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Decision 96-11-017 November 6, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Pacific Gas and Electric Company (U 39 M) for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure.	Application 95-10-024 (Filed October 20, 1995)

(See Appendix A for Appearances.)

I N D E X

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PHASE ONE INTERIM OPINION

1. Summary

Pacific Gas and Electric Company (PG&E), an investor owned public utility subject to the Commission's jurisdiction, seeks 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 PG&E. This Phase 1 interim opinion approves PG&E's application with the conditions discussed in §§ 6 and 7 and set forth in Ordering Paragraphs (OP) 1 through 23. This approval is also conditioned on the outcome of the audit discussed in Section 6 of this decision, and any further conditions or modification of existing conditions which may arise from Phase 2 of this proceeding.

2. Procedural History

PG&E filed its application on October 20, 1995. On December 6, 1995, the Division of Ratepayer Advocates (DRA)[1] filed a protest. At the same time, DRA filed a motion for an audit. (See Section 6 below.)

Assigned Commissioner Neeper and Assigned Administrative Law Judge (ALJ) Econome held a prehearing conference (PHC) on February 1, 1996. PG&E, DRA, the California Department of General Services, the Sacramento Municipal Utility District and Toward Utility Rate Normalization filed PHC statements prior to the PHC.

Both PG&E and DRA served testimony pursuant to the schedule adopted after the first PHC. On August 1, 1996, Commissioner Neeper and ALJ Econome held a second PHC at which time PG&E and DRA informed the Commission that they wished to sponsor a joint recommendation in the form of joint testimony addressing appropriate conditions which the Commission should adopt if it

1 DRA is the predecessor of the Office of Ratepayer Advocates (ORA). All references in this decision except for future directives to this Division are to DRA since DRA, not ORA, filed all relevant pleadings and testimony in this proceeding.

approves PG&E's application. PG&E and DRA served this joint testimony prior to the evidentiary hearing which was held on August 12, 1996. At the hearing, the parties stipulated to the admission of PG&E's and DRA's individual testimony as well as the joint testimony. No other party participated in the evidentiary hearing.

On August 5, 1996, PG&E filed a motion for an order confirming that Public Utilities Code (PU) § 854[2] should not apply to PG&E's holding company formation. (See Section 4 below.) The parties filed opening and reply briefs on limited issues, and the matter was submitted on September 3, 1996 with the filing of reply briefs.

3. Description of the Proposed Reorganization

PG&E proposes to have Parent and Parent's subsidiary (Merger Company) incorporated under California law. PG&E proposes to implement its corporate restructuring using a reverse triangular merger (RTM).[3] PG&E would own all the stock of Parent, and Parent would own all the stock of Merger Company. PG&E, Parent, and Merger Company would enter into a merger agreement by which PG&E would be merged with and into Merger Company, with PG&E as the surviving corporation (the Merger). As consideration for the Merger, the holders of PG&E common stock would receive common stock of Parent on a share for share basis and the outstanding shares of Parent held by PG&E would be canceled. PG&E's existing holders of preferred stock and debt would be unaffected. As a result of the Merger, PG&E would become

2 Unless otherwise indicated, all references to code sections are to the PU Code.

3 PG&E explains that in California, the RTM was used in Southern California Edison Company's (Edison) and San Diego Gas & Electric Company's (SDG&E) holding company formation.

the wholly owned subsidiary of Parent. By letter dated April 25, 1996, PG&E informed the Commission and the parties to this proceeding that PG&E's shareholders approved the proposed reorganization into a holding company corporate structure at their April 17, 1996 annual shareholder meeting.

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

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

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

3. to reserve for issuance a number of shares of Parent stock equal to the number of shares of PG&E common stock reserved for issuance by PG&E's Board of Directors under employee benefit plans, the Dividend Reinvestment Plan, and the Common Stock Shelf Registration Program, immediately prior to the effectiveness of the Merger; and

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

PG&E has not asked us for approval to sell the shares for which it seeks issuance authorization. PG&E states that it also intends to transfer its ownership interest in its subsidiaries PGT and Enterprises, to Parent. PG&E is not seeking specific Commission authorization for this transfer pursuant to PU Code §§ 851 and 853, because PG&E believes that these sections do not apply to this transaction. We have previously stated that any purported transfer of utility property subject to PU Code § 851 without such authority is void. (See In re Pacific Telesis Group (D.93-11-011) 51 CPUC2d 728, 745; Application of SDG&E for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company, Decision (D.) 95-12-018 (SDG&E

Holding Co. Decision), slip op. at p. 6); Application of Roseville Telephone Company for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure, D.96-07-059 (Roseville Holding Co. Decision), slip op. at p. 6.[4] We will reach no conclusion in connection with this application as to whether any such subsidiaries constitute utility property, and thus, if §§ 851 or 853 apply. (See SDG&E Holding Co. Decision, slip op. at p. 6 and Roseville Holding Co. Decision, slip op. at p. 6.)

4. PG&E's Motion

4.1 Background

On August 5, 1996, PG&E filed a motion for an order confirming that PU Code § 854 should not apply to PG&E's holding company formation. Prior to the filing of its motion, PG&E had relied upon our interim decision in the SDG&E holding company application, D.95-05-021 (SDG&E Interim Decision), to assert that § 854 should not apply to PG&E's application.

In the SDG&E Interim Decision, we determined that acquisition activities, including the reorganization contemplated by SDG&E, should be evaluated on a case-by-case basis. 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 § 854. We held, however, that when we have bases of jurisdiction other than § 854 to assure that the proposed transaction will be in the public interest, it is not necessary to classify the kind of reorganization proposed by SDG&E as an acquisition activity subject to § 854. This decision was predicated on our authority under § 854(a) which permits us to

4 Section 853 allows the Commission to apply § 851 to a holding company or other affiliate or subsidiary of a utility if the Commission determines the public interest so requires.

establish the definitions of what constitute merger, acquisition, or control activities for purposes of § 854.[5] In the SDG&E Interim Decision, we stated:

> "The acquisition involved in SDG&E's proposal should not be subject to PU Code § 854 because we have other bases of jurisdiction than PU Code § 854 to assure that the transaction is in the public interest and the change in legal control (ownership by existing shareholders to ownership by Parent) is not a change in actual control. Because we have determined that this is not an acquisition activity that is subject to PU Code § 854, we need not apply the criteria set forth in PU Code § 854 (c)." (SDG&E Interim Decision at p. 3.)

On July 19, 1996, the Commission issued the Roseville Holding Co. Decision. In the Roseville decision, we noted that the legislature amended § 854 after our issuance of the SDG&E Interim Decision. (Citing Stats. 1995 ch. 622, § 1 (AB 119).) Specifically, we noted that the legislature added a new § 854(g) which excludes the formation of a holding company from the provisions of § 854(b)(1) and (2). We then determined, based upon the specific facts of the Roseville case, that the "addition of §§ 854(g) calls into question our continued authority to exempt the formation of a holding company, generally, from § 854 pursuant to the authority granted in § 854(a), which permits us to establish 'the definitions of what constitute merger, acquisition, or control activities.'" (Roseville Holding Co. Decision, slip op. at p. 7.) We stated that it was clear that the Legislature considered the formation of a holding company to be subject to § 854, because otherwise the Legislature would not have found it necessary to

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[5] Section 854(a) states in pertinent part: "The commission may establish by order or rule the definitions of what constitute merger, acquisition, or control activities which are subject to this section."

exempt such an activity from the provisions of § 854(b)(1) and (2). We therefore concluded that the Roseville holding company transaction was subject to § 854. (Id.)

In the Roseville Holding Co. Decision, we noted that Roseville conceded jurisdiction of the Commission pursuant to, inter alia, § 854(a), and that Roseville is not subject to § 854 (b) or (c), which have particularized decisionmaking requirements for acquisitions involving utilities with gross annual revenues in California greater than $500 million. (Id., slip op. at pp. 7 and 63, note 4.)

4.2 PG&E's Position

In its motion, PG&E argues that the plain language and legislative history of the recent amendments to § 854 do not alter the conclusion that the Commission can still exempt the formation of a holding company from § 854. The recent amendments primarily amended § 854(b)(1) and (2) regarding the allocation of benefits of a transaction, which sections are not at issue here. PG&E explains that § 854(g) only says that the newly amended §§ 854(b)(1) and (2) do not apply to holding company formations, not that the other provisions of the code do apply to holding company formations. PG&E states that the amendments do not affect the Commission's discretion under § 854(a), since § 854(a) was left untouched by the recent amendments. PG&E explains that nothing in the legislative history questioned the Commission's prior exercise of its discretion under § 854(a) or suggests that an abuse of the Commission discretion with respect to past approvals of holding company applications was an issue to be solved by the recent amendments.

PG&E also believes that the legislative history of the recent amendments confirmed that the legislature intended to continue the Commission's discretion. PG&E quotes a portion of the AB 119 analysis prepared by the Senate Committee on Energy, Utilities, and Communications (Senate Analysis):

> "The specific exemption from the economic benefit test for the formation of holding companies may be unnecessary and could lead to unintended consequences. The bill does not change existing law which gives the PUC the flexibility to determine the merger, acquisition, or control activities which are subject to Section 854. In a May 1995 decision involving a SDG&E proposal to form a holding company, the PUC exercised this flexibility and found that the requirements of Section 854 did not apply. The language of the exemption also creates some ambiguity. For example, if the formation of a holding company was in conjunction with a merger, would the exemption apply?" (Senate Analysis at p. 3.)

PG&E argues that the rationale and holding of the SDG&E Interim Decision should apply to PG&E's holding company formation, since its holding company formation is identical in all relevant aspects to SDG&E's. PG&E explains that, just as there was no change in actual control through SDG&E's RTM, there is no actual change of control proposed in PG&E's application. PG&E also explains that the "merger" in its application is not of different entities that would trigger the greater scrutiny of § 854. Rather, the "merger" is a paper transaction of corporations established solely for the purpose of effectuating the holding company formation. PG&E explains that the RTM, a transactional tool used to establish a holding company, is much different from the proposed 1989 Edison/SDG&E merger or the proposed merger between Pacific Telesis Group and SBC Communications Inc. in Application 96-04-038. According to PG&E, the RTM merely allows the current organizational structure to be reshaped, the merging corporations are paper corporations with no assets and no intent to conduct business, and PG&E's operations will continue to be exactly as they are today.

Moreover, PG&E notes that in the Roseville Holding Co. Decision, § 854(b)(3) and § 854(c) did not apply to its application, since Roseville Telephone did not meet the revenue threshold of § 854. For this reason, there was no real effect to the Commission's finding that § 854 applied in the Roseville case, and therefore, the Commission did not address the broader consequences of its decision. In contrast, if the Commission were to apply § 854 to PG&E's holding company application, the result would be that the Commission must secure the Attorney General's advisory opinion pursuant to § 854(b)(3), and weigh the various criteria set forth in § 854(c).

4.3 DRA's Position

DRA contends that § 854 should apply to PG&E's reorganization application for the reasons it advocated in SDG&E's application to form a holding company prior to the Commission issuing the SDG&E Interim Decision. However, the Commission disagreed with DRA when it issued the SDG&E Interim Decision. DRA notes that SDG&E's corporate restructuring, under its holding company application, appears indistinguishable from PG&E's proposed corporate restructuring. Therefore, although DRA opposes PG&E's current motion, it recognizes that if the Commission acts consistently, it will agree with PG&E's position. DRA also states that it agrees with PG&E that the recent amendments to § 854 should have no effect on the issue. DRA states that § 854 was either applicable or inapplicable to the PG&E holding company application before the statute was amended, and the amendment did nothing to change this status.

4.4 Discussion

We do not reexamine the basic underpinnings of the SDG&E Interim Decision. Our inquiry is limited to whether the recent amendments to § 854 should change the result we reached in the SDG&E Interim Decision.

As we stated, acquisition activities, including reorganizations such as this, should be evaluated on a case-by-case basis for purposes of § 854. (SDG&E Interim Decision, slip op. at p. 3.) This case appears indistinguishable from SDG&E's holding company application with respect to the relevant facts for determining whether we should evaluate the application under § 854, and we believe a similar result should apply. We do not agree that the recently enacted § 854(g) should change this result in this particular application. Section 854(g) does not abolish our discretion under § 854(a) to exempt a holding company formation from § 854 on a case-by-case basis. A reading of § 854(g) consistent with its plain language and legislative history is that the Commission continues to have this discretion with respect to holding company formations. However, if we exercise our discretion, on a case-by-case basis, and require an application for a holding company formation to be subject to § 854, then pursuant to § 854(g), the provisions of § 854(b)(1) and (2) would not apply.

We note that the facts surrounding this issue are different than those in Roseville's application. First, since Roseville conceded the jurisdiction of § 854, the effect of the recent amendments was not a contested issue fully aired by all parties. Second, there was no practical implication of this finding in the Roseville case, since Roseville did not have gross annual revenues in California greater than $500 million. Thus, §§ 854(b)(3) and 854(c) did not apply to Roseville's application. We therefore hold that in this particular case, consistent with our holding in the SDG&E Interim Decision, PG&E's proposed transaction should not be classified as an acquisition activity subject to § 854. (SDG&E Interim Decision, slip op. at p. 4.)

5. Reasons for the Holding Company Reorganization

5.1 PG&E's Rationale

PG&E justifies its desire to reorganize under a holding company pursuant to the Merger on three grounds. First, PG&E states that formation of a holding company is consistent with, and will facilitate gas and electric industry restructuring. PG&E believes the time has come to reorganize its corporate structure, given the changes to electric industry restructuring which it anticipates as a result of the Commission's electric industry restructuring docket Rulemaking (R.) 94-04-031/Investigation (I.) 94-04-032), and with the potential for significant changes in the gas industry which may result from the Gas Accord now being promoted by PG&E. PG&E believes that its proposed corporate reorganization will give it the flexibility to respond to these and other changes.

Second, PG&E states that the holding company structure will facilitate insulation of the regulated utility business from competitive business. PG&E explains that, historically, competitive businesses have experienced more volatility in earnings than regulated businesses due to the impact of market forces on operating results. Increasing competition in the gas and electric industries may make it appropriate, in PG&E's opinion, to separate certain portions of what is known today as the traditional utility. PG&E explains that its current corporate structure will not accommodate the same degree of separation because all of its businesses must either be part of the utility itself or downstream from the utility. Therefore, any volatility in earnings associated with the competitive business would continue to be reflected in the present utility's financial results. PG&E believes the holding company structure will enhance financial separation and insulation of a utility's activities.

Third, PG&E states that the holding company structure will provide greater financing flexibility in that the structure should facilitate the use of financing techniques and structures that are most appropriate for the specific operational and financial characteristics of non-utility business. As an example, PG&E states that credit support or equity infusions, if necessary, would be provided by the holding company to non-utility subsidiaries. The utility and its assets would be separated from these financial arrangements.

Finally, PG&E pledges that the formation of a holding company structure will have no effect on PG&E's day-to-day utility operations.

> "PG&E does not anticipate any changes in its day-to-day electric or gas operations to result from the change in corporate structure that it is proposing, nor would the formation of a holding company structure alter the pre-existing jurisdiction of this Commission or the Federal Energy Regulatory Commission (FERC). Following the formation of the holding company, our current regulated gas and electric business will continue to operate as a public utility subject to the Commission's jurisdiction and ongoing oversight, as well as that of the FERC. The securities issue of PG&E will continue to be subject to the jurisdictions of this Commission and the Securities and Exchange Commission (SEC). We expect that PG&E's gas and electric operations will constitute the major source of Parent Company earnings for the foreseeable future.
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> "PG&E's existing utility plant and management will continue to serve its customers, the current level of service quality will be maintained, and ongoing service enhancement efforts will continue. Furthermore, the Commission's authority to regulate the rates, terms and conditions of PG&E's electric and gas service will not change due to the formation of the holding company." (Exhibit 1 at p. KMH-6.)

5.2 Evolution of DRA's Critique of PG&E's Rationale

DRA notes that PG&E fails to discuss the public benefit from PG&E's reorganization into a holding company. Notwithstanding this observation, in its individual testimony, DRA recommends approval of PG&E's application if the Commission adopts each of the protective measures and conditions DRA specifies in its report. (See Exhibit 9 at p. 1-5.) In its individual testimony, DRA differed from PG&E as to the appropriate number of conditions and as to the wording of some of the conditions. DRA acknowledges that a corporate reorganization may provide PG&E with additional flexibility, and that the Commission has approved similar reorganizations for California's other two large electric utilities, Edison and SDG&E. DRA states that such a reorganization does bring potential dangers and costs to PG&E's ratepayers, and those dangers and costs should be mitigated by appropriate conditions which DRA proposes in Exhibit 9.

About a month after DRA served Exhibit 9, PG&E and DRA notified the Commission that they wished to sponsor joint testimony setting forth a joint recommendation of agreed upon conditions for approving the holding company structure. DRA believes that the conditions set forth in the joint testimony are in the public interest and provide a measure of protection to ratepayers from harm which might otherwise occur from adoption of a holding company structure. DRA adds that at the same time, these conditions allow PG&E and future affiliates the flexibility to react efficiently to competitive forces.

In its individual testimony, DRA also emphasizes that its affiliate audit of PG&E (see Section 6 below) may demonstrate a need for additional or different conditions which might necessitate a change or supplement to DRA's recommended conditions. PG&E acknowledges that this recommendation is not superceded by the joint testimony. In Exhibit 11 at pp. 2-3 of PG&E's testimony in support of the joint recommendation, PG&E states:

> "In addition to the conditions, PG&E acknowledges that, as ordered by the assigned ALJ, DRA will direct an audit of all of PG&E's significant utility/affiliate transactions from the 1994 reporting period to the present. Depending on the findings of this upcoming audit, DRA reserves the right to seek to modify the conditions contained in this joint agreement. Further, PG&E agrees that all utility/affiliate transactions involving pension and benefit plan assets shall be subject to the independent audit."

5.3 Proper Role of the Commission on Matters of Corporate Governance

We have recently held that the form of organization and ownership of any for-profit venture ought to lie, in the first instance, in the sound discretion of management, subject to the rights provided otherwise to the shareholders to consent, and subject to our oversight to the extent necessary to protect the public interest. (SDG&E Holding Co. Decision, slip op. at pp. 8-9; Roseville Holding Co. Decision, slip op. at p. 9.) 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 § 818, 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.

6. The Audit

6.1 Background

On December 6, 1995, DRA filed a motion for an audit. This motion requested that the Commission order an independent audit of all PG&E's significant utility/affiliate transactions from the 1994 reporting period to the present, and that the audit should be paid for by PG&E shareholders. DRA requested that it not be required to serve its testimony and that hearings not be held until the audit was complete. PG&E opposed the motion. At the February 1, 1996 PHC, the parties devoted considerable time to debating the need, timing, and scope of the audit, as well as who should conduct and pay for the audit.

A February 15, 1996 ALJ ruling (the Ruling), issued after consultation with the Assigned Commissioner, determined that an audit should commence as soon as practicable and proceed with the discovery in this application. The Ruling stated that the audit should be an audit of all significant utility/affiliate

transactions from the 1994 reporting period through the present.
(Ruling at p. 7.) The Ruling also stated that it was appropriate to address PG&E's application in an interim opinion before the conclusion of the audit, which DRA estimated at the time of the motion to be mid-1997. The Ruling further stated:

> "If the interim decision approves the application, it would do so conditioned upon the outcome of the audit. Once the audit is complete, the parties could comment thereon, and hearings, if appropriate, could be scheduled to take additional testimony addressing appropriate further conditions which may arise as a result of the audit." (Ruling at p. 7.)

The Ruling further held that DRA should conduct the audit, but left to the Commission the issue of whether the audit should be funded with ratepayer or shareholder funds. (Id.) The Ruling directed PG&E to fund the audit in the first instance, since if the budget came from DRA's operating budget, it could substantially delay its commencement until at least the next fiscal year, and could substantially delay final resolution of the proceeding. The Ruling directed PG&E to establish a memorandum account to record the direct costs of the audit incurred as a result of the funding obligation set forth in the Ruling. (Id.)

The Ruling also made clear that by granting DRA's motion on the terms set forth in the Ruling, the parties were not precluded from raising the issue of whether another audit might be appropriate at some point after the holding company is formed. (Id. at p. 8.)

We affirm the February 15, 1996 Ruling with respect to the audit. We also note that the granting of this application in Phase 1 of this proceeding is conditioned on the outcome of the audit authorized by the February 15 Ruling, and any further conditions or modification of existing conditions which may arise from Phase 2 of this proceeding. We also note that in Phase 2 of this proceeding, PG&E and DRA have agreed that all utility/affiliate transactions involving pension and benefit plans assets shall be subject to the independent audit. PG&E and DRA further agree to review PG&E's <u>Policy and Guidelines for Affiliate Company Transactions</u> in Phase 2 of this proceeding. (See Section 7.2 below.)

<u>6.2 Costs of the Audit</u>

<u>6.2.1 PG&E's Position</u>

The parties submitted post-hearing opening and reply briefs on who should bear the costs of the audit. PG&E argues that ratepayer funding for the audit is appropriate. PG&E states that PU Code § 797[6] directs the Commission to periodically conduct an audit of affiliate transactions, and is in fact one of the authorities upon which DRA based its motion for an audit. PG&E further notes that DRA chose not to conduct an audit of PG&E's affiliate transactions in PG&E's 1996 general rate case. PG&E argues that the timing of this holding company application

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6 PU Code § 797 states:

> "The commission shall periodically audit all significant transactions, as specified by the commission, between an electrical, gas, or telephone corporation and every subsidiary or affiliate of, or corporation holding a controlling interest in, that electrical, gas or telephone corporation. The commission may, in this connection, utilize the services of an independent auditor, who shall be selected and supervised by the commission. Nothing in this section prohibits the commission from auditing any transaction between an electrical, gas, or telephone corporation and any subsidiary or affiliate of, or corporation holding a controlling interest in, the electrical, gas, or telephone corporation as otherwise permitted or required by law."

following the 1996 general rate case, should not be used by DRA as an excuse to shift to shareholders the costs of this function.

PG&E argues that in past general rate cases, when the Commission has ordered an audit, it has allowed PG&E to recover the cost of the audit in rates. PG&E also states that in the Edison and SDG&E holding company cases, both Edison and SDG&E agreed to permit shareholder funding of audits, but the Commission, as a matter of policy, did not require shareholder funding of the audits. PG&E also states that it is the cost of using outside consultants which raises the issue in the first instance, and DRA requested the use of outside consultants because of its own staffing constraints.

6.2.2 DRA's Position

DRA considers the conditions attached to our approval of PG&E's holding company application "essential to protect ratepayers from harm which they might otherwise suffer from the reorganization." (DRA Opening Brief at p. 31.) DRA notes that Phase 2 will present the audit and recommendations flowing therefrom. DRA states that the primary function of the audit is to ascertain whether the conditions ordered in Phase 1 of this proceeding should be modified or augmented in order to protect the ratepayers.

DRA submits that PG&E's shareholders should pay for the audit, since PG&E itself proposes this reorganization to prepare itself for electric restructuring and other competitive ventures. Although DRA agrees with PG&E that the Commission has allowed utilities to charge their ratepayers with the costs of affiliate audits associated with general rate cases, DRA states that past Commission decisions have ordered shareholders to pay for affiliate audits in corporate reorganization proceedings filed by the utilities. DRA argues that SDG&E shareholders paid for the audit cost associated with its holding company application. Similarly, DRA notes that Edison shareholders paid for all costs of the consultants DRA retained to help evaluate the proposed merger between Edison and SDG&E. DRA recognizes that the utilities in those cases agreed for shareholders to bear the costs, but DRA views this assumption of costs appropriate in instances where the costs were caused by utility applications to reorganize or merge.

6.3. Discussion

Before determining whether shareholders or ratepayers should bear the costs of the audit, we will determine why it is necessary for DRA to perform the audit, and the purpose of the audit.

The need for DRA to perform the audit is directly related to PG&E's application to form a holding company. In fact, DRA filed its motion for an audit at the same time as it filed its protest in this case. Although the scope of the audit is of all significant utility/affiliate transactions from the 1994 reporting period through the present, the purpose of the audit is to determine appropriate further conditions to approval of this application which may arise as a result of the audit. (See Section 6.1 above.) This application is severed into two phases in order that PG&E might obtain an interim approval of its application prior to the conclusion of the audit, which DRA originally estimated to be the middle of 1997. However, the February 15, 1996 Ruling put all parties on notice that "[i]f the interim decision approves the application, it would do so conditioned upon the outcome of the audit." (Ruling at p. 6.) Thus, the purpose of the audit is directly linked to this application.

Since SDG&E and Edison agreed to shareholder funding in their holding company cases, these cases technically cannot be used as direct precedent for our ordering PG&E shareholders to pay for an audit where the issue is contested. However, it appears that these other two utilities recognized that when, such as here, audit costs were directly related to the holding company application, it is appropriate that shareholders pay the cost. Furthermore, in the

Roseville Holding Co. Decision, slip op. at p. 26 and p. 55, OP 16, we held that if an audit occurs in the future, Roseville's parent, rather than Roseville (i.e., the shareholders, not ratepayers) should pay for the audit. In the Roseville decision, Roseville contested whether an audit was necessary.

PG&E's articulated rationale for its desire to reorganize under a holding company structure is for reasons beneficial to shareholders. (See Section 5.1 above.) Moreover, PG&E does not have to demonstrate whether this reorganization will benefit ratepayers. As stated in Section 5.3 above, we adopt a standard of ratepayer indifference to the effects of a holding company reorganization. When a utility seeks to reorganize under PU Code § 818, 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 ratepayers. This being the case, we do not believe that ratepayers should bear the cost of this audit which is directly related to the holding company application.

We also believe that attributing to shareholders the cost of the audit in this case is consistent with a condition agreed to by both PG&E and DRA, that "all formation costs arising from PG&E's holding company reorganization are and will be charged below the line, and will not be used to determine future revenue requirements." (Exhibit 6, at p. 4, condition 16; see also Section 7.16 below.)

Therefore, we hold that the cost of the DRA audit described in Section 6.1 above and the February 15, 1996 ALJ ruling should be borne by PG&E shareholders. PG&E is directed to discontinue the memorandum account authorized by the Ruling at p. 7 to record the direct costs of the audit. The shareholders should bear all costs booked in this memorandum account until the account is discontinued.

We also recognize that our granting the motion for the audit as set forth in the February 15, 1996 ruling does not preclude the parties from raising the issue of whether another audit might be appropriate at some point after the holding company is formed. The parties are free to address this issue in Phase 2. (See Ruling at p. 8.) In this regard, we believe it is prudent for PG&E, Parent, and all controlled affiliates, to retain until further directed in Phase 2 of this proceeding (i) all internal and external correspondence between PG&E'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 PG&E's officers and department heads and controlled affiliates. This condition is consistent with the requirements we placed on Roseville in the event the Commission were to determine a further audit of Roseville is necessary. (See Roseville Holding Co. Decision, slip op. at p. 55, OP 16.)

Finally, ORA (the successor to DRA) should make quarterly filings commencing March 30, 1997, in this proceeding, advising all parties as to the status of the audit, and when it anticipates that the audit will be complete.

7. Further Conditions Required to Protect the Public Interest

As we noted in the recent SDG&E and Roseville Holding Company Decisions, the recent history of utility reorganizations into holding companies has been a history of conditions. In their joint testimony, PG&E and DRA have agreed to a set of 18 conditions which are set forth in Exhibit 6. PG&E describes the goals of these conditions as maintaining an appropriate flow of information to the Commission to facilitate regulatory oversight of PG&E's activities. PG&E states that the conditions reinforce and establish various reporting requirements to the Commission (Conditions 1, 4, 5 a-d, 6, 7, 13, 14, 18 (a-b), describe certain internal business practices to be maintained (Conditions 2, 3, 6, 9, 10, 11, 12, 14, 16, 17) and provide guidance for transactions with external parties (Conditions 8, 14, 15). The jointly recommended conditions generally follow those adopted for Edison and SDG&E, with some differences described more fully below. PG&E also recognizes that DRA reserves the right to seek to modify the conditions, depending upon the result of the audit discussed in Section 6 above. PG&E further agrees that all utility/affiliate transactions involving pension and benefit plan assets shall be subject to the independent audit.

DRA believes that, individually and combined, these conditions are in the public interest, and provide a measure of protection to ratepayers while at the same time affording PG&E and future affiliates the flexibility to react efficiently to competitive forces.

As we stated in the *San Diego* and *Roseville Holding Co. Decisions*, in determining appropriate conditions of our approval for this application, "we are left to strike a 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." (*Roseville Holding Co. Decision*, slip op. at p. 10; see also *San Diego Holding Co. Decision*, slip op. at p. 11.)

We now review the conditions jointly proposed by PG&E and DRA. The numbering of the following subsections corresponds to the numbering of the conditions proposed in the joint testimony (i.e., Section 7.1 addresses condition 1, Section 7.2 addresses condition 2, etc.)

7.1. Access to Affiliate Books and Records

PG&E and DRA jointly recommend the following condition:

> "PG&E shall ensure that the Commission has access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of PU Code § 314. PG&E is placed on notice that the Commission will interpret § 314 broadly as it applies to transactions between PG&E and the holding company or its affiliates and subsidiaries in fulfilling its regulatory responsibilities as carried out by the Commission, its staff and its authorized agents. Administratively, requests for such books and records made by the Commission, its staff or its authorized agents shall be deemed presumptively valid, material and relevant. Any objections to such requests shall be timely raised before the administrative law judge or assigned Commissioner in the proceeding in which such objections arise. In order to sustain an objection to such a request, respondents shall have the burden of showing that the request is not reasonably related to any issue properly before the Commission and, further, is not reasonably calculated to result in the discovery of admissible evidence in the proceeding." (Exhibit 6 at p. 1.)

DRA explains that the purpose of this condition is to ensure that, after the corporate restructuring occurs, that the Commission will possess access to the books and records of PG&E's holding company and each of its affiliates and joint ventures. DRA believes that this condition is in the public interest since complete and accurate information is necessary for regulation or to move in an informed manner toward competition. DRA recognizes that the provision creates a significant presumption of Commission and staff access to documents, and creates a presumption that the information requested is "valid, material and relevant."

We note that this condition is consistent with that adopted for Edison in the Edison Holding Co. Decision, 27 CPUC2d 346, 374-375, OP 1, and is similar to that adopted for SDG&E. (See

SDG&E Holding Co. Decision, slip op. at p. 42, OP 2.) The SDG&E condition is different from the Edison condition, primarily because it reflects procedural changes which have occurred since the Commission issued the Edison decision. We approve this condition with the minor modifications set forth in the following paragraph, which makes the condition more consistent with that adopted for SDG&E, and more consistent with § 314.

By adopting this condition, we do not displace our administrative discovery resolution process, currently set forth in Resolution ALJ-164, dated September 16, 1992. We have modified this condition to refer to this discovery resolution process, which the Commission implemented after issuing the Edison Holding Company Decision. Our current discovery process provides for a mandatory effort for the parties to meet and confer in good faith, reducing the disputes that are brought before us. Usually utilities and staff have been able to resolve or narrow disagreements and balance discovery burdens with the investigative needs appropriate for our regulatory obligations. We hope this will continue to be the case with PG&E and affiliate transactions.

We also remind PG&E that we will interpret § 314 broadly, in a manner not necessarily limited by the principle of relevance to an open proceeding. This is so, since the inspection rights afforded the Commission under § 314 are not limited to particular proceedings. (See Roseville Holding Co. Decision, slip op. at p. 21.) We therefore modify sentences 4 and 5 of this proposed condition to reflect these two observations, and adopt this condition as modified.

7.2 Affiliate Transaction Guidelines

PG&E and DRA jointly recommend the following condition:

> "PG&E, PG&E'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 non-utility activities by PG&E's customers. PG&E will implement its proposed Policy and Guidelines for Affiliate Company Transactions as modified by conditions adopted by the Commission in phase one of the proceeding. These guidelines will be reviewed in the second phase of this proceeding." (Exhibit 6 at p. 1.)

DRA believes that this condition is in the public interest because it requires PG&E and its affiliates to separate, for ratemaking purposes, utility and non-utility functions. DRA states that this condition is similar to that adopted for Edison and is changed only to address DRA's resource constraints to allow for the Commission's staff review.

The major difference between this condition and the similar condition adopted for Edison at 27 CPUC2d at 375, OP 2, is that this condition provides the opportunity for Commission review of PG&E's Policy and Guidelines for Affiliate Company Transactions (PG&E Guidelines) in Phase 2 of this proceeding. We agree that a review of these guidelines in Phase 2 is appropriate, and therefore adopt this condition. Since we do not approve the PG&E Guidelines in this decision, we note that in the event of a conflict between the PG&E Guidelines and our Affiliate Transactions Order, In re Reporting Requirements for Electric, Gas, and Telephone Utilities Regarding Their Affiliate Transactions, D.93-02-019, 48 CPUC2d 163, 178 (Appendix A), the provisions of the Affiliate Transactions Order shall govern.[7]

Furthermore, we note that 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 PG&E and other similarly situated utilities in the future.

7.3 Generally Accepted Accounting Principles

PG&E and DRA jointly recommend the following condition:

> "Utility affiliates shall continue to use Generally Accepted Accounting Principles and the Uniform System of Accounts." (Exhibit 6 at p. 1.)

7 As we stated in the San Diego Holding Co. Decision, slip op. at p. 23, we adopted a poor definition of fair market value in the Affiliate Transactions Order. In that Order, we defined fair market value in a way that systematically understates the correct result: "the price offered by a willing purchaser in an arms-length transaction." (48 CPUC2d at 173.) In the San Diego Holding Co. Decision, we noted that this definition left out reference to the "seller", which is included in the traditional legal formulation of fair market value. (See e.g., Black's Law Dictionary (1990, 6th ed.) at 597 ("amount at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.") We stated that we would take up this definitional issue when we next revise the Affiliate Transactions Order.

We recognize that the PG&E Guidelines contain a definition of fair market value which is more consistent with the traditional legal definition, and is less consistent with our Affiliate Transactions Order. We commend PG&E for including a reference to the seller in its definition. As we stated in the San Diego Holding Co. Decision, slip op. at p. 23, PG&E is placed on notice that it should not rely on the definition of fair market value in the Affiliate Transactions Order in cases in which the current definition understates the proper valuation.

DRA views this condition as useful to promote both understanding in accounting and appropriate ratemaking. DRA states that this condition reflects PG&E's current and continuing use of those principles.

This condition is similar, but not identical, to that adopted for Edison and Roseville. (See 27 CPUC2d at 375, OP 3, (Edison); Roseville Holding Co. Decision, slip op. at p. 52, OP 4.) The condition we have previously adopted for these other two utilities imposes the accounting requirements on the holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries. In this case, PG&E's and DRA's condition places the accounting requirement only on affiliates, and does not precisely define the term. The term "affiliate," as defined in R.92-08-008, as modified at 48 CPUC2d 163, 173, appears to exclude a holding company, which is defined as a controlling corporation. We see no reason to exclude PG&E from the specific accounting requirements adopted for Edison and Roseville, and therefore add these requirements to the condition agreed to by PG&E and DRA.[8] The condition, as modified, is adopted.

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8 We adopt a directive similar to that adopted in the Roseville Holding Co. Decision, slip op. at pp. 12 and 52 and require the designated entities to keep their books consistent with the Uniform System of Accounts "where appropriate" instead of the language used in the Edison decision of "where feasible." (See 27 CPUC2d at 375.) As we stated in the Roseville Holding Co. Decision, slip op. at p. 12:

> "[W]e consider 'where appropriate' preferable. USOA [the Uniform System of Accounts] 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 [Generally Accepted Accounting

(Footnote continues on next page)

7.4 Affiliate Officers and Employees to Appear

PG&E and DRA jointly recommend the following condition:

> "The officers and employees of PG&E Parent Company, its subsidiaries and affiliates shall be available to appear and testify in Commission proceedings in connection with any transactions between PG&E and the affiliated company as necessary or required." (Exhibit 6 at p. 2)

DRA states that this condition provides an opportunity for the Commission to understand and review inter-company transactions which may affect the ratepayers and notes that the condition is similar to that which the Commission adopted for Edison.

The Commission has adopted a similar condition for Edison, SDG&E, and Roseville. However, the condition we adopted for all three of these utilities requires the officers and employees to be available to appear and testify in Commission proceedings as necessary or required, without further limitation.

(Footnote continued from previous page)

> Principles) 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."

(See 27 CPUC2d at 375, OP 4; SDG&E Holding Co. Decision, slip op. at p. 42, OP 2; Roseville Holding Co. Decision, slip op. at p. 52, OP 3.) We did not limit the condition to transactions between PG&E and the affiliated company for these three utilities and do not believe it is in the ratepayers' interest to limit this condition with respect to PG&E. We therefore modify this proposed condition to make it consistent with that which we adopted for Edison, SDG&E, and Roseville, and adopt the modified condition.

7.5 (a-d) Utility Shall Provide Periodic Reports and Statements

PG&E and DRA jointly recommend the following condition:

"Pursuant to OIR No. 92-08-008, PG&E shall furnish the Commission with:

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

'b. Annual statements concerning the nature of inter-company transactions concerning PG&E and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

'c. The balance sheets and income statements of the non-consolidated subsidiaries of the holding company;

'd. All periodic reports filed by the holding company with the Securities and Exchange Commission.'" (Exhibit 6 at p. 2.)

DRA explains that this condition fosters the public interest because it provides the Commission with access to information needed to help determine whether affiliate problems are developing and if so, the nature of the problem. This condition is consistent with that which we adopted for Edison at 27 CPUC2d at 375, OP 5, and we adopt this condition.

__7.5 (e) Affiliate Audit__

PG&E and DRA jointly recommend the following condition:

> "Pursuant to the February 15, 1996 Administrative Law Judge's Ruling in A.95-10-024, an audit of all significant utility/affiliate transactions from the 1994 reporting period through the present should commence as soon as practicable." (Exhibit 6 at p. 2.)

This condition is consistent with the audit which we discuss in more detail in Section 6, and therefore we adopt this condition.

__7.6 Diversion of Management Talent__

PG&E and DRA jointly recommend the following condition:

> "PG&E shall avoid a diversion of management talent that would adversely affect the utility. PG&E shall also provide to the Commission an annual report identifying non-clerical personnel transferred from PG&E to its parent holding company or any of the holding company's non-utility subsidiaries." (Exhibit 6 at p. 2.)

DRA explains that this condition recognizes that the ratepayers may be harmed by certain transfers of talented management from PG&E to an affiliate. DRA also states that this condition provides a means for the Commission to monitor management transfers, which in turn may provide a means to identify and address problems with transfers of management talent. This condition is consistent with that adopted for Edison (27 CPUC2d at 375, OP 6), and is similar to that adopted for SDG&E. (__SDG&E Holding Co. Decision__, slip op. at p. 45, OP 9.) We adopt this condition.

__7.7 Transfer of Tangible Assets__

PG&E and DRA jointly recommend the following condition:

> "Pursuant to OIR No. 92-08-008 (Appendix A, Section II.E., p. 18), PG&E shall report the sale or transfer of any tangible asset to affiliates." (Exhibit 6 at p. 2.)

DRA states that this condition will provide information to the Commission and its staff about PG&E's transfers or sales of tangible assets to any of its affiliates. This information may allow the Commission to ascertain when a potentially controversial transfer or sale has occurred and to inquire about the matter.

This condition ostensibly reiterates the requirements of our Affiliate Transactions Order, 48 CPUC2d at 178 (Appendix A, Section II.E) with respect to the sale or transfer of a tangible asset. Yet that section extends the reporting requirement to sales or transfers to or from "affiliated entities," not just to "affiliates." (See 48 CPUC2d at 178.) The parties are not requesting a modification of our Affiliate Transactions Order, nor are we modifying that order. Therefore, we adopt the proposed condition as modified to comport with our Affiliate Transactions Order.

We also note that Appendix A to the Affiliate Transactions Order contains reporting requirements for transfers of intangible and intellectual property as well as transfers of tangible assets, and those requirements apply notwithstanding the fact that this particular condition only refers to tangible property. Because PG&E is and parent will be subject to the Affiliate Transactions Order, and because PG&E 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 this application.

<u>7.8 Information Transfers</u>

PG&E and DRA jointly recommend the following condition:

> "Valuable customer information, such as customer lists, billing records, or usage patterns, transferred directly or indirectly from PG&E to a non-utility affiliate shall be made available to the public subject to the terms and conditions under which such data was made available to the non-utility affiliate." (Exhibit 6 at p. 2.)

DRA states that this condition is in the public interest because it fosters fair competition in that competitors would be able to receive the same customer information that PG&E shares with its non-utility affiliates. DRA stresses, and we agree, that this condition does not define the circumstances, if any, under which PG&E may lawfully transfer information about its customers or any other subject. This condition is similar to that adopted in the San Diego Holding Co. Decision (slip op. at p. 46, OP 12.) PG&E points out that one difference is that this proposed condition provides more detail of the type of customer information to which the condition applies.

The type of customer information to which this condition applies is descriptive but not inclusive. Thus, "valuable customer information" can include, but is not limited to, customer lists, billing records, or usage patterns. With this clarification, we adopt this condition as proposed by the joining parties.

7.9 Utility Capital Structure

PG&E and DRA jointly recommend the following condition:

> "PG&E shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in its most recent decision on PG&E's capital structure. PG&E's equity shall be retained such that the Commission's adopted capital structure shall be maintained on average over the period the capital structure is in effect for ratemaking purposes. Provided, however, that PG&E shall file an application for a waiver, on a case by case basis and in a timely manner, to this condition if an adverse financial event at the utility reduces the utility's equity ratio by 1% or more. In order to assure that regulatory staff has adequate time to review and assess the application and to permit the consideration of all relevant facts, PG&E shall not be considered in violation of this condition during the period the waiver is pending resolution. Nothing in this provision creates a presumption of either reasonableness or

unreasonableness of PG&E's actions which may have caused the adverse financial event." (Exhibit 6 at p. 3.)

The first two sentences of this condition are almost identical to the condition the Commission adopted for Edison (27 CPUC2d at p. 376, OP 9) and are similar to that adopted for SDG&E. (<u>SDG&E Holding Co. Decision</u>, slip op. at p. 45, OP 7.) DRA notes that the portion of the proposed PG&E/DRA condition following the first two sentences significantly modifies the condition adopted for the other two utilities. DRA believes that the jointly proposed condition continues to protect PG&E ratepayers because it prohibits PG&E from transferring utility capital to its unregulated affiliates. At the same time, DRA believes that this condition provides PG&E with flexibility to change its capital structure in designated instances, and also requires PG&E to apply for a waiver of this condition. DRA believes that this flexibility may benefit ratepayers by permitting PG&E's management to make decisions it deems in ratepayers' interest, even if such decisions change the utility's equity ratio.

In support of the joint testimony, PG&E agrees with DRA that this condition will provide PG&E flexibility in managing its capital structure to respond to an adverse financial event while assuring there are not abuses related to diversion of equity capital to the utility's affiliates. PG&E states that the provision affording PG&E the opportunity to apply for a Commission waiver in the case of an adverse financial event which reduces the utility equity ratio by 1% or more provides this flexibility.

PG&E's individual testimony did not give the Commission the opportunity to grant PG&E a waiver from the condition, but rather provided that the condition automatically did not apply if an adverse financial event at the utility impaired PG&E's ability to meet the utility's adopted capital structure. PG&E stated that this condition was necessary since there has never been a requirement that PG&E's actual capital structure match precisely the Commission's adopted capital structure. In fact, PG&E stated that each year, PG&E's actual capital structure has fluctuated around the target, sometimes exceeding the adopted equity ratio, sometimes falling short of it. PG&E explained that these fluctuations are the natural result of a variety of events that occur in any business, and based on a review of past actual utility capital ratios, PG&E would not have been in compliance with the first two sentences of this proposed condition regarding capital structure in three of the last six years. However, according to PG&E, despite these short-term capital structure fluctuations, over time PG&E has achieved a capital structure which approximates the Commission's adopted capital structure and has maintained the utility's financial condition.

The jointly proposed condition is a reasonable compromise between PG&E's and DRA's individual positions in that it provides for ratepayer protection, but also provides PG&E the flexibility to apply to the Commission for a waiver of the condition in appropriate circumstances. When faced with specific circumstances, the Commission can best determine whether a violation of the intent of this condition has actually occurred or whether a waiver is appropriate. Therefore, we adopt this condition as jointly proposed by PG&E and DRA.

7.10 Utility Dividend Policy

PG&E and DRA jointly recommend the following condition:

> "The dividend policy of PG&E shall continue to be established by PG&E's Board of Directors as though PG&E were a comparable stand-alone utility company." (Exhibit 6 at p. 3.)

DRA explains that this condition protects PG&E ratepayers, because the condition confirms that PG&E's management should consider ratepayer interests and should not declare dividends merely to benefit PG&E affiliates. The Commission has adopted this condition for both Edison (27 CPUC2d at 376, OP 10) and SDG&E (SDG&E Holding Co. Decision, slip op. at p. 44, OP 5). This condition is reasonable and we adopt it.

7.11 Utility Guarantees

PG&E and DRA jointly recommend the following condition:

> "PG&E shall not guarantee the notes, debentures, debt obligations, or other securities of its parent holding company or any of its subsidiaries without first obtaining the written consent of this Commission." (Exhibit 6 at p. 3.)

DRA states that this condition protects ratepayers from utility guarantees which may harm ratepayers by jeopardizing the financial health of PG&E, thus potentially increasing rates and reducing service. This condition is consistent with that which the Commission adopted for Edison at 27 CPUC2d at 376, OP 11. This condition is reasonable and we adopt it.

7.12 Utility Capital Requirements

PG&E and DRA jointly recommend the following condition:

> "The capital requirements of PG&E, as determined to be necessary to meet its obligation to serve, shall be given first priority by the Board of Directors of PG&E's parent holding company and PG&E." (Exhibit 6 at p. 3.)

DRA explains that to the extent that PG&E affiliates compete with PG&E for scarce capital, this condition is necessary to protect ratepayers by requiring the directors of PG&E and the holding company to place top priority on PG&E's utility obligation to serve its customers. For this reason, DRA maintains that this condition is in the public interest. This condition is consistent with that which the Commission adopted for Edison (27 CPUC2d at 376, OP 12) and SDG&E (SDG&E Holding Co. Decision, slip op. at p. 44, OP 6). This condition is reasonable and we adopt it.

7.13 Utility as Proportion of Corporate Reporting

PG&E and DRA jointly recommend the following condition:

> "Pursuant to OIR No. 92-08-008, PG&E shall provide the Commission with an annual report

> detailing the utility's proportionate share of the holding company's i) total assets; ii) total operating revenues; iii) operating and maintenance expense; and iv) number of employees." (Exhibit 6 at p. 3.)

DRA explains that this condition is one required by our Affiliate Transactions Order, and PG&E and DRA have agreed to apply it in this application. (See 48 CPUC2d at 179-180.) This condition is modified from that which we adopted for Edison (27 CPUC2d at 376, OP 13) in that it requires annual, not quarterly, reports, consistent with our Affiliate Transactions Order. Since PG&E is required to comply with our Affiliate Transactions Order, it is not necessary to repeat a portion of that order as a condition. However, we adopted a similar condition for Edison and both PG&E and DRA agree to this condition. Since the condition complements, and does not conflict with our Affiliate Transactions Order, we adopt it. However, we note that in the event of a conflict with our Affiliate Transactions Order, the provisions of the Affiliate Transactions Order should govern.

7.14 Transfer of Intellectual Property

PG&E and DRA jointly recommend the following condition:

> "For transfers of product rights, patents, copyrights and other intellectual property, valuation shall be at fair market value which may be a single cost price, a royalty on future revenues or a combination of both. Such payments, if any, shall be developed on a case-by-case basis and identified for review in the subsequent general rate case or replacement proceeding." (Exhibit 6 at p. 3.)

The agreed upon language is derived from PG&E's Policy and Guidelines for Affiliate Company Transactions attached as Attachment A, page 11 to Exhibit 1. PG&E states that this agreed upon language requires that these items be identified for review.

DRA states that to the extent that ratepayers receive compensation for the transfers set forth in this condition, ratepayers will receive the fair market value for property transferred from PG&E to affiliates and others.

We adopted a similar condition for Edison (see 27 CPUC2d at p. 376, OP 14). However, we did not specifically determine how the royalty payment was to be valued, other than to state that it should be developed on a case-by-case basis. The condition we adopted in the Roseville Holding Co. Decision, slip op. at pp. 58-59, OP 29, similarly did not determine how the royalty payment was to be valued. Therefore, we make a minor modification to this condition in the event that there are other appropriate valuation techniques to employ. We also note that we do not necessarily approve the valuation methodology set out in PG&E's Policy and Guidelines for Affiliate Company Transactions by adopting this condition, since the parties have agreed to review these guidelines in Phase 2.

Finally, the condition we adopted in the Roseville Holding Co. Decision stated that royalty payments should be developed on a case-by-case basis in proceedings pursuant to PU Code § 851. By adopting the condition proposed by PG&E and DRA, we do not address the issue of whether any transfers covered by this condition are also subject to other statutes or Commission orders (i.e., PU Code § 851), and our adoption of this condition does not supercede the requirements of any applicable statutes or orders with respect to the transfer. In the event of a conflict between this condition and other applicable statutes or Commission orders, the statues and Commission orders shall govern. We therefore adopt the proposed condition with another minor modification. We permit the review in general rate cases or their replacement proceedings, "or other appropriate proceedings," in the event an application (such as one pursuant to PU Code § 851) is the appropriate forum to review this matter.

7.15 Interconnection Facilities

PG&E and DRA jointly recommend the following condition:

> "Neither PG&E's holding company nor its subsidiaries shall provide interconnection facilities and related electrical equipment to PG&E, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to PG&E, unless the third party may obtain and provide facilities and equipment of like or superior design and quality through competitive bidding. The holding company and its non-utility subsidiaries may participate in any competitive bidding for such facilities and equipment." (Exhibit 6 at p. 3.)

DRA explains that the public policy objective of this condition is to prevent anticompetitive behavior between the utility and an affiliate where these facilities are needed to connect buyers or sellers to the utility's system. DRA states that this condition is the same as adopted for Edison and SDG&E.

This condition is consistent with that which the Commission adopted for Edison (See 27 CPUC2d at 376, OP 15) and is similar to that adopted for SDG&E. (SDG&E Holding Co. Decision, slip op. at pp. 45-46, OP 10.) We find this condition reasonable and adopt it.

7.16 Holding Company Costs

PG&E and DRA jointly recommend the following condition:

> "All formation costs arising from PG&E's holding company reorganization are and will be charged below the line, and will not be used to determine future revenue requirements." (Exhibit 6 at p. 4.)

DRA explains that this condition ensures that PG&E ratepayers will not pay for corporate reorganization. We adopted a similar condition for SDG&E. (SDG&E Holding Co. Decision, slip op. at p. 46, OP 11.) This condition is reasonable and we adopt it.

7.17 Employee Transfer Fee

PG&E and DRA jointly recommend the following condition:

> "When a PG&E employee is transferred from PG&E to either the holding company or an affiliate, that entity shall make a one-time payment to PG&E in an amount equivalent to 25% of the employee's base annual compensation, unless PG&E can demonstrate that some lesser percentage (equal to at least 15%) is appropriate for the class of employee involved. All such fees paid to PG&E shall be credited to the Electric Revenue Adjustment Account or the Core and Non-core Gas Fixed Cost Accounts, as appropriate, on an annual basis, or as otherwise necessary to ensure that PG&E's customers receive the fees. This transfer payment provision will not apply to clerical workers. Nor will it apply to the initial transfer of employees to PG&E's business units at the time of initial separation from PG&E pursuant to a PU Code §851 application or other Commission proceeding. However, it will apply to any subsequent transfers between PG&E and previously separate business units." (Exhibit 6 at p. 4.)

DRA states that this condition recognizes the ratepayers' costs expended in hiring and training employees and in losing talented utility personnel to the holding company or the affiliates. DRA explains that this condition provides some compensation to ratepayers for such costs and is therefore in the public interest. DRA recognizes that this condition is similar to one which the Commission adopted for SDG&E, and notes that PG&E and DRA agreed to a slight modification here to reflect PG&E's gas operations. (See SDG&E Holding Co. Decision, slip op. at p. 45, OP 8.) This condition is reasonable and we adopt it, with minor modifications to eliminate any perceived confusion which may exist regarding the effect of the provisions of recently enacted AB 1890 on the intent of this condition.

7.18 Employee Pensions and Benefits

PG&E and DRA jointly recommend the following condition:

"a. PG&E shall provide to the Commission:

'1. all employee handbooks (summary plan descriptions) of PG&E, its parent, affiliates and subsidiaries, within one month of any revisions thereto;

> "2. annual actuarial reports on all pension and benefit trusts of PG&E, its parent, affiliates and subsidiaries; and
>
> 3. annual trust audits of all pension and benefit trusts of PG&E, its parent, affiliates and subsidiaries.
>
> "b. PG&E shall continue to identify for review in its general rate cases or replacement proceedings, all transfers between PG&E and its parent, affiliates and subsidiaries of assets, goods and services, including the pension and benefit trust assets, as they are described and valued in PG&E's <u>Policy and Guidelines for Affiliate Company Transactions</u>." (Exhibit 6 at p. 4.)

PG&E states that this condition provides appropriate information to the Commission to facilitate its review of transactions involving the employee benefit trust funds. PG&E notes that the Commission did not adopt this condition for either Edison or SDG&E.

DRA explains that in its individual testimony, it proposed that the Commission should condition approval of this application, inter alia, by requiring PG&E to provide to the Commission specific information about PG&E employee pensions and benefits, particularly as they are transferred from PG&E to the holding company or its affiliates. DRA states that the purpose of this condition is to ensure that ratepayers do not cross-subsidize affiliate activities and costs, and to guard against anticompetitve transfers.

By adopting this condition, we do not address the issue of whether any transfers covered by this condition are also subject to other statutes or Commission orders (i.e., PU Code § 851), and our adoption of this condition does not supercede the requirements of any applicable statutes or orders with respect to the transfer

We view this condition as complementary. In the event of a conflict between this condition and other applicable statutes or Commission orders, the statutes and Commission orders shall govern.

With this understanding, we adopt the proposed condition with a minor modification. We permit the review in general rate cases or other replacement proceedings, "or other appropriate proceedings," in the event an application (such as one pursuant to PU Code § 851) is the appropriate forum to review this matter. We also note that we do not necessarily approve the valuation methodology set out in PG&E's <u>Policy and Guidelines for Affiliate Company Transactions</u> by adopting this condition. In Phase 2, we will conduct a review of these guidelines.

8. <u>Comments to the Proposed Decision</u>

Pursuant to PU Code § 311 and our Rules of Practice and Procedure, the Proposed Decision of ALJ Econome was published on October 4, 1996. PG&E and ORA had an opportunity to file comments. We adopt the only change to the proposed decision recommended by the parties. PG&E recommends that we allow PG&E 45 days, as opposed to 30 days, to respond to the Commission regarding its acceptance of the holding company conditions (pursuant to Ordering Paragraph 25). PG&E requests this minor change to allow PG&E to respond to the Commission after PG&E's December 18, 1996, Board Meeting. PG&E's requested change is reasonable and we adopt it. We also make minor modifications to Section 7.17 and OP 22 in light of AB 1890 which became law on September 23, 1996.

<u>Findings of Fact</u>

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

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

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

helps to insulate the credit of PG&E from the risks of ownership of such businesses.

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

5. PG&E seeks authority pursuant to PU Code § 818 to permit Parent to issue 100 shares of common stock, to be owned by Parent.

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

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

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

9. PG&E seeks authority pursuant to PU Code § 818 for Parent to reserve for issuance a number of shares of common stock equal to the number of shares of PG&E common stock reserved for issuance by PG&E's Board of Directors under employee benefit plans, the Dividend Reinvestment Plan, and the Common Stock Shelf Registration Program, immediately prior to the effectiveness of the Merger.

10. PG&E has not asked the Commission for approval to sell the shares for which it seeks issuance authorization.

11. PG&E intends to transfer the stock of its subsidiary corporations PGT and Enterprises to Parent following the Merger. PG&E has not asked for authority to do so pursuant to PU Code §§ 851 or 853.

12. As a result of the Merger, PG&E would be a wholly owned subsidiary of Parent, and the owners of PG&E preferred stock and debt would be unaffected.

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

14. On August 5, 1996, PG&E filed a motion for an order confirming that PU Code § 854 should not apply to PG&E's holding company formation.

15. A February 15, 1996 ALJ ruling, issued after consultation with the Assigned Commissioner, determined that an audit of all significant utility/affiliate transactions from the 1994 reporting period through the present should commence as soon as practicable, and should proceed with the discovery in this application. The ruling also stated that if the interim (Phase 1) decision approved this application, it would do so conditioned upon the outcome of the audit. Once the audit is complete, the parties could comment thereon, and hearings if appropriate, could be scheduled to take additional testimony addressing appropriate further conditions which may arise as a result of the audit. The ruling stated that DRA should conduct the audit, but left to the Commission the issue of whether the audit should be funded with ratepayer or shareholder funds.

16. PG&E and DRA have agreed that all utility/affiliate transactions involving pension and benefit plan assets should be subject to the independent audit.

17. The need for DRA to perform the audit is directly related to PG&E's application to form a holding company. Although the scope of the audit is of all significant utility/affiliate transactions from the 1994 reporting period through the present, the purpose of the audit is to determine appropriate further conditions to this application which may arise as a result of the audit.

Conclusions of Law

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

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

3. In this particular case, consistent with our holding in the SDG&E Interim Decision, PG&E's proposed transaction should not be classified as an acquisition activity subject to § 854.

4. The form of organization and ownership of any for-profit venture subject to the Commission's jurisdiction ought to 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.

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

6. The proposed reorganization is not adverse to the public interest in light of the conditions the Commission is imposing in this decision, in light of the conditions that the Commission may impose in Phase 2, and in light of the Commission's power to regulate PG&E and its affiliates in the future to detect and remedy any abuses that may arise.

7. The February 15, 1996 ALJ ruling should be affirmed with respect to the audit. The granting of this application in Phase 1 is also conditioned on the outcome of the audit authorized by the February 15 ruling, and any further conditions or modification of existing conditions which may arise from Phase 2 of this proceeding.

8. The cost of the audit described in Section 6.1 of this decision and in the February 15, 1996 ALJ ruling should be borne by PG&E shareholders. PG&E is directed to discontinue the memorandum account authorized by the ALJ ruling at p. 7 to record the direct costs of the audit. The shareholders should bear all costs booked in this memorandum account until the account is discontinued.

9. The granting of the motion for the audit as set forth in the February 15, 1996 ALJ ruling does not preclude the parties from raising the issue of whether another audit might be appropriate at

some point after the holding company is formed. In this regard, PG&E, Parent, and all controlled affiliates should retain, until further directed in Phase 2 of this proceeding (i) all internal and external correspondence between PG&E'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 PG&E's officers and department heads and controlled affiliates.

10. ORA (the successor to DRA) should make quarterly filings in the proceeding commencing March 30, 1997 advising all parties as to the status of the audit, and when it anticipates the audit will be complete.

11. The conditions discussed in Sections 6 and 7 of this decision and adopted in the Ordering Paragraphs 1 through 23 of this decision are necessary to protect the public interest.

12. The application of PG&E for issuance of stock of Parent and Merger Company should be approved subject to the conditions set forth herein, and future conditions which we may adopt in Phase 2 of this proceeding.

13. Since we do not approve the PG&E Guidelines in this decision, we note that in the event of a conflict between the PG&E Guidelines and our Affiliate Transaction Order, In re Reporting Requirements for Electric, Gas, and Telephone Utilities Regarding Their Affiliate Transactions, D.93-02-019, 48 CPUC2d 163, 171 Appendix A, the provisions of the Affiliate Transactions Order shall govern.

14. 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 PG&E and other similarly situated utilities in the future.

15. 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.

16. This decision should be effective today in order for PG&E to timely implement its proposed reorganization structure.

INTERIM ORDER

IT IS ORDERED that:

1. The application of Pacific Gas & Electric Company (PG&E) for authority pursuant to Public Utilities (PU) Code § 818 for the issuance of stock by PG&E Parent Co., Inc. (Parent) and PG&E Merger Company is granted, subject to the conditions set forth in the following Ordering Paragraphs 2 through 23, inclusive, and conditioned on the outcome of the audit discussed in Section 6 of this decision, and any further conditions or modification of existing conditions which may arise from Phase 2 of this proceeding.

2. The cost of the audit described in Section 6.1 of this decision and in the February 15, 1996 Administrative Law Judge (ALJ) ruling shall be borne by PG&E shareholders. PG&E is directed to discontinue the memorandum account authorized by the ALJ ruling at page 7 to record the direct costs of the audit. The shareholders shall bear all costs booked in this memorandum account until the account is discontinued.

3. Until further directed in Phase 2 of this proceeding, PG&E, Parent, and all controlled affiliates shall retain (i) all internal and external correspondence between PG&E'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 PG&E's officers and department heads and controlled affiliates.

4. The Office of Ratepayer Advocates (the successor to the Division of Ratepayer Advocates (DRA)) shall make quarterly filings in the proceeding commencing March 30, 1997, advising all parties as to the status of the audit, and when it anticipates the audit will be complete.

5. PG&E shall ensure that the Commission has access to books and records of the holding company and each of its affiliates and their joint ventures, consistent with the requirements of PU Code § 314. PG&E is placed on notice that the Commission will interpret § 314 broadly as it applies to transactions between PG&E and the holding company or its affiliates and subsidiaries in fulfilling its regulatory responsibilities as carried out by the Commission, its staff and its authorized agents. Administratively, requests for such books and records made by the Commission, its staff or its authorized agents shall be deemed presumptively valid, material and relevant. Any objections to such requests shall be timely raised pursuant to Resolution ALJ-164 or any superceding Commission rules applicable to discovery disputes. In order to sustain an objection to such a request, respondents shall have the burden of showing that the request is not reasonably related to any issue that may be properly brought before the Commission and, further, is not reasonably calculated to result in the discovery of admissible evidence in any proceeding.

6. PG&E, PG&E'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 non-utility activities by PG&E's customers. PG&E will implement its proposed <u>Policy and Guidelines for Affiliate Company Transactions</u> as modified by conditions adopted by the Commission in Phase 1 of this proceeding. These guidelines will be reviewed in Phase 2 of this proceeding.

7. Utility affiliates shall continue to use Generally Accepted Accounting Principles and the Uniform System of Accounts. 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.

8. The officers and employees of PG&E Parent Company, its subsidiaries and affiliates shall be available to appear and testify in Commission proceedings as necessary or required.

9. Pursuant to Order Instituting Rulemaking (OIR) 92-08-008, PG&E shall furnish the Commission with:

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

b. Annual statements concerning the nature of inter-company transactions concerning PG&E and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;

c. The balance sheets and income statements of the non-consolidated subsidiaries of the holding company;

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

10. Pursuant to the February 15, 1996 Administrative Law Judge's Ruling in Application (A.) 95-10-024, an audit of all significant utility/affiliate transactions from the 1994 reporting period through the present should commence as soon as practicable.

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

12. Pursuant to OIR 92-08-008 (Appendix A, Section II.E, page 18), PG&E shall report the sale or transfer of any tangible asset to or from affiliated entities.

13. Valuable customer information, such as customer lists, billing records, or usage patterns, transferred directly or indirectly from PG&E to a non-utility affiliate shall be made available to the public subject to the terms and conditions under which such data was made available to the non-utility affiliate.

14. PG&E shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in its most recent decision on PG&E's capital structure. PG&E's equity shall be retained such that the Commission's adopted capital structure shall be maintained on average over the period the capital structure is in effect for ratemaking purposes. Provided, however, that PG&E shall file an application for a waiver, on a case-by-case basis and in a timely manner, of this condition if any adverse financial event at the utility reduces the utility's equity ratio by 1% or more. In order to assure that regulatory staff has adequate time to review and assess the application and to permit the consideration of all relevant facts, PG&E shall not be considered in violation of this condition during the period the waiver is pending resolution. Nothing in this provision creates a presumption of either reasonableness or unreasonableness of PG&E's actions which may have caused the adverse financial event.

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

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

17. The capital requirements of PG&E, as determined to be necessary to meet its obligation to serve, shall be given first

priority by the Board of Directors of PG&E's parent holding company and PG&E.

18. Pursuant to OIR 92-08-008, PG&E shall provide the Commission with an annual report detailing the utility's proportionate share of the holding company's (i) total assets, (ii) total operating revenues, (iii) operating and maintenance expense, and (iv) number of employees.

19. For transfers of product rights, patents, copyrights and other intellectual property, valuation shall be at fair market value which may be, inter alia, a single cost price, a royalty on future revenues or a combination of both. Such payments, if any, shall be developed on a case-by-case basis and identified for review in the subsequent general rate case or replacement proceeding, or other appropriate proceeding.

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

21. All formation costs arising from PG&E's holding company reorganization are and will be charged below the line, and will not be used to determine future revenue requirements.

22. When a PG&E employee is transferred from PG&E to either the holding company or an affiliate, that entity shall make a one time payment to PG&E in an amount equivalent to 25% of the employee's base annual compensation, unless PG&E can demonstrate that some lesser percentage (equal to at least 15%) is appropriate for the class of employee involved. All such fees paid to PG&E

shall be accounted for in a separate memorandum account to track them for future ratemaking treatment (i.e., credited to the Electric Revenue Adjustment Account or the Core and Non-core Gas Fixed Cost Accounts, or other ratemaking treatment, as appropriate) on an annual basis, or as otherwise necessary to ensure that PG&E's customers receive the fees. This transfer payment provision will not apply to clerical workers. Nor will it apply to the initial transfer of employees to PG&E's business units at the time of initial separation from PG&E pursuant to a PU Code § 851 application or other Commission proceeding. However, it will apply to any subsequent transfers between PG&E and previously separate business units.

23. a. PG&E shall provide to the Commission:

1. all employee handbooks (summary plan descriptions) of PG&E, its parent, affiliates and subsidiaries, within one month of any revisions thereto;

2. annual actuarial reports on all pension and benefit trusts of PG&E, its parent, affiliates and subsidiaries; and

3. annual trust audits of all pension and benefit trusts of PG&E, its parent, affiliates and subsidiaries.

b. PG&E shall continue to identify, for review in its general rate cases or replacement proceedings, or other appropriate proceedings, all transfers between PG&E and its parent, affiliates and subsidiaries of assets, goods and services, including pension and benefit trust assets, as they are described and valued in PG&E's <u>Policy and Guidelines for Affiliate Company Transactions</u>.

24. PG&E's August 5, 1996, motion for an order confirming that PU Code § 854 should not apply to PG&E's holding company formation is granted insofar as we determine that, in this particular case, PG&E's proposed transaction should not be classified as an acquisition activity subject to § 854.

25. PG&E and Parent shall file a written notice with the Commission, served on all parties to this proceeding, of their agreement, evidenced by a resolution of their respective boards of directors duly authenticated by a secretary or assistant secretary of PG&E or Parent, as the case may be, to conditions set forth in Ordering Paragraphs 1 through 23, inclusive. Failure to file such notice within 45 days of the effective date of this decision shall result in the lapse of the authority granted by this decision.

This order is effective today.

Dated November 6, 1996, at San Francisco, California.

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

APPENDIX A
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APPENDIX A
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(END OF APPENDIX A)