

RETURN TO ENERGY BRANCH  
ROOM 3102

E-10

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY & COMPLIANCE DIVISION  
Accounting and Finance Branch

RESOLUTION E-3071  
December 17, 1987

R E S O L U T I O N

INVESTMENT MANAGEMENT AGREEMENT FOR PACIFIC GAS & ELECTRIC COMPANY (PG&E) AUTHORIZING THE SERVICES OF AN INVESTMENT MANAGER OR ADVISOR FOR QUALIFIED AND NON-QUALIFIED NUCLEAR DECOMMISSIONING TRUST FUNDS FOR DIABLO CANYON NUCLEAR GENERATING STATION UNITS 1 AND 2, AND FOR HUMBOLDT BAY UNIT 3.

(Advice Letter 1160-E, filed June 23, 1987).

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SUMMARY

1. By Advice Letter 1160-E filed on June 23, 1987, Pacific Gas & Electric Company (PG&E) requested Commission authority to establish trust funds for the purpose of accumulating funds from ratepayers for the ultimate decommissioning of Diablo Canyon Nuclear Generating Station Units 1 and 2 (Diablo) and for Humboldt Bay Unit 3. Master Trust Agreements (Trusts) were duly authorized by Resolution E-3048 on November 25, 1987.
2. The Trusts require that a management and oversight committee be authorized to engage investment managers and advisors to direct the investments by the Trustees. By Advice Letter 1160-E, dated June 23, 1987, PG&E requests the approval of its choice for investment manager, M.D. Sass Investors Services Inc.
3. This Resolution authorizes PG&E and the Committee of its Qualified and Non-Qualified Trusts to engage M.D. Sass Investors Services Inc. (Sass) pursuant to the authorized Trusts and approves the proposed investment management agreement.

BACKGROUND

1. Ordering Paragraph 2 of Decision 87-05-062 dated May 1987 in Order Instituting Investigation O.I.I. 86 required PG&E to submit its selection for investment manager to the Commission for approval. As more fully described in Resolution E-3048 dated November 25, 1987, the Commission authorized PG&E to create a tax Qualified and a Nonqualified Master Trust Agreement establishing separate trusts for each of the 2 units at Diablo and for the unit at Humboldt. Both Master Trusts have various restrictions placed upon the types of investments permissible for the trust funds which were established to preserve, protect and invest revenues received from PG&E's California jurisdictional customers in rates authorized by the Commission for the ultimate decommissioning of these units.

2. Decision 87-05-062 did not establish any specific minimum qualifications or requirements to be met by any proposed investment manager. The only investment requirements or policies are those either defined or prescribed by the Internal Revenue Code Section 468A and related regulations for qualified and Nonqualified nuclear decommissioning trusts funds. As a result, PG&E established its own requirements and solicited proposals from a large number of potential investment managers. The California Public Utilities Code, as described in Resolution E-3048, also requires that the Trusts be segregated and separately managed. The authorized Master Trusts provide for an independent Committee, composed of two PG&E representatives and three outside representatives confirmed by this Commission to authorize the engagement of a Trustee and one or more investment managers or advisors to the Trustee. On an interim basis, until outside members are confirmed, PG&E was authorized to employ an all company Committee which can act with full powers.

3. PG&E's management and interim Trust Committee requests that the nomination of M.D. Sass be confirmed by this Commission. M.D. Sass located in New York City, New York. The firm would act as Investment Manager for the Trustee, Harris Trust and Savings Bank, (Harris) of Chicago, Illinois for the Diablo and Humboldt Trusts.

DISCUSSION

1. In its review of Advice Letter 1160-E 718-E, the Commission Advisory and Compliance Division (CACD) interviewed representatives of both PG&E and Sass. In the course of its review of the proposed investment management agreement (Agreement) the CACD inquired into the organizational background, references and past performance of Sass and also discussed with its representatives the proposed investment strategy and objective Sass had developed for the trust funds. The CACD also reviewed the process used by PG&E in selecting Sass as investment managers.

2. It is clear that there are as many strategies possible as there are potential advisors. Accordingly, prior performance linked to the continued involvement of the same personnel responsible for prior successful investment offered one of the most important selection criterion for a manager or advisor. The restrictions of the investment opportunities of the trust funds offer one alternative of investing all decommissioning revenues in long term U.S. government treasury securities. This would most securely preserve the nominal dollar value of the funds. It is also equally likely to ensure that the present value of the funds will decline and the ratepayers and the utility will be faced with a shortage of funds for future decommissioning expenses.

3. Through the use of sound, intelligent long-term investment strategies the present value of the funds can be preserved and a likelihood of profit in real value terms might occur. As a result, the CACD believes that the investment managers or advisors need to be on notice that the continuation of their agreements with the trusts and the Committee will be based upon an appraisal of the Trusts' investment performance under their direction. The Committee is required by the Master Trust Agreements to report annually on the performance of the trustee and any investment managers or advisors and prepare a detailed triennial report not only evaluating performance but also evaluating potential successors.

4. Evaluation of Trustees would be based primarily upon the accuracy, efficiency and security of the funds and the competitiveness of the fee structure. The investment managers and advisors must be evaluated not just on the preservation of capital and/or the competitiveness of their fees but instead on the net performance of the funds compared to the foregone opportunities of other investment opportunities. Net performance would be the sum of earnings less market value lost and less all management and advisory fees and brokerage costs compared to

other opportunities. Other opportunities would include but is not be limited to:

(a) the net performance of all other investment managers or advisors for all other California or other decommissioning trust funds.

(b) The net performance of a proforma portfolio mimicking a static investment program:

- (i) in specific long-term treasuries, or
- (ii) an indexed fund to the available investment market.

5. The proposed investment managers for San Diego Gas and Electric Company and Southern California Edison Company decommissioning trust funds, as well as PG&E's, correctly note that external short-term market fluctuations can greatly affect point in time portfolio valuations. Thus, the CACD believes that quantitative measures of performance must reasonably be based upon multiple year analyses with qualitative factors also being considered. Qualitative factors affecting manager or advisor ratings would include, but not be limited to, such items as turn-over in assigned personnel; a change in ownership or management; the addition or deletion of other clients which might adversely or favorably affect performance (managed by the manager or advisor), or sustained gains or loss in other portfolios); and the development of new systems of recordkeeping, strategy formulation or the obsolescence of current systems.

6. The CACD believes that it would be unreasonable to establish binding or restrictive evaluation criteria at this time. It believes that all California trust committees should continually re-examine their evaluation criteria and discuss such criteria with both the investment manager or advisors and the CACD, or its successor, on behalf of the Commission and to achieve maximum benefit of the annual reports and triennial evaluations. None of the foregoing should proscribe the Committee's duties and authority to engage or terminate any manager or advisor as allowed by the Master Trust Agreements and the Investment Management Agreement, or its successor(s) as authorized herein.

FINDINGS

1. The Investment Manager Agreement is fair and reasonable for the Diablo Canyon Nuclear Generating Station Units 1 and 3 and Humboldt Bay Nuclear Generating Station Unit 3 decommissioning trusts. M.D. Sass Investor Services Inc., is qualified at this time to act as investment manager on behalf of the trust funds.
2. The Investment Manager Agreement is in conformance with the requirements of Commission Decision 87-05-026 and with the terms and conditions of the Master Trust Agreement authorized by Resolution E-3048 dated November 25, 1987.
3. The Master Trust Agreement and the Investment Manager Agreement provide adequate requirements that the investment manager or advisor will be fairly evaluated on a reasonable and a regular basis. This assures them an adequate opportunity to perform, yet still provides sufficient safeguards to preserve the assets of the trust funds and maximize the earnings on allowable investments.
4. We further find that the investment manager agreement is in compliance with Decision 87-05-062; therefore,

IT IS ORDERED THAT:

1. Pacific Gas & Electric Company is authorized to place into effect the investment management agreement for its nuclear decommissioning trusts for Diablo Canyon Nuclear Generating Station Units 1 and 2 and Humboldt Bay Unit 3 with M.D. Sass Investors Services Inc.
2. All subsequent proposed investment management or advisory agreements shall also require Commission approval.
3. Advice Letter 1160-E and the accompanying investment management agreement shall be marked to show that they were approved by Resolution E-3071.
4. The Executive Director is authorized to sign the investment management agreement on behalf of the Commission.

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5. After the investment management agreements are executed by all parties, the Chief Administrative Law Judge shall be the Commission contact for all matters regarding the investment management agreement and ancillary agreements.

6. This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting of December 17, 1987. The following Commissioners approved it:

STANLEY W. HULETT  
President

DONALD VIAL  
FREDERICK R. DUDA  
G. MITCHELL WILK  
JOHN B. OHANIAN  
Commissioners

  
Executive Director