making its showing is a choice we leave to Roseville.

15. Correspondence Filing System

Roseville agrees that it should retain correspondence between and concerning Roseville and affiliates for five years.

16. Retention of E-mail

DRA proposes that electronic mail (e-mail) between Roseville decisionmakers and affiliates should be retained for five years. Roseville argues that it does not know whether it will have an e-mail system between Roseville decisionmakers and affiliates; therefore, it may not be feasible to maintain such messages, and if it had such a system, the value to auditors does not justify the expense of storage.

We will not require Roseville to implement an e-mail system, but if it does, we will expect it to retain copies of e-mail correspondence between its officers or department heads and affiliates for a period of five years. If we were to require retention of copies of paper, but not copies of electronic messages, to assist in detecting otherwise unreported transactions between a utility and its affiliates, it is not difficult to imagine that e-mail would be preferred for selected messages. We cannot take seriously the suggestion that storage of e-mail is a burdensome expense.*

17. Documentation of Contacts

DRA proposes that we require "documentation of contacts (e.g., meetings, phone calls and desk calendars) between utility

* Roseville renews this argument in its comments on the draft decision but has not shown any technical, legal, or factual error. We are not requiring Roseville to implement an e-mail system, merely to retain copies of any correspondence that it may generate by this means in the future, as DRA points out in its reply comments.

personnel (above and below the line transactions)" to be retained for five years. Roseville believes that only officers and department heads should be subject to this requirement, which should be understood to refer to contacts with affiliates. Consistent with the proposed conditions 15 and 16, above, we will restrict this requirement to officers and department heads.

18. <u>Retention of Marketing Materials</u>

DRA proposes that we should require affiliates to retain all marketing material, proposals to customers, business plans and strategic plans for five years. Roseville objects to this condition as burdensome, unfair (because affiliates' competitors are not required to retain such records), and unjustified (because they do not relate to ratepayer concerns).

Requiring copies of such documents to be retained is not much of a burden, unless it could be shown to conflict with a particular affiliate's record retention policy. Such documents are customarily retained, at least for some time, in the normal course of business. Nothing in the record shows that competitors of affiliates gain a material advantage by being free to immediately discard copies of such materials. Whether the burden is justified, however, requires us to determine the purpose that retaining such records serves.

DRA argues that the lack of such records makes regulatory oversight impossible.[13] We are not convinced.

First, affiliates may be in businesses totally unrelated to Roseville's utility duties. Whatever the wisdom may be of utility holding companies acquiring drug store chains, for example, the marketing and business plans of such affiliates bear only tangential relation to the purposes for which we regulate Roseville.

Second, even when affiliates are in a competitive telecommunications business that is more closely related to

Roseville's utility duties, we cannot tell what use these materials will be in regulating Roseville unless it is to uncover instances of the affiliate trading on its relationship to the Roseville "brand." Our policy on the use of a utility's corporate identity is long-settled; it is a matter of ratepayer indifference:

> 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.

Edison Decision, 27 CPUC2d at 369. Therefore, we will not require this condition.

19. Time Reporting

Roseville agrees that it should be required to maintain a positive time reporting system (consistent with Part 64 of the regulations of the Federal Communications Commission (FCC)) to record time spent on services performed for affiliates.

20. Access to Books and Records of Affiliates

DRA proposes that Roseville should be required to "[p]rovide complete access to ALL books and records of all affiliates" (emphasis in original). Roseville agrees with this condition to the extent that it merely restates PU Code Section 314(b). The access provided by that statute 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 is not limited to transactions with the utility and is not further limited to those transactions that might adversely effect ratepayers. It requires "complete" access to "all" books and records.

On this record, we do not see the need for either broader access than provided by statute or to restate as a condition the authority that the Commission already has pursuant to the PU Code.

21. Presumption Regarding Production of Books and Records

DRA proposes a condition that raises a presumption that Commission requests for the production of books and records of Roseville or its affiliates are to be deemed presumptively valid. Roseville agrees with this condition to the extent that it merely restates PU Code Section 314(b).

We think this is an area which will benefit from careful attention to the separate issues that are involved, which are inspection and evidence.

Section 314(a) of the PU Code grants the Commission, each Commissioner, and each officer and person employed by the Commission the right "at any time; [to] inspect the accounts, books, papers, and documents of any public utility." Section 314(b) subjects "any business which is a subsidiary or affiliate of, or a corporation which holds a controlling interest in, an electrical, gas, or telephone corporation" to the same right, subject to the transaction subject matter limitations previously discussed. The statute does not limit the right to particular proceedings. That is, the right to inspect does not depend on the issues in any given investigation, rulemaking, application or complaint.

The right provided by the statute may be exercised either directly through an inspection or through the examination under oath of any officer, agent, or employee of the utility or affiliate. A written record must be made of the examination and filed with the Commission. An inspection, on the other hand, may be made on demand by a Commissioner or an officer of the Commission. In the case of any other person employed by the Commission making an inspection demand, that person must produce "under the hand and seal of the [C]ommission, authorization to make the inspection." (PU Code § 314(a).)

It is clear, therefore, that whenever the Commission seeks to visit the offices of a utility or its affiliate to conduct an inspection of books and records, its power to do so derives from, and is circumscribed by, the statute. The limitation imposed by the statute equally applies when the Commission wishes, independently of any other proceeding, to subject officers, agents, or employees of the utility or its affiliate to examination under oaths in relation to its business and affairs.

This is to be contrasted with the authority of the Commission pursuant to Section 311(a) of the PU Code. That statute authorizes the Commission, each Commissioner, and certain officers to "issue subpoenas for the attendance of witnesses and the production of papers, waybills, books, accounts, documents, and testimony in any inquiry, investigation, hearing, or proceeding in any part of the state." No limitation appears in that statute on the persons to whom subpoenas may be issued. Nor does the statute limit the purposes for which books and records may be sought. That is dictated by the nature of the inquiry, investigation, hearing, or proceeding in accordance with the Rules of Practice and Procedure as carried out by the presiding officer. Ultimately, therefore, the reach of the Commission's reach into the books and records of utility affiliates in connection with a proceeding is limited only by due process, the Rules, and applicable laws of evidence and privilege.

We agree that Roseville and its affiliates should be subjected to no greater burden under PU Code Section 314 than they would otherwise find themselves. That statute, however, applies only in the relatively restricted circumstances of demands for inspection and examinations independent of other proceedings. It does not govern discovery and evidentiary matters in any other inquiry, investigation, hearing, or proceeding, which fall under PU Code Section 311(a).

For situations in which DRA, and other parties, are seeking discovery from Roseville or an affiliate in a proceeding, requests for production should already enjoy a presumption of validity under the general rule that all evidence is discoverable which is relevant or likely to lead to the discovery of admissible evidence in the proceeding. Under the Rules, disputes concerning discovery are referred to the Law and Motion Calendar, where an ALJ is authorized to determine the scope of permissible discovery. We expect that the ALJ would take into proper account the fact that the presumption ought be more rigorously applied in the case of a utility and its affiliates than in the case of an unrelated third party. But the facts and circumstances of each discovery dispute are unique. For that reason, we hesitate to craft a special rule applicable solely to Roseville and its affiliates. It is the duty of every person whom we enlist in our fact-finding endeavors to assist the Commission in determining relevant facts. We will continue to rely on existing procedures to resolve differences that may arise.

22. Internal Controls on Records

DRA proposes four conditions relating to internal controls, which would require (1) documenting procedures and controls for compliance with corporate policy, (2) maintaining records in good order, (3) using a budgeting process for subsidiaries, and (4) providing audited financial statements for each subsidiary. Roseville finds the first two conditions acceptable, but objects to the second two conditions on the grounds that some subsidiaries may be too small to justify the expense of separate budgets and audited financial statements. Roseville also argues that independent auditors of Parent should be permitted to exercise their professional accounting judgment as to when a review of financial statements of subsidiaries is indicated.

DRA cites the Edison Decision as the justification for these conditions.[14] In that case, we ruled that "Edison, Edison's holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of nonutility activities by Edison's customers. These procedures and controls are explained in Edison's *Corporate Policies and Guidelines for Affiliate Transactions*. This document is attached hereto, and by this reference is made part of these conditions." (Edison Decision, 27 CPUC2d at 375.) The guidelines to which the Edison Decision refers are reproduced in the order, but only portions are made conditions of approval of the application in that case. Specifically, we required only the "accounting and other procedures and controls related to cost allocations and transfer pricing," and the remaining provisions of the guidelines that we did not otherwise address were included there because the applicant in that case deemed them appropriate. It is clear that the budget requirement of those guidelines fell into the applicant-elected category.[15] In light of our decision on proposed condition 10, above, not to require an annual capital budget, it makes no sense to impose a budgeting requirement on the subsidiaries.

With respect to auditing of financial statements of subsidiaries,[16] the connection to cost allocations and transfer pricing is direct. When an affiliate is involved in a transaction with Roseville that entails cost allocations and transfer pricing, some scrutiny is indicated to check on the consistent and accurate treatment of the transaction in accordance with the adopted allocation and transfer pricing rules. By the same token, however, when an affiliate is not involved in such transactions, an audit is unnecessary. A separate condition (number 24) would require auditing of intercompany transactions and related transfer prices.

23. Internal Controls on Procedures

Roseville agrees that it should have appropriate internal controls to ensure enforcement of the conditions of this decision and that it should designate a responsible officer, such as its controller, for implementation and oversight of such controls.

24. Auditing of Affiliate Transactions

Roseville agrees that intercompany transactions and related transfer prices should be audited to ensure that policies are observed and that potential or actual deviations are detected and corrected in a timely and cost efficient manner by either internal or external auditors.[17]

25. Verification Audit

DRA proposes that within 3-6 years after this decision, an audit should be conducted at Parent's expense of Roseville's affiliate transactions and compliance with the conditions of this decision (Verification Audit). Roseville argues that an outside audit is regulatory overkill given the availability of periodic affiliate transactions reports and resources that are available to conduct an audit by Commission staff if required. DRA is concerned, however, that over the

* In its comments on the draft decision, DRA now believes that a fixed date, such as four years, should be used, instead. We believe that Ordering

period in which the Verification Audit would be conducted the number and complexity of transactions in which Roseville may become involved could grow dramatically, exceeding staff's ability effectively to review the transactional history.

In the SDG&E Holding Company Decision, we approved a settlement that provided for an outside audit of SDG&E and its affiliates for this purpose. Here, however, the parties are divided on the need for a Verification Audit. We think the wiser course is to hold this issue open until later, when specific facts and some actual transactional history is available to help us decide whether the Verification Audit is necessary in the circumstances and to determine its scope. We agree with DRA that if an outside audit is required, it should be at the expense of Parent, rather than Roseville. But we will decide the necessity at a later date.

26. Forum for Verification Audit

We will hold this application open for the limited purpose of determining the need for the Verification Audit and receiving its results, if necessary.

27. Officer Approval for Employee Transfers to Affiliates

Roseville agrees that all employee transfers from the utility to an affiliate should be approved by an officer.

28. No Detriment Standard for Employee Transfers to Affiliates

DRA proposes that Roseville be required to demonstrate the utility will suffer no detriment as the result of any employee transfer from the utility to an affiliate. Roseville objects on the grounds that this condition unfairly limits employee opportunities, hinders recruitment by the utility, and may lead to losing employees to competitors.

Paragraph 16 provides an adequate mechanism to assure that the need for and timing of an audit will be brought up from time to time.

DRA cites the Edison Decision as justification for this condition.[18] In that case, the applicant adopted a guideline that stated "[t]he staffing of the unregulated affiliates will not be to the detriment of utility operations." (Edison Decision, 27 CPUC2d at 392.) However, that guideline was not among the 15 conditions that we imposed in that case. (See id. at 374-76.) We did impose a condition that required the utility to "avoid a diversion of management talent that would adversely affect the utility." (Id. at 375.) DRA's proposed formulation is much more sweeping than the outcome in the Edison case because it would seem to apply to each employee, regardless of level. We think, rather, that the analysis should be governed by the utility's remaining personnel posture overall if a transfer or group of related transfers were implemented.[19] It hardly seems necessary to impose a condition that requires Roseville to refrain from any transfer that would impair its ability to discharge its duties as a public utility in light of the potential applicability of PU Code Section 851 to transfers of business units from utilities to affiliates, depending on the facts and circumstances. (See In re Southern California Edison Company (1995) (D.95-11-026).)

29. Employee Transfers to Affiliates to be Voluntary

Roseville agrees that employee transfers should be on a voluntary basis.

30. Transferred Employees to Resign from Utility First

Roseville agrees that employees to be transferred to an affiliate should be required to resign from the utility.

31. No Diversion of Management

DRA proposes that Roseville should avoid a diversion of management talent that would adversely affect the utility. Roseville objects that it is impossible to show that the utility would suffer absolutely no detriment, and therefore impossible to ever transfer a manager.

This condition is identical to one we approved in the SDG&E Holding Company Decision and required in the Edison Decision. Roseville's fears are overblown. A rule of reason must apply to the requirement. Management talent is a collective concept, and an individual manager may be a greater or lesser component of that collective aggregate we are calling "management talent." Can valuable managers be transferred? Yes. Can every valuable manager be transferred in every circumstance? No. The standard, in every case, is the ability of the utility to discharge its public calling, which is always a facts and circumstances inquiry.

32. Employee Transfer Fee of 25%

DRA proposes that we require Roseville to collect a capitation fee from affiliates for transferred employees equal to 25% of the transferred employee's first-year base annual compensation. Roseville resists this condition on the grounds that it has previously been required in situations in which it was necessary to approximate the avoided cost to affiliates for headhunter fees when another utility had frequently transferred employees to an affiliate. Roseville asserts that it has never paid a headhunter fee, "does not intend to have its affiliates pay such fees" and has "no history of frequent transfers between Roseville's businesses."

In the SDG&E Holding Company Decision, we dealt with this issue, but only in terms of the difference between a 15% fee and a 25% fee. Similarly, in a pair of Pacific cases, we dealt with this issue in terms of the difference between a 10% fee and a 25% fee. (See In re Pacific Bell (1987) 27 CPUC2d 1, 129; ISG Decision, 45 CPUC2d at 135 (using business unit valuation as an alternate in the case of a mass transfer).) We chose the higher fee for Pacific because the evidence showed that it "represents a realistic measure of an approximation of the market value of benefits received by affiliates associated with such transfers *at this time*, since it focuses on the costs avoided by the affiliates as a result of obtaining employees from the regulated utility. As such it is superior to the present 10% fee, which is keyed to Pacific Bell's costs, rather than the market value of the benefits conferred on the affiliate." (27 CPUC2d at 153 (emphasis added).)

No evidence in this record allows us to reach the conclusion that a 25% fee approximates the market value of such transfers almost ten years later in what may be a different labor market. It is equally true, however, that no evidence supports the conclusion that a 0% fee is a better approximation. Nor do we have any basis for splitting the difference and imposing a 12½% fee or any other compromise.

Instead, we will adopt a rough rule, the purpose of which is to provide a default transfer pricing mechanism. In its general rate cases[*], Roseville will have the burden, from time to time, of showing that it has received the market value of employee transfers to affiliates whenever its revenue requirements are an issue. For this purpose, market value shall be deemed to be the recruiting costs to the affiliate of hiring an employee from the outside.[20] In the absence of any evidence by Roseville that would be admissible to determine market value, 25% of first year base annual compensation shall be presumed to reflect market value. However, unless application of a 25% transfer fee for the applicable period would reduce revenue

* Roseville comments that in its pending general rate case it has proposed to be regulated in a manner than will involve price cap filings in which revenue requirements are not at issue, and we have adopted its suggestion that references to "rate proceedings and rate cases" be made into "general rate cases." In so doing, we do not exclude such issues or affiliate transactions, cost allocation, cross-subsidization, and anti-competitive behavior from NRF proceedings to the extent relevant.

requirements by more than 1% or $100,000, whichever is less, this showing shall not be required.

33. Rate Adjustment for Sales to Affiliates

DRA proposes that Roseville's rates should be adjusted to reflect the value of goods and services provided to affiliates, either through an immediate $1.5 million reduction in rates or an annual reduction in rates for actual affiliate related costs.

Roseville objects to the first alternative on the grounds that under its current rate of return regulation, it would not be required to reduce current rates for an actual savings of $1.5 million. Therefore, Roseville argues, it should not be required to reduce current rates for an estimated savings of that amount that DRA projects in the future. Roseville then argues that under its current rate proposal in another proceeding, it would fall under the new regulatory framework (NRF), which provides no mechanism to automatically translate an affiliated transaction efficiency into a rate cut.

DRA relies on projected economies of scale in a combined operation of Roseville and its affiliates as the source of estimated savings that will accrue in the future. It is not necessary to determine the merit of DRA's estimate in this proceeding, however, since the "Commission can defer this revenue impact resulting from Roseville's forming a holding company to Roseville's" general rate case, in DRA's words. This is an excellent suggestion, and we will take it.

34. Utility to be Insulated from Parent Financing Activities

DRA proposes that with respect to financing activities of Parent: (i) ratepayers are to be insulated from effects of non-utility activities; and (ii) the financial health of the utility is to be assured. Roseville does not object to this condition; however, we are not persuaded that the condition is specific enough to be meaningful,[21] and we will not impose it.

35. Balanced Capital Structure

As required in the Edison Decision, DRA proposes that Roseville should be required to maintain a balanced capital structure, and Roseville agrees that is a proper condition.

36. Maintenance of Equity

DRA proposes that Roseville should be required to maintain equity at a level that would maintain, on average, its most recently approved capital structure over the period that such structure is in effect for ratemaking purposes. Roseville objects to the condition on the grounds that it "cannot be locked into a specific capital structure." We will adopt the condition imposed in the Edison Decision, which we also recently approved in the SDG&E Holding Company Decision. We note that if Roseville ceases to be subject to rate-of-return regulation, its capital structure would cease to be in effect for ratemaking purposes.

37. Stand-alone Dividend Policy

DRA proposes that Roseville should continue to set its dividend policy as if it were a stand-alone utility. Roseville feels that such a condition is unnecessary in light of the requirement that it maintain a balanced capital structure. We required this condition in the Edison Decision, and we approved of this condition in the SDG&E Holding Company Decision. We believe that Roseville is taking too narrow a view of dividend policy. Dividend policy is determined not only by capital structure, but also a number of other factors, including projected capital requirements, as appropriate.[22]

38. First Call on Capital

DRA proposes that Parent should give the capital requirements of Roseville first priority. Roseville has no objection to this condition.

39. Approval of Commission for Utility Guarantees

DRA proposes that Roseville should not be permitted to guarantee the financial obligations of Parent or affiliates without our prior approval. Roseville has no objection to this condition.

40. Income Tax Allocation on Stand-alone Basis

DRA proposes as a regulatory tool for ratemaking purposes that income tax allocation among Roseville, Parent, and affiliates should be on a stand-alone basis. Roseville does not object so long as it is clear that such allocation must be consistent with GAAP and requirements of tax law.

It appears that DRA and Roseville are talking about different aspects of the tax allocation. DRA is focused on ratemaking, and Roseville is focused on its tax returns to the federal and state taxing authorities. The one does not determine the other. For example, for purposes of computing estimated test-year income tax expense in a ratemaking matter, we have traditionally excluded as a tax deduction the interest expense associated with non-utility plant and investment, particularly construction work in progress. (See In re Income Tax Expense for Ratemaking Purposes (1984) 15 CPUC2d 42, 45-46.) Therefore, while Roseville and its affiliates filing a consolidated income tax return may need to make some intercompany allocations in preparing the return, we may find a different allocation appropriate for particular ratemaking purposes. (See id. at 51.)

We do not wish to re-examine the complexities of either allocation process here. We have previously stated our general policy on income tax expense for ratemaking purposes. (See Id.) We do note that our established policy is for the use of the "stand-alone" or "separate return" method. Since, however, this is not an issue that uniquely affects Roseville, we will not make it a condition of our approval of its application. Roseville should be prepared to address the ratemaking tax allocation issue in the appropriate proceeding in accordance with already developed Commission policy in this area.

41. Cost Recovery from Affiliates

DRA proposes that (i) costs incurred by Roseville (generally for the provision of services) on behalf of affiliates should be fully recovered from the affiliate, (ii) non-tariffed services should be provided to affiliates only if they are critical or essential services to the affiliate, and (iii) such services should be priced at the higher of market price or fully loaded cost plus 10%. Roseville (i) agrees with the principle of cost recovery, (ii) objects to the limitation of services to "critical or essential" services, and (iii) thinks that services should be priced (when not at market) at the fully loaded labor cost plus 5%.

DRA's proposal derives from the ISG Decision. In that case, we made clear that we were not establishing generic affiliate transactions guidelines. (Id. 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.) Also, we did not require the utility to so limit its services to all affiliates, only a specific affiliate. The "critical or essential" limitation should not be expanded beyond the facts in that case unless required by similar circumstances. Those circumstances are not present in this application, and we will not limit services to only critical or essential services.

We cannot agree with Roseville's suggestion that the transfer price should use fully loaded labor costs plus a mark-up.* The limitation of costs to labor costs implicitly assumes that Roseville would be providing all services to its affiliates through its own staff, rather than relying on outside contractors. The principle of cost recovery requires that the affiliate reimburse the utility for services received whether those services are provided by the utility or outsourced at the expense of the utility.[23]

With respect to the mark-up, two approaches are possible to resolve the difference between the parties. We can consider the mark-up either as a proxy for profit, or we can consider the mark-up as a true-up adjustment to account for any cost element that may have been overlooked in pricing the transfer of services from the utility to the affiliate.

If the mark-up is a proxy for profit, the economic principle of profit maximization might favor a higher mark-up.[24] Since the mark-up only applies when the market price is lower than the fully loaded cost, however, it makes more sense to use the mark-up to account for any missing cost element.

We found a 5% mark-up to be appropriate as a true-up in the Edison Decision, and we approved a 5% mark-up in the SDG&E Holding Company Decision. In the only case in which we have imposed a 10% mark-up, we had evidence to show that 35% was appropriate and other evidence to show that 2.2% was appropriate. (In re Pacific Bell (1986) 20 CPUC2d 237, 268.) We concluded "that 10% is an appropriate markup to apply" given the evidence in that proceeding. (Id.) We continued that mark-up in a later case involving the same utility. (ISG Decision, 45 CPUC2d at 124.) The current Commission policy, as articulated in the latter case, was "for the utility to price its nontariffed

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* Roseville reargues this point in its comments on the draft decision, but

services provided to an affiliate at the higher of cost or market value." (Id.) The continuation of the 10% mark-up, by contrast, reflected our decision not to deviate from transfer pricing rules applicable to the utility in that case. (Id.)

Given that this issue is significant for ratemaking purposes, we will treat a 5% mark-up as presumptively reasonable. In a Roseville general rate case, evidence will be proper to determine, if there is a material issue in the proceeding, whether a lesser or greater mark-up is more reasonable in Roseville's circumstances at the time.

42. Audit Trail for Transfer of Assets, Goods, etc.

DRA proposes that transfers from Roseville to affiliates should be documented in sufficient detail to provide an audit trail. Roseville agrees to this condition.

43. Pricing of Transfer of Assets, Goods, etc.

DRA proposes that transfers from Roseville to an affiliate of assets, goods, services or valuable information not produced, purchased or developed for sale should be priced at the higher of fully loaded cost or fair market value. Roseville agrees, but proposes that pricing for transfers subject to PU Code Section 851 should be determined by the Commission on a case-by-case basis. We will adopt that addition.

44. Mark-up of 10% on Transfer Fully Loaded Costs

DRA proposes that transfers from Roseville to an affiliate of assets, goods, services or valuable information not produced, purchased or developed for sale when priced at the fully loaded cost should include a 10% mark-up on labor. We have already determined that a 5% mark-up on non-tariffed services is presumptively reasonable.

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fails to adduce any technical, legal or factual error.

45. Part 64 to Govern Fully Loaded Costs

DRA proposes that fully loaded costs be determined as set forth in Part 64 of the FCC regulations, and Roseville agrees. Commission policy is for the utility to price its nontariffed services provided to an affiliate at the higher of cost or market value, and cost is the cost allocated under FCC Part 64, as modified by the Commission to distinguish the allocation of company overheads between utility and below-the-line services from the allocation of overheads to nontariffed services provided by a utility to an affiliate. (ISG Decision, 45 CPUC2d at 124.)

46. [Omitted[25]]

47. Price Studies for Assets, Goods or Services over $100,000

DRA proposes that Roseville should be required to prepare price studies for transfers of assets, goods or services involving more than $100,000. Roseville agrees, noting that PU Code Section 851 governs asset transfers. For transfers to or from any affiliate in any year that aggregate $100,000 in consideration, Roseville should be required to demonstrate that it has determined fair market value through a method appropriate to the asset, good, or service. Such methods may include independent appraisals, published closing prices, market surveys, or a combination of methods adequately documented for audit purposes. In ratemaking proceedings and in cases in which the transferred property is subject to PU Code Section 851, Roseville will be required to make an affirmative showing of fair market value.

48. Assets Defined

DRA proposes that the definition of "assets" should include real, personal, and intangible (to include copyrights, patents, going concern, and other elements as defined by the Commission) property. Roseville has no objection.

49. Royalties and Benchmark Payments or Other Compensation

DRA proposes that intangible property should be subject to a royalty, benchmark payment, or other compensatory regime in the future to be determined on a case-by-case basis. Roseville does not agree to pay any such royalty. We imposed such a condition in the Edison Decision, but restricted it to "product rights, patents, copyrights, or similar legal rights." (Edison Decision, 27 CPUC2d at 376.) We will follow that formulation in this case.

50. Name, Logo, and Intangibles

DRA reserves the right to assess a payment for a name or logo and recommends that "payment for intangibles should evolve" as Commission policy evolves. Roseville agrees that DRA may raise the matter in the future as Commission policy evolves. It is not our current policy to request payment for use of a name or logo; however, DRA will not be estopped from raising this issue in other proceedings in the future, should our policy change.

51. Valuation at Net Book Value when less than $100,000

DRA proposes for small transfers of assets (which are those with a higher of fair market value or net book value less than $100,000), valuation should be at net book value. Roseville agrees with this proposal.

52. Co-location

DRA proposes that an affiliate which co-leases equipment with a Roseville facility should be required to pay fair market value for the co-location, and that third parties should be offered co-location rights on the same terms and conditions. Roseville agrees that it should be bound by any existing or future nondiscrimination requirements imposed generally by the FCC, the Commission and the courts, but it objects to a condition specifically applicable to it, and it does not agree to construct new facilities to accommodate third parties in situations where an affiliate co-location exhausts the space available in an existing facility.

As we noted in the SDG&E Holding Company Decision, no special rule appears needed for valuation of co-location rights. These should be subject to the same rule as for other property.[26] With respect to non-discriminatory co-location, the proper dividing line between open access and access by invitation only ought to be whether the co-location rights in question are directly related to Roseville's duty to serve as a utility. Accordingly, affiliates seeking to install an equipment rack in one of Roseville's central offices should be treated identically with any non-affiliate seeking to install substantially the same equipment rack in accordance with applicable law, regulations, and decisions. DRA has not explained why Roseville's utility facilities are a special problem in this regard.

The proposed condition does not expressly exclude co-leasing of equipment in a Roseville facility that is an office or other location not directly used to render utility service. In a co-location setting that is not so directly related to Roseville's duty to serve as a utility, non-discriminatory co-location would be unduly intrusive. For example, if a Roseville affiliate were to install, under an appropriate arrangement, a copy machine for its own use in Roseville's reproduction center, we should not require Roseville to accommodate every other business that might wish to have the same privilege.

<u>53. Pricing of Property for Sale</u>

DRA proposes that transfers of assets, goods, services, or valuable information produced, purchased or developed for sale be priced at current fair market value or tariffed rate. Roseville sees nothing controversial in this condition.

Roseville is already required to provide service in accordance with the rates provided in its tariff, so the condition is not needed for Roseville's utility services. (See also Affiliate Transactions Order, 48 CPUC2d at 176-77 (excluding from the tabular reporting requirements any tariffed telephone services, but requiring disclosure of special services utility contracts with affiliates).)

With respect to transfers of such property not involving utility services, we are more concerned with fair market value when the utility is the recipient, rather than the source of the property. (See id.) In the Edison Decision, we approved corporate guidelines that noted that the utility's only service produced for sale was its regulated utility service, so that it generally would not have transfers of goods or services that would be priced at fair market value and the policy would apply to transfers between non-utility affiliates. (See Edison Decision, 27 CPUC2d at 386.) To the extent that such guidelines "relate to accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of nonutility activities by [the utility's] customers" they were conditions of our approval. (Id. at 375.) The proposed condition is one that relates to transfer pricing to protect against cross-subsidization. It is therefore appropriate when Roseville is the provider.

54. Audit Trail for Property for Sale

DRA proposes that transfers of assets, goods, services, or valuable information produced, purchase or developed for sale be adequately documented to preserve an audit trail. Roseville agrees.

55. Pricing of Goods and Services Received from Affiliates

DRA proposes that the receipt of goods and services by Roseville from an affiliate should be priced at the lower of fair market value or fully allocated cost. DRA refers to the transfer pricing rule established by the Affiliate Transactions Order, and Roseville agrees that the Affiliate Transactions Order requires the lower of cost or market price. However, Roseville believes that such a rule should be changed in response to the development of a competitive market and does not wish to have the rule continue to apply to it after it no longer applies to others. No purpose would be served by crafting a special condition applicable to Roseville.*

56. Affiliate Billing to be Timely

DRA proposes that intercompany billings be required to be issued on a timely basis, and Roseville does not object.

57. Affiliate Billing in Sufficient Detail for Audit Trail

DRA proposes that intercompany billings be required to be maintained in sufficient detail for audit trail purposes, and Roseville does not object.

58. Prompt Reimbursement

DRA proposes that intercompany billings be required to be made within 30 days, and Roseville does not object.

59. Payments Directly to Utility

DRA proposes that affiliate payments be required to be made directly to Roseville, and Roseville does not object.

* In its comments on the draft decision, DRA points out that we are imposing many conditions specific to Roseville as a result of this Decision and correctly notes that we are being inconsistent in this regard. However, most of those conditions are conditions that Roseville agreed should be applied to it.

60. Adequate Documentation

DRA proposed that intercompany billings be required to be supported by adequate documentation, and Roseville does not object.

61. Direct Billing of Shared Costs to Utility

DRA proposes that costs shared between Roseville and any affiliate be required to be billed directly to the affiliate, on behalf of Parent in order to provide a more direct audit trail, and Roseville does not object.

61a. Pricing for Formal Referrals

DRA proposes that should a formal referral program be established, such services should be required to be priced using the same higher of cost or market price methodology as other services. Roseville states that (i) it has no referral program, (ii) it is willing to have non-regulated affiliates pay for referrals, but (iii) affiliates should pay the market value.

As discussed above with respect to proposed condition number 41, this is a ratemaking issue and does not properly fit as a condition of approval for reorganization under a holding company structure.

62. Default Referral Fee of 13%

DRA proposes that a 13% referral fee (based on the affiliate's first month recurring and non-recurring revenue resulting from the referral) should be used, unless and until Roseville demonstrates that another rate is justified.

As discussed above under proposed condition 14, this is a ratemaking issue that depends on the facts and circumstances for particular utilities at the time of the ratemaking. It is not appropriate as a condition to the issuance of stock of the proposed holding company.

63. [Omitted[27]]

64. Most Favored Nation Access to Property/Information

DRA proposes that affiliate access to property or valuable information must be at the same terms and conditions as being offered to third parties. With respect to non-utility services, Roseville does not believe that it should be required to treat affiliates the same as non-affiliates. With respect to utility services, Roseville "agrees to the concept of nondiscriminatory access to utility facilities for co-location and interconnection per FCC and Commission rules [and] the concept of making any unbundled network functionality available on a nondiscriminatory basis." However, in Roseville's view, it is not necessary for the Commission to adopt such a condition for this application since the Commission is considering these issues in generic proceedings.

In the SDG&E Holding Company Decision, we approved a condition that whenever valuable customer information, such as market, technological or similar data is provided by the utility 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 slightly different: "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 the utility would be able to offer data to affiliates only after it had offered it to third parties.

In that decision, we declined to expand the applicant's duties as a utility.[28] We therefore agree with Roseville that outside of its duties as a utility, generally, it should be not be required to refrain from transferring property to affiliates that it does not offer to the public at large.

In approving a similar condition in the SDG&E Holding Company Decision, we were concerned with proprietary data of the utility 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 interpreted "the same terms and conditions" to mean access on comparably timely terms when the data has a short-term competitive usefulness.

Unlike the electric industry, which is in the early stages of transition from monopoly to competitive markets, however, the telecommunications industry is at a relatively advanced stage of competition. Roseville does not occupy the same position of dominance in the telecommunications market as does San Diego Gas & Electric Company in the energy market. We will not require an equal-access condition because the record does not demonstrate that the same competitive concerns are present in this situation. We do not mean to suggest, however, that Roseville should consider itself immune from all future scrutiny in this regard. If Roseville provides proprietary data to affiliates but withholds it from competitors with an anticompetitive intent or effect, it will be no defense in a proper proceeding that we declined to impose the condition in this application.

65. Only Critical or Essential Services to Affiliates

DRA proposes that the services provided by Roseville to affiliates should be limited to critical or essential services, which are defined as services "that the affiliate must have in order to operate in the manner authorized [by this order, excluding] services that the affiliate could provide using its current or additional in-house personnel or could obtain through a third-party vendor without potentially disclosing proprietary information despite responsible precautions. The effect of this condition would be to greatly limit, if not eliminate, services that the utility provides to affiliates, and thus simplify auditing and regulating the utility. Roseville opposes the condition. We have already decided we would not expand the ISG Decision beyond its facts.[29] (See page 33, *supra*.)

66. Separate Facilities and Equipment

DRA proposes that affiliates[30], where feasible, should acquire, maintain and operate their own facilities and equipment. Roseville objects to this as "micro-management."

The purpose of the condition is to encourage Roseville to be separate from its affiliates in fact and function as well as in form. Such a degree of separation also has the advantage of avoiding allocation difficulties. These and related conditions all address the potential problem of determining when Roseville is performing its public calling as opposed to acting in its proprietary capacity or as an agent for others.[31] On the other hand, a required degree of separation may impose added costs, or at least prevent cost savings that could arise from the contribution of affiliates to the expenses of the utility.

This is a problem that has a better solution than the proposed condition. We will apply the legal doctrine of "piercing the corporate veil" as necessary properly to account for the substance rather than the form of transactions affected by shared resources between a utility and one or more of its affiliates. Thus, intermingling of affiliate properties or accounts with those of the utility will be considered along with such factors as failure to observe corporate formalities, absence of corporate records, and non-functioning officers and directors in determining whether to disregard the separate identify of an affiliate.*

67. Separate Administrative Staffs

DRA proposes that affiliates be required to retain their own administrative staffs. This condition is susceptible to the same treatment under the piercing-the-veil doctrine as facilities and equipment as an indicator of the need, in the appropriate case, to disregard the separate legal existence of the affiliate.

68. Separate Financing

DRA proposes that affiliates should be required to provide for their own financing needs. Roseville agrees that affiliates should not receive free or below market financial support from the utility.

In the Edison Decision we confronted this issue and decided that the utility should "not guarantee the notes, debentures, debt obligations, or other securities of its parent holding company or any of its subsidiaries without first obtaining the written consent of this Commission." (Edison Decision, 27 CPUC2d at 376.) In the Affiliate Transactions Order, we require utilities to report the guarantee of such financings with a citation to the applicable Commission decision, if any, authorizing the guarantee. (Affiliate Transactions Order, 48 CPUC2d at 179.) "Guarantee" in this sense should be understood to include an undertaking to a third party as surety for the affiliate's performance of its payment covenants. Although we require reporting of loans and equity investments under the Affiliate Transactions Order,[32] we do not require prior

* DRA argues that prevention is a superior approach to potential problems in this area, compared to an after-the-fact determination of what allocations should have been. Paradoxically, the result would be, in DRA's view, more rather than less regulation. We hope this will not be the case as utilities become less regulated on a rate-of-return basis

Commission approval for such financial transactions. Thus, the proposed condition would restrict Roseville to a greater extent than other utilities, and nothing in the record shows why Roseville is unique in this regard.*

69. [Omitted][33]

70. Parent to Move Away from Common Board of Directors

DRA proposes that Parent and Roseville should not share a common Board of directors and the same officers for more than an unspecified period after formation of Parent. Roseville opposes this condition. We are uncertain how long a period to set forth in this order in response to this suggestion, and the record provides no guidance on what would be appropriate. Moreover, we feel that this is another area best handled by the "piercing the corporate veil" doctrine. To the extent that Parent and Roseville have substantially identical boards and officers, we will be less inclined to treat them separately when to do so would hinder our regulation of the utility. But that will be only one among a number of factors we will consider on a case-by-case basis.

71. Parent to Minimize Reliance on Services of Utility

DRA proposes that Parent should use the utility departments only for a minimal level of services. Roseville opposes this condition.

This condition does not much differ from the "critical or essential" condition discussed earlier. (See *supra* at 33.) Facts showing that Parent's internal operations are tightly integrated and intertwined with those of Roseville may be evidence that weighs in a corporate veil multi-factor balancing analysis. But we would not know how to describe in advance how

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* See note *, page 40, *supra*.

much reliance is more than "minimal," and we therefore decline to impose the condition.

72. Billing of Corporate Functions

DRA proposes that corporate functions performed by the utility should be billed to Parent and affiliates at fully loaded costs, as determined by FCC Part 64, plus 10%. We have dealt with all of this proposed condition above. Corporate functions should be treated like any other service. (See discussion of proposed conditions number 41, number 44, and number 45, *supra*.)

73. [Omitted[34]]

74. [Omitted[35]]

75. [Omitted[36]]

76. [Omitted[37]]

77. [Omitted[38]]

78. [Omitted[39]]

79. [Omitted[40]]

80. Affiliate Transactions Order Definitions to Govern

DRA proposes that the definitions contained in the Affiliate Transactions Order should take precedence over any conflicting definitions in Roseville's application. We confirm that this is the case. To the extent otherwise applicable, the definitions set forth in the Affiliate Transactions Order or any successor order will apply to Parent, Roseville and affiliates in precedence to any conflicting definition in this application.

81. Definitions in Edison Case to Supplement

DRA proposes that the definitions included in the Edison Decision should be "used to amplify" those in the Affiliate Transactions Order. Roseville objects. We feel that if the Affiliate Transactions Order definitions are deficient, they should be modified for all utilities, rather than on a case-by-case basis as holding company reorganizations arise.

82. Special Definition of "Intangible"

DRA proposes a definition of "intangible" from the Edison Decision, which we will not require, for the same reason.

83. Other Aspects of "Intangible"

DRA reserves the right to examine other aspects of the definition of intangible property, such as the value of name, reputation, logo, or going concern as the accepted definition of intangibles evolves. In the SDG&E Holding Company Decision, we stated that our current policy is not to include such elements in the definition, but that DRA will not be estopped from raising this issue in other proceedings in the future, should our policy change. We will follow the same course here.

84. Interpretation of "Fully Allocated Costs"

DRA proposes that "fully allocated costs" be determined in the same manner as required by the Commission for telephone utilities. This continues to be our policy with respect to Roseville as it is with other telephone utilities, as discussed above under proposed condition 45. Therefore, no condition need be attached to our approval.

Findings of Fact

1. Roseville is an investor-owned public utility subject to the jurisdiction of this Commission.

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

3. Roseville's principal reason for the proposed restructuring is to respond to what it considers a changing business environment in the telecommunications industry,

including the onset of competition within markets that Roseville has historically served as a regulated monopoly. Roseville considers the holding company form of organization suitable because it would serve to isolate ratepayers from unregulated competitive business enterprises, thereby focusing regulation to enhance protection for subscribers to regulated services.

4. Parent is a California corporation organized by Roseville. Merger Company is a California corporation organized by Roseville.

5. Roseville seeks authority pursuant to PU Code Sections 818 to permit Parent to issue 100 shares of common stock initially.

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

8. Roseville 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 Roseville common stock outstanding immediately prior to the effectiveness of the Merger.

9. Roseville 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 Roseville common stock reserved for issuance by Roseville's board of directors under employee benefit plans and similar arrangements immediately prior to the effectiveness of the Merger.

10. Roseville intends to transfer the stock of its subsidiary corporations to Parent following the Merger.

Roseville has not asked for authority to do so pursuant to PU Code Section 851.

11. As a result of the Merger, Roseville would be a wholly owned subsidiary of Parent, and the owners of Roseville debt securities would be unaffected.

12. As a result of the Merger, Roseville, Parent, and their future subsidiaries would be affiliated entities within the meaning of the Affiliate Transactions Order.

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

14. Roseville seeks authority pursuant to Section 854 to consummate the Merger.

15. DRA represents the interests of public utility customers and subscribers.

16. DRA proposes that approval of the application be made subject to 76 conditions.

Conclusions of Law

1. The proposed transaction will result in the acquisition of Roseville by Parent.

2. 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.

3. The Merger is subject to PU Code Section 854.

4. Roseville'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.

5. 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.

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

7. The proposed reorganization is not adverse to the public interest in light of the conditions that the Commission may impose and the Commission's power to regulate Roseville and its affiliates in the future to detect and remedy any abuses that may arise. The Commission can apply the legal doctrine of "piercing the corporate veil" as necessary properly to account for the substance rather than the form of transactions affected by shared resources between a utility and one or more of its affiliates.

8. DRA should select and supervise the outside auditor or consultant for the Verification Audit, if we subsequently determine that one is required.

9. The application of Roseville for issuance of stock of Parent and Merger Company should be approved subject to the conditions set forth herein.

10. 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 Roseville and other similarly situated utilities in the future.

11. 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.

INTERIM ORDER

IT IS ORDERED that:

1. The application of Roseville Telephone Company (Roseville) for authority pursuant to Public Utilities (PU) Code Section 818 for the issuance of stock by the California corporations Roseville Communications Company (Parent) and RTC Reorganization Sub (Merger Company) is granted, subject to the conditions set forth in the following Ordering Paragraphs.

2. Prior to the issuance of stock of Parent, Roseville shall file a copy of the amendment of the articles of incorporation of Parent evidencing the change of name of Parent from "Roseville Comtech" to "Roseville Communications Company," which copy shall be certified by the Secretary of State of the State of California.

3. The officers and employees of Parent and its subsidiaries shall be available to appear and testify in Commission proceedings as necessary or required.

4. Parent and each of its subsidiaries and the joint ventures of Parent and/or its subsidiaries shall keep their books in a manner consistent with generally accepted accounting principles and, where appropriate, consistent with the Uniform System of Accounts.

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

6. Roseville shall maintain ledgers to track affiliate transactions through separate accounts receivable and payable, with separate sub-accounts for each affiliate.

7. Roseville shall include in its annual reports pursuant to the Commission's decision In re Reporting Requirements for Electric, Gas, and Telephone Utilities Regarding Their Affiliate Transactions (1993) 48 CPUC2d 163 (the Affiliate Transactions Order) a description of organizational changes, such as changes to Parent's structure.

8. Roseville shall include in its annual reports pursuant to the Affiliate Transactions Order a description of changes to its corporate guidelines for affiliate transactions.

9. Roseville shall notify the Commission in the event that it establishes any formal referral program involving a course of regular and repeated referrals of customers of Roseville to one or more affiliates, and Roseville shall track, on a monthly basis, referrals of customers to affiliates, for a period of one year thereafter.

10. Roseville shall retain correspondence concerning Roseville between its officers and department heads and affiliates for five years or until the completion of the audit contemplated by Ordering Paragraph 16, whichever is longer.

11. If Roseville uses electronic mail (e-mail), it shall retain copies of e-mail correspondence between its officers or department heads and affiliates for a period of five years or until the completion of the audit contemplated by Ordering Paragraph 16, whichever is longer.

12. Roseville shall document the substance of meetings between its officers or department heads and affiliates and retain copies of such documentation for a period of five years or until the completion of the audit contemplated by Ordering Paragraph 16, whichever is longer.

13. Roseville shall maintain a positive time reporting system (consistent with Part 64 of the regulations of the Federal Communications Commission (FCC)) to record time spent on services performed for affiliates.

14. Roseville shall document procedures and controls for compliance with corporate policy regarding affiliate transactions and maintain records relating thereto in good order. Roseville shall implement and maintain appropriate internal controls to ensure enforcement of the conditions of this decision, and it shall designate a responsible officer, such as its controller, for implementation and oversight of such controls. Such controls shall include retention of audit workpapers for five years or until the completion of the audit contemplated by Ordering Paragraph 16, whichever is longer.

15. Transactions between Roseville and its affiliates and related transfer prices shall be audited on an on-going basis to ensure that corporate policy regarding affiliate transactions is observed and that potential or actual deviations are detected and corrected in a timely and cost efficient manner by either internal or external auditors.

16. 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 determine whether the need for a Verification Audit exists, and if so, that it be scheduled. For such purpose, 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

* Based on Roseville's comment on the inconsistency with the treatment of the Verification Audit in the text, this Ordering Paragraph has been modified to be consistent with the treatment in the text.

determines that the needs of the Commission dictate otherwise. At such prehearing conference, or at a prehearing conference in a Roseville New Regulatory Framework review application, as appropriate, DRA may move for an audit. If Roseville agrees that an audit is appropriate at such time, the Executive Director shall make staff assignments as necessary to conduct an audit of Parent, Roseville and controlled affiliates, at the expense of shareholders of Parent to examine Roseville's affiliate transactions for the purpose of verifying Roseville's compliance with its affiliate transactions policies and guidelines, this Decision, and other applicable Commission orders and regulations (Verification Audit). Roseville 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 Roseville 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 Roseville regarding the identity of potential contractors. Roseville, 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 Roseville's officers and department heads and controlled affiliates, and (ii) to the extent prepared in the normal course of business, desk calendars, meeting summaries, phone call summaries or logs and electronic mail correspondence between Roseville's officers and department heads and controlled affiliates. 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. 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 any other Roseville 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, Roseville ratepayers shall continue to fund the normal PU Code Sections 314.5 and 797 audits. However, in no event shall Roseville 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. If, however, Roseville does not agree that a Verification Audit is required, DRA may move for a Commission order that a Verification Audit be conducted at such time. Either party may move for an evidentiary hearing in connection with such motion, the scope of which shall be appropriately limited consistent with its purpose, which is to determine the need for, rather than the results of, a Verification Audit.

17. All employee transfers from Roseville to an affiliate shall be approved by an officer of Roseville and shall be voluntary; provided, however, this condition shall not prohibit Roseville from terminating the employment of any employee who declines a transfer. Any employee who accepts an offer of transfer shall terminate his or her employment with Roseville prior to undertaking employment with any affiliate.

18. Roseville shall avoid a diversion of management talent that would adversely affect the utility.

19. Roseville shall have the burden, from time to time, of showing that it has received the market value of employee transfers to affiliates* whenever its revenue requirements are an issue. For this purpose, market value shall be deemed to be the recruiting costs to the affiliate of hiring an employee from the outside. In the absence of any evidence by Roseville that would be admissible to determine market value, 25% of first year base annual compensation shall be presumed to reflect market value. However, unless application of a 25% transfer fee for the applicable period would reduce revenue requirements by more than 1% or $100,000, whichever is less, this showing shall not be required.

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

21. The capital requirements of Roseville, as determined to be necessary to meet its obligations to serve, shall be given first priority by the board of directors of Parent and Roseville.

22. The dividend policy of Roseville shall continue to be established by Roseville's board of directors as though Roseville were a comparable, stand-alone utility company.

23. Roseville shall not guarantee the notes, debentures, debt obligations, or other securities of Parent or any affiliate without first obtaining the written consent of this Commission.

* Roseville commented on a drafting error that had this as "utilities," which has been corrected.

24. Costs incurred by Roseville (generally for the provision of services) on behalf of affiliates shall be fully recovered from the affiliate, and such non-tariffed services should be priced at the higher of market price or fully loaded cost plus a reasonable percentage to account for costs that may have been overlooked. For such purpose, a 5% mark-up shall be presumptively reasonable in all general rate cases.

25. Transfers from Roseville to affiliates shall be documented in sufficient detail to provide an audit trail.

26. Transfers from Roseville to an affiliate of assets, goods, services or valuable information not produced, purchased or developed for sale shall be priced at the higher of fully loaded cost or fair market value, provided that pricing for transfers subject to PU Code Section 851 shall be determined by the Commission on a case-by-case basis.

27. For transfers by Roseville to or from any affiliate in any year that aggregate $100,000 in consideration, Roseville shall be required to demonstrate that it has determined fair market value through a method appropriate to the asset, good, or non-tariffed service. Such methods may include independent appraisals, published closing prices, market surveys, or a combination of methods adequately documented for audit purposes. In ratemaking proceedings and in cases in which the transferred property is subject to PU Code Section 851, Roseville shall be required to make an affirmative showing of fair market value.

28. For purposes of the conditions contained in this order, the definition of "assets" shall include real, personal, and intangible (to include copyrights, patents, going concern, and other elements as defined by the Commission) property.

29. Where product rights, patents, copyrights, or similar legal rights are transferred from Roseville to an affiliate, a royalty payment may be required to ensure that ratepayers receive

appropriate compensation, and such royalty payments shall be developed on a case-by-case basis in proceedings pursuant to PU Code Section 851.

30. For small transfers of assets (which are those with a higher of fair market value or net book value less than $100,000) from Roseville to an affiliate, valuation shall be at net book value and documentation shall be maintained to preserve an audit trail.

31. Intercompany billings between Roseville and any affiliate shall be issued on a timely basis and documentation shall be maintained to preserve an audit trail. Payment terms shall be net 30 or such other commercially reasonable payment terms as Roseville may determine that are calculated to result in payment promptly. In the case of payments due to Roseville, such payments shall be made directly to Roseville.

32. Costs shared between Roseville and any affiliate shall be billed directly to the affiliate.

33. To the extent otherwise applicable, the definitions set forth in the Affiliate Transactions Order or any successor order will apply to Parent, Roseville and affiliates in precedence to any conflicting definition in this application.

34. Transfers by Roseville of assets, goods, non-tariffed services, or valuable information produced, purchase or developed for sale shall be priced at current fair market value.

35. Roseville 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 Roseville or Parent, as the case may be, to the conditions set forth in Ordering Paragraphs 2 through 34, 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 July 17, 1996, at Sacramento, California.

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

APPENDIX A

Appearances

Applicant:	Roseville Telephone Company by E. Garth Black and *Mark P. Schreiber*, attorneys-at-law, of Cooper, White & Cooper, San Francisco.
Interested parties:	Division of Ratepayer Advocates by *Ira Kalinsky*, attorney-at-law, and Lee-Whei Tan.
	Comtech Mobile Telephone Company by Peter A. Casciato, attorney-at-law.

Appendix B

Glossary of Defined Terms

Abbreviation	Definition
Affiliate Transactions Order	*In re Reporting Requirements for Electric, Gas, and Telephone Utilities Regarding Their Affiliate Transactions* (1993) 48 CPUC2d 163
ALJ	Administrative Law Judge
D.	Decision
DRA	Division of Ratepayer Advocates
Edison Decision	*In re Southern California Edison Company* (1988) 27 CPUC2d 347 (D.88-01-063)
GAAP	Generally accepted accounting principles
Merger	The merger of Roseville 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 Roseville, 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 Roseville, as described in the section titled "Description of the Proposed Reorganization."
PHC	Prehearing Conference
PU Code	Public Utilities Code
Roseville	Roseville Telephone Company
SDG&E Holding Company Decision	*In re San Diego Gas & Electric Company* (1995) ____ CPUC2d ____ (D.95-12-018)
SDG&E Section 854 Decision	*In re San Diego Gas & Electric Company* (1995) ____ CPUC2d ____ (D.95-05-021)
USOA	Uniform System of Accounts
Verification Audit	An audit to be performed 3-6 years following the date of the decision in this application, if required subsequently.

APPENDIX C

Endnotes

[1]Roseville contemplated that Parent would be known as "Roseville Comtech," but it has determined to change the name of Parent to "Roseville Communications Company," pursuant to a stipulation in this matter with Comtech Mobile Telephone Company.

[2]Comtech's protest was limited to Roseville's naming of Parent as Roseville Comtech. Roseville and Comtech executed a stipulation on December 1, 1995 in which Roseville agreed to select a new name for Parent. Comtech agreed to withdraw its protest "if the new name resolves the issues raised in its protest."

[3]Roseville Telephone Company, Quarterly Report on Form 10-Q for the Fiscal Quarter Ended June 30, 1995 (http://www.sec.gov/Archives/edgar/data/85153/0000085153-95-000015.txt).

[4](In re San Diego Gas & Electric Company (1995) ___ CPUC2d ___ (Decision (D.) 95-05-021) (SDG&E Section 854 Decision).) We determined that acquisition activities, including reorganizations such as this, should be evaluated on a case-by-case basis. (Id.) We observed that acquisition activities that do not involve any change in control still have the potential of giving rise to effects that should be evaluated under PU Code Section 854. (Id.) However, when we have other bases of jurisdiction than PU Code Section 854 to assure that the proposed transaction will be in the public interest, it is not necessary to classify this kind of reorganization as an acquisition activity subject to PU Code Section 854. (See id.) Unlike the proposed reorganization involved in that case, moreover, Roseville is not subject to PU Code Sections 854(b) or 854(c), which have particularized decisionmaking requirements for acquisitions involving utilities with annual revenues in California greater than $500 million.

[5]The term "the parties" refers to Roseville and DRA for purposes of this discussion, since Comtech's sole issue relates to the name of Parent.

[6]DRA also criticized the application on the grounds that "Roseville suggests that the holding company structure will provide improved financial information to management." However, that is not one of the reasons that Roseville advanced.

[7]Section 854(g) provides that the formation of a holding company does not require the Commission to find that the transaction will provide short-term and long-term economic benefits to ratepayers of very large electric, gas, or telephone utilities under Section 854(b). We doubt that the Legislature intended to subject small and mid-size utilities to a ratepayer benefit standard for these types of transactions while exempting the largest utilities.

[8]DRA does not specify whether these are subsidiaries of Parent, of Roseville, or of either. Roseville does not address this issue. We shall assume that DRA intended, and Roseville agrees, to mean any affiliate (as defined in the Affiliate Transactions Order) of Roseville or Parent.

[9]DRA does not specify whether these are joint ventures involving Parent and subsidiaries, joint ventures involving only Roseville, or some other kinds of joint ventures. Roseville does not address this issue. We shall assume that DRA intended, and Roseville agreed, to mean joint ventures involving Roseville, Parent, or affiliates, in any combination.

[10]We are not creating any new cause of action or remedy specific to Roseville by this decision. Any complaint must be properly founded on the jurisdiction of this Commission to hear and decide matters within its authority as provided by statute and other applicable law.

[11]In addition, our statement in the ISG Decision that it "simply affirms existing Commission rules for utility/affiliate transactions" must be placed in its proper context. (See ISG Decision, 45 CPUC2d at 115.) Pacific circulated the affiliate transaction guidelines that it intended to observe in

dealings with its proposed subsidiary. Those guidelines had been "based on Commission decisions concerning affiliate transaction." (Id.) We then cited two decisions that governed the application with respect to affiliate transaction rules. (Id. at 120.) Those were two rate cases, one of which established standards for payments to affiliates, and the other of which "adopted a 13% premium payable by affiliates to the [local exchange company] when a sale results from a customer referral by the utility." (Id.) The latter case discussed two types of referrals, which it termed "dial-tone referrals (referrals for which Pacific Bell receives compensation and which are accomplished under formal procedures), and informal referrals (referrals for which Pacific Bell receives no compensation)." (In re Pacific Bell (1987) 27 CPUC2d 1, 112.) Based on the evidence in that case, including an audit and expert testimony regarding the methodology by which referrals should be valued for specific transactions involving Pacific, we required "affiliates receiving referrals to pay 13% of the sales revenue resulting from [any such] referrals in order to approximate the market value of those referrals." (Id. at 138.) In addition to being limited to Pacific, we adopted the 13% referral fee on an interim basis pending a further review. (Id.) We do not think that the result in that case can be applied automatically to every local exchange company.

[12] This is not to suggest that a rational business might never engage in price wars or that it looks at the cost/price issue on a per transaction basis, but simply that over time businesses do not persist in unprofitable behavior, all other things being equal.

[13] In the SDG&E Holding Company Decision we did require retention of marketing material, proposals to customers, and business and strategic plans, in each case to the extent prepared in the normal course of business. However, that was the result of a settlement agreement only, and we did not articulate a regulatory purpose in that case.

[14] See Ex. 2, at A-6.

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

Managers will monitor budget performance and take action, if necessary, to control costs. Budgets will be used as a tool to detected and provide early warning of variances from planned expenditures. Explanations for substantial variances will be provided as soon as they are detected." (Edison Decision, 27 CPUC2d at 391.) Note that the subject matter of this section does not relate to cost allocations or transfer pricing, but to expenditures.

[16] "Each subsidiary must retain auditors to provide audited financial statements. The audits may be performed by internal auditors or outside public accountants [as decided by the subsidiary's board of directors]. Intercompany transactions and related transfer prices will be audited to ensure that policies are observed and that potential or actual deviations are corrected in a timely and cost efficient manner." (Id. at 391-92.)

[17] It requires only mention that the primary purpose of an external audit, conducted by certified public accountants who are not employees differs from the audit we will require in these circumstances. The purpose of the audit is to "examine transactions that are much less material than those reviewed by external examinations." (See Vincent J. Love, Understanding and Using Financial Data (1992) § 5.2.) Such an audit should "focus on the correctness of particular account balances." (Id.) Whether to have internal or external auditors conduct such an examination should be left to management, since it leads not to an opinion on financial statements of the entity examined, but to the detection of errors or fraud. (See id.) We will require workpapers in connection with such audits to be retained for a period of five years.

[18] See Ex. 2, at A-8.

[19]For example, an outside engineer may be a valued member of the utility's operations. If she were transferred, the utility might well suffer a detriment, but also might be able to carry on its functions with less experienced help. On the other hand, a wholesale transfer of the entire engineering department to an affiliate could well represent a situation in which the utility seriously impaired its capacity to discharge its duties. We would always want to look at any transfer in context.

[20]An employee who has not been employed by the utility for a period of six months prior to commencing employment with the affiliate shall be deemed an outside employee.

[21]DRA cites a portion of an appendix to the Edison Decision as the basis for this condition: "The transfer pricing methodology [proposed by applicant in that case] will maintain separate accountability of the various entities [under the holding company] and will ensure that transactions between utility and nonutility affiliates do not harm the utility or its customers." (27 CPUC2d at 385, "Section II-A, General.") This is a different issue than protecting the utility from the untoward effects that could arise from its affiliates raising funds in the debt or equity markets.

[22]In considering future ratemaking for Roseville, we will consider the pattern of its retained earnings as appropriate to assess any financing-related component of its rate proposals.

[23]We will not attempt to articulate the different rules that should apply to the calculation of "fully loaded" costs in these different situations. Cost recovery through imposition of general and administrative overhead rates and indirect salary rates on direct labor costs are well understood accounting concepts. A cost recovery factor for administration of outside contracts that inure to the benefit of the utility and its affiliates may also be appropriate. Each, however, depends on facts not in this record to determine.

[24]Assuming no competitive pressure.

[25]DRA omitted an unspecified item from its report as not applicable to Roseville. (Ex. 2, at A-11.) To maintain comparability of the numbering used in the exhibit and briefs, its number is referenced here.

[26]Higher of market value or net book value (if applicable), subject to alternative valuation at net book value only when estimated market value under $100,000.

[27]See Ex. 2, at A-14.

[28]For example, no useful purpose would be served by limiting affiliate access to property consisting of central stores of office supplies to the same access provided to the public at large.

[29]DRA also cites the Edison Decision's corporate guidelines as support for this condition. While those guidelines do set forth a "general policy" encouraging affiliate self-sufficiency, that policy does not appear to be "related to cost allocations and transfer pricing." (See Edison Decision, 27 CPUC2d at 375, 386.)

[30]DRA expressed this condition in terms of "subsidiaries" rather than affiliates, but the underlying rationale applies to the broader category.

[31]It is easy to imagine many situations in which this distinction could have practical application. For example, suppose the Commission were conducting an inspection of a utility and asked to examine the contents of a certain computer only to be told, "The hard drive on that machine belongs to an affiliate" or "The hard drive on that machine belongs to the utility, but you'll have to get permission from the affiliate that owns the machine to read it." Needless to say, such responses would not assist the Commission in its inquiries, nor would they be tolerated.

[32]Except for transfer of funds for investment between the utility and its affiliated entities under a cash management system (although negative intercompany cash balances must be reported).

[33]See Ex. 2, at A-15.

[34]See Ex. 2, at A-16.

[35]See Ex. 2, at A-16.

[36]See Ex. 2, at A-16.
[37]See Ex. 2, at A-16.
[38]See Ex. 2, at A-16.
[39]See Ex. 2, at A-16.
[40]See Ex. 2, at A-16.