Decision **DRAFT DECISION OF ALJ THOMAS** (Mailed 12/26/01)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation whether Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and their respective holding companies, PG&E Corporation, Edison International, and Sempra Energy, respondents, have violated relevant statutes and Commission decisions, and whether changes should be made to rules, orders, and conditions pertaining to respondents' holding company systems.	Investigation 01-04-002 (Filed April 3, 2001)
In the Matter of the Application of SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) for authorization to implement a plan of reorganization which will result in a holding company structure.	Application 87-05-007 (Filed May 6, 1987)
In the Matter of the Application of San Diego Gas & Electric Company (U 902-M) for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure.	Application 94-11-013 (Filed November 7, 1994)
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)
Joint Application of Pacific Enterprises, Enova Corporation, Mineral Energy Company, B Mineral Energy Sub and G Mineral Energy Sub for Approval of a Plan of Merger of Pacific Enterprises and Enova Corporation With and Into B Mineral Energy Sub ("Newco Pacific Sub") and G Mineral Energy Sub ("Newco Enova Sub"), the Wholly Owned Subsidiaries of a Newly Created Holding Company, Mineral Energy Company.	Application 96-10-038 (Filed October 30, 1996)

INTERIM OPINION ON MEANING OF FIRST PRIORITY CONDITION

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I. Summary

This interim decision provides an initial interpretation of the "first priority" condition incorporated into the decisions approving the holding company systems of Respondents Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE or Edison), and San Diego Gas & Electric Company (SDG&E), as well as their respective parent holding companies, PG&E Corporation (PG&E Corp.), Edison International (EIX), and Sempra Energy (Sempra) (collectively, Respondents).

In previous briefing on this issue in this docket, Respondents have argued that the condition requires, variously, only that they maintain a certain debt-equity ratio, level of capital expenditure, or level of "equity investment" in the utilities' plant and equipment. We find that Respondents' limited interpretations of the condition are not justified by the law, the decisions themselves, or the records of the holding company proceedings. Instead, we find that the first priority condition's reference to the term "capital" must be interpreted expansively. At least under certain circumstances, we find that the condition includes the requirement that the holding companies infuse all types of "capital" into their respective utility subsidiaries when necessary to fulfill the utility's obligation to serve. We do not conclusively find at this time that any Respondent violated the first priority condition. Finding such a violation requires a case-by-case analysis of each Respondent's individual circumstances that will be the subject of later proceedings in this docket.

However, we take official notice[1] of the fact that in the time since briefing on this issue was submitted, one of the holding companies, PG&E Corp., has become a proponent of a proposed Plan and Disclosure Statement on file in the on-going PG&E bankruptcy case.[2] Because this Plan and Disclosure Statement proposes the transfer of significant assets from PG&E to PG&E Corp., PG&E Corp. could unfairly benefit from such a transfer, to the detriment of ratepayers. On the basis of our expansive interpretation of the first priority condition in this decision, we conclude that the condition prohibits (1) a holding company's acquisition of the assets of its utility subsidiary for inadequate consideration, and (2) a holding company's acquisition of such assets at any price, if such transfer would impair the utility's ability to fulfill its obligation to serve, or to operate in a prudent and efficient manner.[3]

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[1] Rule 72 of the Commission's Rules of Practice and Procedure provides that the Commission may take "official notice" of "such matters as may be judicially noticed by the courts of the State of California." Evidence Code section 452 provides that a trial court may take judicial notice of the official acts of the legislative, executive, and judicial departments of the United States and of any state of the United States, as well as the records of any state or federal court. Evid. Code sections 452(c) & (d).

[2] *In re Pacific Gas & Electric Company*, Case No. 01-30923 DM, United States Bankruptcy Court, N.D. Cal.

[3] The condition, as initially proposed in the PG&E authorization proceedings, was identical to the condition we previously had imposed on EIX and Sempra. *See* D.96-11-017, 69 CPUC2d 167, 201 (1996) (ordering paragraph 17). Following an audit, however, we issued a second decision in which the condition was modified, adding requirements concerning the requirement for capital "to operate the utility in a prudent and efficient manner." *See* D.99-04-068, 194 P.U.R.4th 1, 9 (1999). The full text of the condition, as imposed on each of the holding companies, is recited below.

II. Background

A. Nature of the Proceeding

This proceeding is an investigation into transactions between the three major California investor-owned utilities and their respective holding companies. The Commission seeks to determine both whether these entities engaged in conduct in the past that violated relevant statutes and Commission decisions that allowed them to establish holding companies,[4] and whether additional rules, conditions, or other changes are needed to protect ratepayers and the public from dangers of abuse of the holding company structure.

In each decision establishing the holding company systems, we incorporated a provision requiring that the utilities be given first priority within those systems.[5] In PG&E's case, the provision read as follows:

> The capital requirements of PG&E, as determined to be necessary and prudent to meet the obligation to serve or to operate the utility in a prudent and efficient manner,

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[4] The holding company decisions for each Respondent are as follows:

PG&E—D.96-11-017, 69 CPUC2d 167 (Nov. 6, 1996) (PG&E Authorization 1); D.99-04-068, 194 P.U.R.4th 1 (April 22, 1999) (PG&E Authorization 2);

SDG&E—D.95-05-021, 59 CPUC2d 697 (May 10, 1995) (SDG&E Authorization 1); D.95-12-018, 62 CPUC2d 626 (Dec. 6, 1995) (SDG&E Authorization 2); and D.98-03-073, 184 P.U.R.4th 417 (March 26, 1998) (Sempra Merger Authorization); and

Edison—D.88-01-063, 27 CPUC2d 347 (Jan. 28, 1998) (Edison Authorization).

[5] We do not now determine whether any of the differences in these conditions have meaning beyond that we find here to be consistent across all three provisions.

> shall be given first priority by PG&E Corporation's Board of Directors.[6]

The Edison / EIX condition provides that:

> The capital requirements of the utility, as determined to be necessary to meet its obligation to serve, shall be given first priority by the Board of Directors of Edison's parent holding company and Edison.[7]

In SDG&E / Sempra's case, the first priority condition states that:

> The capital requirements of SDG&E, as determined to be necessary to meet its obligations to serve, shall be given first priority by the Board of Directors of Parent and SDG&E.[8]

In our Order Instituting Investigation (OII), we cited conduct of each Respondent that implicated the first priority condition:

> Available information suggests that at no time since wholesale energy prices started rising in the summer of 2000, while the utilities were increasingly strident in their claims of worsening financial condition, imminent bankruptcy, and the consequent threat to their ability to fully meet their obligation to serve, did any of their respective holding companies provide an infusion of capital to address the utilities' capital needs as detailed above. We will investigate whether this apparent failure to infuse capital violates the condition in our holding company decisions that the holding company give "first

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[6] PG&E Authorization 2, 194 P.U.R.4th at 45, Ordering Paragraph 8; s*ee also* PG&E Authorization 1, 69 CPUC2d at 201, Ordering Paragraph 17.

[7] Edison Authorization, 27 CPUC2d at 376, Ordering Paragraph 12.

[8] SDG&E Authorization 2, Ordering Paragraph 6, 62 CPUC2d at 651; *see also* Sempra Merger Authorization, 184 P.U.R.4th at 498, 502, Ordering Paragraph 2(c) & Attachment B(IV)(5).

> priority" to the capital needs of its utility subsidiary to meet its obligation to serve.[9]

We asked Respondent holding companies, *inter alia,* to furnish information regarding whether they provided sufficient capital to their utility subsidiaries to alleviate or mitigate the subsidiaries' need for capital during that time period, and each Respondent utility to inform us whether it had made demands on its respective holding company to infuse needed capital.[10]

In response to this order and in other documents, the holding companies have suggested, *inter alia,* that their utilities' recent financial needs constitute needs for operating cash, or working capital, and that these needs do not implicate the first priority condition because, they contend, that condition is limited to needs for so-called "equity capital." To resolve this issue, we ordered briefing on the meaning of the first priority condition.

B. Respondents' and Intervenors' Claims

Respondents make several arguments about the meaning of the first priority condition, but each contends that the condition cannot be interpreted to require infusions of operating funds into the utilities to enable them to make energy purchases. We address these arguments below, and find that if the condition, and specifically its use of the term "capital" is interpreted expansively, it follows that PG&E Corp.'s bankruptcy Plan raises the inference of a first priority condition violation.

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[9] *Order Instituting Investigation*, filed April 3, 2001, *mimeo.,* at 15.

[10] *Id.*

PG&E proposes an interpretation of the first priority condition that would limit the condition to utility capital requirements for investment needed for capital additions.[11] Similarly, PG&E Corp. alleges that the first priority condition

> [p]rovides that the holding company's board of directors, when faced with investment allocation decisions, would invest equity capital in the [u]tility in preference to other investments, when the board determines that the [u]tility's investment requirements are necessary and prudent to meet the [u]tility's obligation to serve and that such investment would provide an opportunity to earn a reasonable rate of return.[12]

Edison asserts that the first priority condition "does not require . . . EIX . . . to infuse cash into SCE to fund the power purchases . . . SCE has experienced since about May 2000."[13] Rather, Edison contends, the first priority condition only requires that the holding companies make available to the utilities "funds for investment in plant and equipment."[14]

SDG&E claims that the first priority condition "requires a utility holding company to permit the utility to retain sufficient earnings to make the capital investment in its systems and facilities necessary both to

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[11] *Brief of Pacific Gas and Electric Company on Legal Issues for First Priority Condition* (PG&E Brief), filed May 17, 2001.

[12] *PG&E Corporation's Brief on Legal Issues Pursuant to Assigned Commissioner's Ruling (Special Appearance)* (PG&E Corp. Brief), filed May 17, 2001, at 1.

[13] *Brief of Southern California Edison Company on First Priority Condition* (Edison Brief), filed May 17, 2001, at 1-2.

[14] *Id.* at 3.

maintain the Commission's approved capital structure and to meet the utility's obligation to provide safe and reliable service to its customers."[15]

The Utility Reform Network (TURN), the Office of Ratepayer Advocates, the City and County of San Francisco, and the City of Long Beach also briefed the first priority issue. They assert that the plain language of the first priority condition "requires a holding company to infuse money into its utility subsidiary when the utility's internal access to capital is impaired such that discharge of its obligation to serve or its ability to operate normally is threatened."[16] Otherwise, they claim, the utilities fail to fulfill their obligation to serve. In addition, TURN argues that the term "capital" in the condition must be given an expansive meaning, and be defined so as to distinguish it from the "balanced capital structure" condition that also appears in the Commission's holding company decisions.[17]

C. The PG&E Bankruptcy Proceeding

On September 20, 2001, PG&E filed its proposed *Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company* (the "Plan") together with its Disclosure Statement in *In re*

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[15] *Opening Brief of San Diego Gas & Electric Company* (SDG&E Brief), filed May 17, 2001, at 1.

[16] *Opening Brief of the Office of Ratepayer Advocates on the Meaning of the "First Priority" Condition* (ORA Brief), filed May 17, 2001, at 2; *see also Reply Brief of The Utility Reform Network* (TURN Reply), filed May 23, 2001, at 8 ("ORA's 'plain meaning' interpretation of the 'first priority' condition should be adopted by the Commission.")

[17] *Opening Brief of The Utility Reform Network* (TURN Brief), filed May 17, 2001, at 10-12.

Pacific Gas & Electric Company, Case No. 01-30923 DM, United States Bankruptcy Court, N.D. of California (the "Bankruptcy Case").

Under PG&E's proposed Plan and Disclosure Statement, PG&E's electric transmission operations will be spun off into a separate business, temporarily named ETrans, under PG&E Corp; PG&E's natural gas transmission operations will be spun off into a separate business, temporarily named GTrans, under PG&E Corp.; and PG&E's hydroelectric and nuclear generating operations will be spun off into a separate business, temporarily named Gen, under PG&E Corp.

On November 27, 2001, the Commission timely filed and served its Objection to PG&E's Disclosure Statement.[18] In this Objection, the Commission argued that the proposed Plan is unconfirmable and the Disclosure Statement is inadequate and deceptive. Of particular relevance to the question of the meaning of the first priority condition, the Commission raised certain issues regarding (a) the value of the assets PG&E seeks to transfer, (b) the consideration to be received in exchange therefor, and (c) the identities of the transferees.

III. Discussion

A. On its Face, the First Priority Condition is Not Limited in the Manner Respondents Suggest

Before we discuss the relationship of the first priority condition to PG&E Corp.'s Plan, we first must interpret the underlying meaning of the condition. We interpret it broadly, and reject Respondents' narrow

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[18] *See California Public Utilities Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas & Electric Company Proposed by Pacific Gas & Electric Company and PG&E Corporation*, filed on November 27, 2001 in *In re Pacific Gas & Electric Company*, Case No. 01-30923 DM, United States Bankruptcy Court, N.D. Cal.

interpretations. Because the Commission is the arbiter of the meaning of its own decisions, our interpretation should be given great weight. In this case, the Commission nowhere limited the term "capital" in the first priority condition to funds necessary solely for infrastructure investment, or in any other manner proposed by Respondents.

Case law supports a broad interpretation of the term "capital," at least where, as here, the term contains no limiting language. For more than a hundred years, California courts have given the term "capital" an expansive definition: "'Capital stock' . . . is . . . as well expressed by the simple word 'capital,' and means the money and property with which the company carries on its corporate business."[19] "This money and property of the corporation constitutes the actual capital of the company . . . ."[20] "The capital of a corporation is its assets, regardless of their source, which are utilized for the conduct of the corporate business and for the purpose of deriving gains and profits therefrom."[21]

> The working capital of a corporation includes all of its assets starting with the paid in capital for shares of stock issued by it to its shareholders and such accretions thereafter derived from any source including increased market value of its investments in land and physical property, donations and accumulated earnings. All of a corporation's capital

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[19] *Kohl v. Lilienthal*, 81 Cal. 378, 385 (1889), citing *Martin v. Zellerbach*, 38 Cal. 300, 309 (1869).

[20] *Kohl*, 81 Cal. at 385.

[21] *Veterans Foundation v. Commissioner of Internal Revenue*, 38 T.C. 66, 74 (1962), 1962 U.S. Tax Ct. LEXIS 154, at **23.

> may be considered working capital if committed for a planned use.[22]

"Capital," accordingly, encompasses all types of funds and assets possessed by a corporation. If we had intended to limit the term in the first priority condition, we would have done so. We did not. Accordingly, we conclude that "capital,' as used in the first priority condition includes "money," "property," "assets, regardless of their source," or "working capital," as do the foregoing cases. Respondents' proposed limitation of the term to "equity capital" finds no support in the language of the decisions; without such limitation, there is no basis to imply one.

The other terms in the condition are equally clear. We agree with ORA that the term "first priority" means the highest "preferential rating assigning rights to scarce products or materials." Likewise, the term "requirements" refers to need. Further, we agree with ORA that the meaning of the phrase "obligation to serve" is not in dispute. "It denotes the . . . obligation that each of the utilities subject to this OII must provide its services within its service territory."[23] There is nothing in the term that limits a utility's obligations to constructing infrastructure or maintaining a particular debt-equity ratio. Thus, once again, the condition requires an infusion of "capital"—defined broadly—"should a utility lack sufficient money to, for example, buy power on the wholesale market or maintain essential physical infrastructure."[24]

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[22] *American Lawn Mower Co. v. U.S.*, 63-2 U.S. Tax Cas. (CCH) P9779, 1963 U.S. Dist. LEXIS 9471, at *16.

[23] ORA Brief at 4.

[24] *See id.*

We conclude, therefore, that when a utility's access to or possession of capital of any type is impaired, and its ability to discharge its obligation to serve is consequently threatened, the first priority condition requires its holding company to give the utility preference over all competing potential recipients of capital resources.

B. The Relationship of the Condition to the Decision as a Whole Supports the Commission's Reading

Our broad reading of the first priority condition is consistent with the context of each holding company authorization decision as a whole. The decisions' discussions of this condition in broad terms, as well as the existence of the balanced capital structure condition as a separate requirement, support our conclusion that the condition encompasses the requirement that the holding companies infuse all types of "capital" into their respective utility subsidiaries when necessary to fulfill the utilities' obligation to serve.

The text of these decisions makes clear that in adopting the first priority condition the Commission was not concerned with ensuring technical compliance with the capital structure requirements of the various utilities' general rate cases. Rather, the Commission was concerned with preventing the utilities from becoming unable to acquire sufficient money to meet their obligation to serve. Respondents' interpretation of the first priority condition would make it impossible for the Commission to ensure reliable utility service.

Given the Commission's clear desire—and statutory duty—to ensure that the holding company systems would not eviscerate the utilities' ability to fulfill their obligation to serve, Respondents' interpretation is far too narrow. In each decision, we discussed the first priority condition in broad terms of utility needs and financial strength on the one hand and holding company responsibility and financial assistance to the utilities on the other. None of the decisions limits the application of the condition or the particular term "capital."

In SDG&E's initial holding company proceeding in 1985,[25] in which the first priority condition originated, the Commission repeatedly describes the first priority condition as pertaining to the need to maintain the utility's financial health. For example, the Commission discusses the first priority condition in a section entitled "Regulatory Controls."[26] Noting the "various problems a holding company structure poses with respect to this Commission's ability to protect ratepayers from the adverse consequences of a diversification strategy," the Commission describes the conditions proposed to address these problems as "relating to the maintenance of the utility's *financial strength.*"[27] The Commission further describes the first priority condition as "related to . . . *financing* priorities."[28] Finding of Fact 33 similarly states that requiring the holding company and utility board of directors to give priority to the utility's capital needs "would protect the utility's *financial strength.*"[29]

Although the PG&E, Edison, and subsequent SDG&E decisions do not address the first priority condition in great detail, what the

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[25] D.86-03-090, 20 CPUC2d 660 (1986). SDG&E ultimately decided not to form its holding company at that time and reapplied in 1995.

[26] *Id.* at 681.

[27] *Id.* (emphasis added).

[28] *Id.* (emphasis added).

[29] *Id.* at 689 (emphasis added).

Commission does say emphasizes the breadth of the condition's application and its focus on protecting ratepayers. For example, the first PG&E decision notes the first priority 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."[30] In SDG&E Authorization 2, the Commission states that "[t]he parties agree that Parent and SDG&E should give SDG&E's utility needs the highest priority."[31] In the Edison decision, the Commission repeats the condition in its entirety in several places without any limiting language, noting that it is "identical" to the corresponding SDG&E provision.[32]

In support of its position that the term capital should be interpreted narrowly, Edison cites several instances in the decision in which the term capital appears.[33] In the first, the Commission notes TURN's concern "that the holding company formation may decrease the utility's ability to meet its capital needs" and refers to the holding company's potential to raise capital at lower cost.[34] However, the Commission rejects TURN's contention in this regard, so it is incorrect to conclude that the Commission had a particular meaning of the term "capital" in mind. Moreover, the discussion does not arise in the context of the first priority condition.

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30 PG&E Authorization 1, 69 CPUC2d at 194.

31 SDG&E Authorization 2, 62 CPUC2d at 638.

32 Edison Authorization, 27 CPUC2d at 368, 373 and 376.

33 *See* Edison Brief at 6-7.

34 Edison Authorization, 27 CPUC2d at 362.

In the second instance Edison cites, the Commission addresses and rejects a condition requiring the holding company to file capital budgets for itself and its subsidiaries.[35] Again, nothing in this discussion—including the use of the broad term “capital investment”—explicitly or implicitly limits the holding company’s obligation to the utility as stated in the first priority condition.

Last, Edison cites a discussion of proposed conditions regarding royalty payments for affiliate transfers, in which the Commission stresses management’s responsibility to protect the utility’s property, including its “capital” and “business income.”[36] However, this excerpt is not one in which the Commission purports to define the term “capital” as used in the first priority condition. Moreover, it further illustrates the Commission’s concern that the holding company maintain the utility’s financial health and ability to fulfill its obligation to serve.

In short, the decisions’ discussion of the first priority condition supports a broad interpretation, as there is nothing in the decisions to indicate that it should be limited in any way.

C. The Records of the Holding Company Proceedings Support a Broader Reading of the First Priority Condition Than Respondents Suggest

Although the Commission need not refer to the parties’ contemporaneous discussions of the condition to glean the meaning of the words, they reinforce the broad reach of the condition’s language. Nowhere in the record of the proceedings—including exhibits, filed

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[35] *See id.* at 366.

[36] *See id.* at 370.

testimony, and hearing testimony—does any party define the word "capital" in the limited manner Respondents suggest. We address the record of each decision below.

1. SDG&E

As discussed above, the first priority condition originated in SDG&E's 1985 application. The record of that proceeding, then, is instructive as to the meaning and application of the first priority condition in the subsequent holding company proceedings. It not only supports a broad reading of the term "capital requirements," but shows that—contrary to SDG&E's position—the first priority condition imposes an affirmative obligation on the holding company to infuse capital necessary for the utility to fulfill its obligation to serve, not just to maintain a balanced capital structure.[37]

In SDG&E's first proceeding, before SDG&E proposed the first priority condition, DRA (ORA predecessor) staff witness Kenneth Chew proposed a number of financial conditions, including the "balanced capital structure" condition and another condition which would have

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[37] *See* Section II(B)(3) above. SDG&E's argument that the first priority condition only requires that the utility "maintain the Commission's approved capital structure" (SDG&E Brief at 1) not only contradicts the record, but also would render the first priority condition an exact—and thus superfluous—duplicate of another condition in the relevant holding company decision. That other condition requires that "SDG&E . . . maintain a balanced capital structure consistent with that determined to be reasonable by the Commission . . . ." (SDG&E Authorization 2, 62 CPUC2d at 651.) SDG&E's claim in its comments on the draft decision of ALJ Thomas that the financial conditions "were all meant to be read together to mean that SDG&E should be required to invest equity capital in amounts sufficient to maintain its Commission-authorized equity ratio . . ." is illogical. Had the Commission intended to impose only this obligation, it would not have created two separate conditions setting forth the same requirement.

restricted the utility's ability to issue dividends to the holding company.[38] Mr. Chew was concerned the holding company's other businesses "could have an adverse impact on the utility's capital structure" and "might also drain the utility of capital needed for maintaining an adequate level of service."[39] He testified that the holding company's access to SDG&E's earnings through dividends "may impair the capital structure of SDG&E *or* impact the utility's ability to provide adequate services," and that a condition restricting dividends would "ensure that when funds are needed by the utility, they will be available."[40] In response to the question whether the holding company structure "would potentially affect a utility's access to funds for future expansion," Mr. Chew stated the utility would be "competing with its corporate affiliates for funds to meet its future capital requirements."[41] On cross-examination, Mr. Chew reiterated this concern and noted that the parent company "has to allocate the capital investment" between the utility and the affiliate.[42]

This testimony reflects not only ORA's concern that the utility might not maintain its capital structure, but that it might not have sufficient capital to fulfill its service obligation. Although ORA did not explicitly address the possibility that the utility might suffer financial

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38 Prepared Direct Testimony of Kenneth K. Chew, Exhibit 35, A.85-06-003, B-2 to B-3. Pursuant to Rule 73 of the Commission's Rules of Practice and Procedure, the Commission takes official notice of this testimony, as well as the other testimony and briefs from prior proceedings hereinafter cited.

39 *Id.* at 5.

40 *Id.* at 10 and B-3 (emphasis added).

41 *Id.* at 14.

42 Chew testimony, A.85-06-003, Transcript Vol. 8, at 1107.

distress due to an unforeseen or sudden inability to meet operating expenses, Mr. Chew's overall concern was that the holding company would drain the utility and leave it with no funds with which to operate. We do not read Mr. Chew's discussion of the utility's access to funds for "future expansion" or his reference to such expansion as a "capital requirement" as an explicit limitation on the holding company's obligation to the utility; "expansion" requires capital for different purposes, including those funds used to operate the utility as well as those needed to improve plant and equipment.

Following Mr. Chew's testimony, SDG&E proposed the first priority condition as one of three "financial conditions."[43] SDG&E witness Stephen Edwards' testimony responded to Mr. Chew's fears regarding utility financial health and ability to serve ratepayers:

- "The capital needs of SDG&E will get top priority. If a conflict as to allocation of capital occurs—a result less likely under a holding company than if non-utility subsidiaries must depend upon SDG&E for capital—that conflict will be resolved by meeting SDG&E's *service* obligations first."[44]

- "[The three financial conditions] strike the necessary balance and flexibility to allow SDG&E to continue paying dividends under adverse circumstances (such as significant regulatory disallowance), while establishing the principle that SDG&E has first call on equity capital when needed to reach or maintain

[43] SDG&E Rebuttal Testimony of Stephen A. Edwards, Exhibit 51, A.85-06-003, Attachment A, at 2-3.

[44] *Id.* at 3 (emphasis added).

> authorized equity levels *and* meet its obligation to serve."[45]

The overriding concern for the utility's financial health and ability to serve is further emphasized in the testimony of SDG&E Vice President / Treasurer Lee Haney and President / CEO Thomas Page. In a discussion of modifications to the proposed condition regarding utility retention of capital versus dividend distribution to the holding company, Mr. Haney stated that "[w]e wanted to be very clear that the utility is first and foremost in priority. Its financial health is first priority."[46] Similarly, with regard to the difference the holding company structure would make for the availability of capital for the utility, Mr. Page testified that "the capital demands of the utility, which in fact do take priority, are going to influence the amount of capital that is available elsewhere."[47] Mr. Page also emphasized the awareness that the utility may not always have "excess cash" as it did at that time and that SDG&E is "very, very mindful of the fact that that may not be the case; that the demand for the utility

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[45] *Id.* at 4 (emphasis added). *See also* Concurrent Brief of San Diego Gas & Electric Co. (U 902-M) (SDG&E Concurrent Brief), A.85-06-003, filed Dec. 9, 1985, at 44 (emphasis added) ("Beyond the generic attribute of insulation provided by the holding company structure, SDG&E has provided corporate assurances and proposed conditions which would add further protections for the utility and its ratepayers. Conditions 11, 12, and 13 . . . assure that the capital structure *and* capital needs of the utility will be met.")

[46] R. Lee Haney Testimony, A.85-06-003, Transcript Vol. 6 at 769.

[47] Thomas A. Page Testimony, A.85-06-003, Transcript Vol. 1 at 80. *See also* SDG&E Concurrent Brief, A.85-06-003, at 24 (emphasis added) (by committing to give the utility's capital needs first priority, "the Commission and customers are assured that the utility will not be under-capitalized *nor* will diversification be financed at the expense of utility service.")

company will in fact exceed all internal cash flows, and given that prioritization those needs are going to be met."[48]

As SDG&E points out,[49] Mr. Page also stated that "the capital that is demanded for the utility company can cover quite a spectrum now, depending on how you would meet the resource plan and what your customer growth is."[50] SDG&E interprets this testimony as equating capital solely with funds used to build facilities.[51] On the contrary, capital for meeting a resource plan or accommodating customer growth is not necessarily limited to just one type; rather, many different types of capital are necessary to operate a utility and serve customers.[52]

SDG&E also relies on an excerpt of Mr. Edwards' cross-examination testimony regarding the allocation of capital between the utility and other affiliates as evidence of the parties' intent to limit the first priority condition's application.[53] In response to a question seeking examples of "conflict between the needs of the utility for capital and the actual decisions of the holding company management," Mr. Edwards stated he was only aware of decisions regarding "whether *utility*

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[48] Thomas A. Page Testimony, A.85-06-003, Transcript Vol. 1 at 81. *See also* SDG&E Closing Statement, A.85-06-003, Transcript Vol. 12 at 1476 ("We will maintain the financial health of the utility . . . . ").

[49] *See* SDG&E Brief at 7-8.

[50] Thomas A. Page Testimony, A.85-06-003, Transcript Vol. 1 at 80.

[51] *See* SDG&E Brief at 8.

[52] In addition, SDG&E contends Mr. Page's use of "cash" refers to "the type of equity investment necessary in utility systems and facilities . . ., not working cash . . . ." SDG&E Brief at 8. We disagree, for obvious reasons.

[53] *See* SDG&E Brief at 7.

management has properly allocated or sufficiently allocated capital to utility needs in providing adequate service and service standards."[54] He further testified that there is "plenty of precedent" regarding utilities' meeting service obligations through "capital funding of projects or sufficient facilities . . . ."[55] This reference to "capital funding of projects or sufficient facilities," however, can be read as Mr. Edwards' providing an example of capital the holding company is required to infuse into the utility; Mr. Edwards' testimony does not indicate that "projects or facilities" are the only two components of a utility fulfilling its obligation to serve.

2. Edison

In the Edison proceedings, the first priority condition came directly from the SDG&E decision and was identical to it.[56] Thus, examination of the record of the SDG&E proceedings, discussed above, is directly applicable to the Edison condition. Moreover, the record of the Edison holding company proceeding itself illustrates an overall concern with the utility's financial health and ability to serve. For example, Edison witness J.S. Pignatelli spoke of the first priority condition as follows:

- "[A]s we have committed, the first priority of all equity is to the utility, and the Commission should be and staff should be evaluating us on our performance as the utility and on the capital required for the utility."[57]

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[54] Edwards testimony, A.85-06-003, Transcript Vol. 11 at 1435 (emphasis added).

[55] *Id.* at 1435-36.

[56] *See* Edison Authorization, 27 CPUC2d at 368.

[57] Pignatelli Testimony, A.87-05-007, Transcript Vol. 2 at 252.

- Re: whether infusions of equity needed by utility will come from the holding company, "That's correct, in addition to the retained earnings of the utility. But that infusion of capital from the holding company can be financed with equity or with debt of the holding company . . . .[T]he holding company . . . can finance either through debt or equity to provide an equity infusion to the utility . . . ."[58]

Again, nothing in this testimony explicitly limits the term "capital" as used in the condition.

3. PG&E

Lastly, examination of the record in the PG&E proceedings—the most recent proceedings—reinforces the Commission's reading of the condition.[59] During its holding company authorization proceedings, PG&E repeatedly reassured the Commission that the holding company would provide the utility with financial support if the utility should encounter financial difficulties. For example, PG&E stated:

- "The management of both PG&E Corporation and Pacific Gas and Electric Company fully intend to preserve the utility's financial integrity and access

[58] *Id.*, Transcript Vol. 3 at 319-20.

[59] The PG&E first priority condition differs slightly from the others. In PG&E Authorization 1, the provision read: "The capital requirements of PG&E, as determined to be necessary to meet its obligations to serve, shall be given first priority by the Board of Directors of PG&E's parent holding company and PG&E." 69 CPUC 2d at 201. In PG&E Authorization 2, it provides that "[t]he capital requirements of PG&E, as determined to be necessary and prudent to meet the obligation to serve or to operate the utility in a prudent and efficient manner, shall be given first priority by PG&E Corporation's Board of Directors." 194 PUR 4th at 45.

to capital – both for business reasons and to satisfy the utility's obligation to serve."[60]

- "[I]n cases involving utility financial distress, association with the holding company is more likely to help. If the utility were in financial distress and could not generate adequate internal capital, the holding company would be in a stronger position to raise the necessary capital. The holding company would have a number of other businesses that should generate cash or have access to the capital markets. In such a case the holding company may be able to raise capital, even though the utility could not."[61]

- "Further, PG&E Corporation will be subject to the Phase I condition requiring PG&E Corporation to give first priority to Pacific Gas and Electric Company's capital needs. As a result, this Commission should be satisfied that it is highly unlikely that PG&E Corporation would not have the means to provide capital to Pacific Gas and Electric Company should its internal cash generation be insufficient."[62]

- "To the extent that utility affiliates compete with the utility for scarce capital, [the first priority condition] protects ratepayers by requiring the directors of the utility and the holding company to place top

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60 PG&E Testimony In Response To Overland Affiliate Audit, A. 95-10-024, Exhibit 201 at 18-2.

61 *Id*. at 18A-26.

62 Reply Brief of Pacific Gas & Elec. Co. (Phase 2), filed Nov. 25, 1998, A.95-10-024, at 19.

priority on the utility's obligation to serve its customers."[63]

- "[The first priority condition recommended in PG&E Authorization 2] is virtually identical with a condition included in the Phase I Interim Decision, but incorporates the phrase 'to operate the utility in a prudent and efficient manner' so as not to preclude capital expenditures not immediately required to avoid service interruptions."[64]

This testimony illustrates PG&E's commitment that the holding company structure would provide broad financial protections to the utility, with no clear limitations on the type of financial protections. PG&E and PG&E Corp., however, cite to the testimony of Gary Harpster, ORA's expert, as indicating a limited view of the term "capital."[65] We disagree.

Mr. Harpster states the first priority condition "addresses investments needed to meet PG&E's obligation to serve" and "requires PG&E Corporation to place priority on investments needed to operate the utility in a prudent and efficient manner."[66] He also refers to the "[m]any capital additions PG&E would make on a stand-alone basis to achieve cost-

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63 PG&E Testimony in Response to Overland Affiliate Audit, A.95-10-024, Exhibit 201, at 18-4.

64 *Id.* at 18-7. PG&E reads this testimony as describing a limited view of "capital." *See* PG&E Reply at 8. However, in light of the many other broad discussions set forth above, the term "capital expenditure" can just as likely refer to the many different types of capital a utility needs to operate and satisfy its service obligation.

65 *See* PG&E Brief at 4; PG&E Corp. Brief at 2-3.

66 Audit of Affiliate Transactions of the PG&E Co., A.95-10-024, Exhibit C-102, Vol. 3, at 30-23.

savings . . . not literally required to avoid an interruption of service.[67] Even if "capital additions" is read to mean solely improvements to plant and equipment, there is no indication ORA or PG&E intended to restrict the application of the first priority condition to any particular type of capital. Rather, read in light of the many different forms of capital needed by a utility and the rest of the record—including PG&E's broad statements regarding its view of the condition's applicability—Mr. Harpster's testimony may be read as providing just one example of capital, not limiting capital to a certain type.

As set forth above, the record of the proceedings demonstrates that ORA and the Commission were concerned the holding company structure would compromise the financial health of the utilities and impair their ability to fulfill their obligation to serve. In response, the utilities reassured the Commission the financial health of the utility and its ability to provide service were their "first priority." Nothing in the record excludes application of the first priority condition to a situation where capital other than that used for plant and equipment is needed.

D. Contrary to Respondents' Arguments, Infusions of Working Capital Can Provide a Return on Investment, and Do Not Constitute a Taking

PG&E Corp. argues there is no reasonable opportunity to earn a return on investments of "working capital"—essentially, cash for operating expenses, according to PG&E Corp.—as opposed to "equity capital"—*i.e.*, investment in plant and equipment, as PG&E Corp. uses the term. On this basis, it contends that an interpretation of the first priority condition that encompasses both working and equity capital would be

67 *Id.*

unconstitutional, because enforcing the condition as to working capital would constitute a taking, in violation of the Fifth Amendment. Accordingly, PG&E Corp. argues, we must avoid an unconstitutional interpretation of the condition, and limit it to referring to infusions of "equity."

As an initial matter, it is worth observing that the underlying premise—that only infusions of equity for plant and equipment investment benefit a corporation's shareholders—is patently false. Corporate owners regularly infuse working capital into the corporations they own, with the expectation that by doing so, they will reap future benefits by, for example, returning an ailing corporation to profitability.[68] If providing infusions of working capital necessarily were equivalent to pouring money down the drain, as PG&E Corp. implies, no one ever would do this. As the cases cited above indicate, however, infusing working capital into a corporation that has fallen on hard times can benefit the shareholders by returning the corporation to profitability. There is nothing necessarily special about "equity capital." Thus, even if PG&E Corp. were correct that the Constitution forbids compelling one corporation to give money to another absent a reasonable opportunity to earn a return on that investment, a broad reading of the first priority condition as referring to both "equity capital" and working capital is not necessarily inconsistent with that alleged Constitutional prohibition.

In any event, however, PG&E Corp. is wrong about what the Constitution requires. PG&E Corp. argues that the Constitution prohibits

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68 *See, e.g.*, *In re Lifschulz Fast Freight*, 132 F.3d 339, 342 (7th Cir. 1997); *Roth Steel Tube Co. v. Commissioner*, 1985 T.C.M. (CCH) 698 (1985); *Spectra Plastics, Inc. v. Nashoba Bank*, 15 S.W.3d 832, 834 (Tenn. Ct. App. 1999).

any regulation that would force it to spend money without guaranteeing it a reasonable return on that investment. The authority on which PG&E Corp. relies for this assertion, however, pertains to whether the rate a regulated utility is permitted to charge is confiscatory. As PG&E Corp. was at pains to point out in moving to dismiss for lack of jurisdiction, however, it is not a public utility, and has no property dedicated to the public use. It is a holding company. Moreover, the first priority condition is not a rate regulation; it is an order that imposes on the holding company an obligation to its utility subsidiary under certain circumstances. Accordingly, all of the cases on which PG&E Corp. relies—which address the question whether a rate set for a regulated utility is constitutional—are irrelevant.[69]

The question whether a holding company or affiliate can be compelled to infuse needed capital into a regulated subsidiary—or even to guarantee the subsidiary's losses—is a different question, concerning not rate regulation, but the imposition of liability on one business (the holding companies) for costs or needs incurred by another business (the utilities). Courts already have addressed this issue, and determined that there is

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[69] PG&E Corp.'s reliance on *Brooks-Scanlon Co. v. Railroad Comm'n*, 251 U.S. 396 (1920), is particularly misplaced. Not only did that case involve the law of takings as it applies to rate regulation (not applicable here), but it involved a rate regulation that required the utility permanently to operate at a loss. The rule in that case has no applicability to "transitional or temporary periods." *Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 437 (5th Cir. 1999). Although we do not reach any conclusion here regarding whether Respondents have violated the first priority condition, we note that the utilities' recent financial troubles have been occasioned, in part, by a temporary and transitional rate freeze. This is not a case, as some Respondents have argued, where the Commission intentionally set an artificially low rate in order to compel the holding companies to make up the difference.

nothing necessarily unconstitutional about requiring a holding company to infuse needed cash into one of its regulated subsidiaries.

In *Branch v. United States*, 69 F.3d 1571 (Fed. Cir. 1995), the Federal Circuit considered the constitutionality of 12 U.S.C. § 1815(e), which provides that any bank in a bank holding company system is liable for losses caused by the failure of any other bank within the same holding company system. Relying on this statute, the FDIC issued an order requiring Maine National Bank to pay for an approximately $1 billion loss caused by the failure of a sister bank.[70] Maine National sued the FDIC, alleging violations of the Takings Clause of the Fifth Amendment, as well as its right to substantive due process. The Federal Circuit analyzed Maine National's claims under a three part test, looking to: (1) the character of the government action; (2) the economic impact on the claimant; and (3) the extent to which the regulation interfered with reasonable investment-backed expectations.[71]

As to the character of the statute, the *Branch* court found its purpose was to protect private parties from the financial effects of bank failures, and the public interest in a viable bank insurance system.[72] The court found this purpose to be consistent with impositions of liability that the Supreme Court had approved in earlier cases.[73]

As to the economic impact on the claimant, even though it was severe, the court held it was reasonable to place the burden of bank

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70 *Branch,* 69 F.3d at 1574.

71 *Id.* at 1578-79.

72 *Id*. at 1579.

73 *Id.*

failures on sister banks, rather than on unrelated banks or taxpayers in general, for three reasons: (a) it is rational to "impose costs inherent in a certain type of business activity on those who have profited from the fruits of that activity" (*i.e.*, the holding company system); (b) because holding companies, unlike other banks or the public at large, have a measure of control over the success of their subsidiaries, it is rational to impose the costs of failure on them, rather than on the public at large; and (c) the statute reduced the risk that bank holding companies would favor their successful subsidiaries, knowing that the public would be responsible for losses caused by the failure of any of their less successful banks.[74] Regarding investor expectations, the court pointed to the fact that banking is a highly regulated industry, and that "it would have been unreasonable for the owners of Maine National Bank to expect that the bank's assets would never be subject to liability based on losses suffered by other members of the [holding company] system."[75]

All three of these factors indicate that even on the broadest possible reading, the first priority condition would be facially constitutional. Like the cross-guarantee provision at issue in *Branch*, the first priority condition is designed to protect the public interest. Similarly, it is not unreasonable to put the risk of a utility's sudden or unexpected need for capital on its holding company, which has profited in the past from its ownership of the utility, and will profit in the future when the utility is returned to financial health, rather than on ratepayers, which do not earn profits from infusions of capital into the utility. Finally, the

[74] *Id.* at 1580.

[75] *Id.* at 1582.

electric industry, like the banking industry, is heavily regulated. "[W]hen an investment is made in . . . a highly regulated industry, to be reasonable, expectations must be based not only on the then-existing federal regulations but also on the recognition that there may well be related changes in the regulations in the future."[76]

In short, an interpretation of the first priority condition that requires the holding companies to infuse both "equity" and working capital into their utility subsidiaries, at least under certain conditions, is consistent with the Constitution and with reasonable investor expectations.

E. A Broad Interpretation of the First Priority Condition Is Consistent with the Standard of "Ratepayer Indifference"

The holding companies note that in approving their formation, in most cases we adopted a standard of ratepayer indifference. That is, we approved their formation provided that conditions we imposed left ratepayers indifferent to whether the utilities continued to be stand-alone companies, or whether they were reorganized under a holding company structure.[77] On this basis, the holding companies argue the first priority condition cannot be interpreted as requiring them to infuse working capital into their utility subsidiaries. They contend that if the utilities were stand-alone companies, no one could require their myriad individual shareholders to infuse needed working capital. Accordingly, they argue, a requirement that the holding company—the utility's single shareholder

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[76] *American Continental Corp. v. United States*, 22 Cl. Ct. 692, 697 (1991).

[77] *See* Edison Authorization, 27 CPUC2d at 366; SDG&E Authorization 2, 62 CPUC2d at 635; PG&E Authorization 1, 69 CPUC2d at 185; PG&E Authorization 2, 194 P.U.R.4th at 6.

now—make such infusions would afford a positive benefit to ratepayers, thus violating the principle of ratepayer indifference.

This argument ignores a significant change effected by the formation of the holding companies—the transfer to the holding companies of ownership of all the utilities' unregulated subsidiaries.[78] The transfer of ownership of these assets necessarily increased the ability of the holding company to raise and / or borrow money, and necessarily decreased the utility's ability to do the same. This change necessitates action by the holding company to place the utility back in the position it would have been in but for the holding company formation, at least in the case of unforeseen or sudden crises restricting the utility's access to money.

The transfer of ownership also created a sort of moral hazard—a danger that the holding companies would favor their new unregulated subsidiaries at the expense of their utility subsidiaries, knowing that the public always would be available to cover any financial needs of the utilities.[79] The requirement that the holding companies give first priority to all kinds of capital needs of their utility subsidiaries thus was necessary to protect the public interest from these effects of the holding company formation. In other words, the requirement does not affirmatively benefit ratepayers, but is necessary to maintain ratepayer indifference.

In addition, the holding companies' formation created a situation that did not exist before. Where the utility would have generated

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[78] *See, e.g.*, Edison Authorization, 27 CPUC2d at 353 (transfer of ownership in the case of SCE's holding company formation).

[79] *See Branch*, 69 F.3d at 1580.

earnings for itself—and had the option either of paying them out to shareholders, investing in infrastructure or, importantly, investing them in their non-utility subsidiaries—the formation of holding company system and transfer of non-utility subsidiaries to the holding company precluded the utilities from using this final option, and required them to dividend more funds to the parent so *it* could invest in those same subsidiaries, increasing their value to it as owner, rather than their value to the utility.

In other words, formation of the holding company system not only transferred some of the utility's assets to the holding company, but necessarily caused an ongoing drain of utility assets, in the form of earnings, from the utility into the holding company system, leaving the utility with fewer, and the holding company with more, assets upon which to rely in times of need. The requirement that the holding companies infuse capital into the utilities in times of need—"equity," working, or otherwise—thus was necessary to rebalance the scales and make ratepayers indifferent to the continuing asset transfers that formation of the holding company system would require.

F. Whatever Else it Means, the First Priority Condition Prohibits a Holding Company from Transferring to Itself the Assets of a Utility Subsidiary (1) For Less Than Proper Consideration, or (2) For Any Value, If Such Transfer Would Impair the Utility's Ability to Fulfill its Obligation to Serve or Operate in a Prudent and Efficient Manner.

Because, as we find to be the case, the first priority decision must be interpreted expansively, it follows *a fortiori* that a plan such as PG&E Corp.'s implicates the first priority condition. As is clear from the previous discussion, we do not read the first priority condition's use of the term "capital" restrictively as Respondents would have us do.

However, even if we were to accept Respondents' restrictive reading of the first priority condition, a utility's plant and facilities are part of its "capital" and clearly are part of its "capital requirements." The utility cannot function without them, and, indeed, the Public Utilities Code defines "public utility" in part by reference to its plant and facilities.[80] As we discuss at length earlier in this decision, the California Supreme Court has agreed, holding that "capital" is the "money and property with which the company carries on its corporate business."[81] We do not believe any reasonable person could differ with the conclusion that the plant and facilities that would be spun off pursuant to PG&E's proposed Plan and Disclosure Statement are – under even Respondents' restrictive reading of the term "capital" – PG&E's capital assets.

As a matter of fundamental public policy, the acquisition by a holding company parent of the assets of its utility subsidiary for less than adequate consideration would unreasonably deprive that subsidiary of capital and would, *ipso facto*, violate the principle that the holding company parent must give "first priority" to the capital requirements of that subsidiary. Likewise, as a matter of fundamental public policy, the acquisition by a holding company parent of the assets of its utility subsidiary, if that taking would impair the utility's ability to serve, or to operate in a prudent and efficient manner, would unreasonably deprive that subsidiary of capital and would, *ipso facto*, violate the principle that the holding company parent must give "first priority" to the capital requirements of that subsidiary. No reasonable person could find that

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[80] Cal. Pub. Util. Code §§ 216, 218.

[81] *Kohl,* 81 Cal. at 38, citing *Martin,* 38 Cal. at 309.

such acquisitions would be anything other than a clear violation of the obligation of the holding company parent to give first priority to the capital needs of its utility subsidiary.

For example, if the holding company parent acquired assets from its utility subsidiary and paid the subsidiary a total of $2 billion for those assets, but the assets were in fact worth $5 billion, the utility subsidiary could unnecessarily and unreasonably suffer a huge financial loss, or lose the opportunity to realize a significant gain. Such consequences would likely adversely affect the financial viability of the utility and would almost certainly result in an unacceptable diminishment of that utility's ability to serve its customers and to operate in a prudent and efficient manner. However, it is precisely such an unreasonable and unacceptable loss or failure to realize a gain that is threatened by the Plan and Disclosure Statement under review in the PG&E bankruptcy case.

Accordingly, the first priority condition was intended to prohibit a holding company parent from acquiring valuable assets from its utility subsidiary for its own benefit for less than proper consideration, or from transferring assets out of the utility at any price if such transfer would impair the utility's ability to fulfill its obligation to serve, or to operate in a prudent and efficient manner.

As set forth above, the Commission raised certain issues in its Objection to PG&E's Disclosure Statement regarding: (a) the value of the assets PG&E seeks to transfer, (b) the consideration to be received in exchange therefor, and (c) the identities of the transferees. In its present form, the Plan and Disclosure Statement reveals only as follows:

> (a) PG&E's electric transmission assets will be transferred to ETrans (or one or more subsidiaries

> or affiliates of ETrans) in partial consideration of $770 million in cash (subject to adjustment), $380 million in long-term notes and the assumption of certain (unspecified) liabilities;
>
> (b) PG&E's gas transmission and storage assets will be transferred to GTrans (or one or more subsidiaries or affiliates of GTrans) in partial consideration of $390 million in cash (subject to adjustment), $420 million in long-term notes and the assumption of certain (unspecified) liabilities; and
>
> (c) PG&E's generation assets will be transferred to Gen (or one or more subsidiaries or affiliates of Gen) in partial consideration of $200 million in cash (subject to adjustment), $1.9 billion in long-term notes and the assumption of certain (unspecified) liabilities.[82]

Specifically, neither the Plan nor the Disclosure Statement provides enough information to allow either the Commission or a court to analyze the consideration to be paid for such assets. Such an analysis is necessary so that this Commission can make informed decisions about whether such transfers are fair and reasonable and in fact give first priority to PG&E's capital requirements, or, alternatively, whether they reflect sweetheart deals between PG&E and PG&E Corp.

However, without conducting further hearings in this proceeding, we are unable to make specific, conclusive findings of fact regarding whether the asset transfers contemplated in PG&E's proposed reorganization plan would violate the first priority condition. In view of the potentially serious adverse impacts on both PG&E and ratepayers that

[82] See, PG&E's Disclosure Statement on file in the Bankruptcy case, at pages, 71, 75 and 78.

are likely to result in the event that the Plan and Disclosure Statement is adopted, and in view of the expedited time frame on which the PG&E bankruptcy case is moving forward, we will dismiss PG&E Corp. from this proceeding without prejudice so that the issue of whether the adoption of the Plan and Disclosure Statement would result in a violation of the first priority condition can be resolved in the appropriate judicial forums.[83]

IV. Comments on Draft Decision

Pursuant to Pub. Util. Code § 311(g)(3), and Rule 77.7(f)(9), we may reduce the 30-day period for comments on the draft decision due to public necessity. Here, the public necessity provision is implicated by the time pressures imposed by the proceedings in the PG&E bankruptcy case. We believe that it is essential to the public interest that we issue this decision holding that the first priority condition prohibits a holding company's acquisition of the assets of its utility subsidiary for inadequate consideration, or at any price, if such transfer of assets would impair the utility's ability to fulfill its obligation to serve, or to operate in a prudent and efficient manner.

Comments are due by hand delivery and e-mail to the ALJ and the service list by 4 p.m. Pacific Standard Time on January 4, 2002. No reply comments will be accepted.

[83] The Commission notes that PG&E Corp previously moved to be dismissed from this proceeding. This Decision does dismiss PG&E Corp. from this proceeding, although for completely different reasons than those presented in PG&E's moving papers.

Findings of Fact

1. In adopting the first priority condition, the Commission was not merely concerned with ensuring technical compliance with the capital structure requirements of the various utilities' general rate cases.

2. The Commission was concerned in adopting the first priority condition with preventing the utilities from becoming unable to obtain sufficient funds to meet their obligation to serve.

3. The term "first priority" means the highest preferential rating assigning rights to scarce products or materials.

4. The term "requirements" refers to need.

5. The term "capital," where not otherwise limited or qualified, encompasses all of the following: the money and property with which a company carries on its corporate business; a company's assets, regardless of source, utilized for the conduct of the corporate business and for the purpose of deriving gains and profits; and a company's working capital.

6. The term "capital" is not limited in the first priority condition to mean only "equity capital," infrastructure investment, or any other term that does not include, simply, money or working cash.

7. The term "obligation to serve" includes all actions a utility must take to provide utility service to California ratepayers, and is not limited to maintaining infrastructure.

8. In the holding company authorization decisions, the Commission did not define the term "capital requirements" as used in the first priority condition. However, the Commission discussed the first priority condition in broad terms of utility needs and financial strength, and holding company responsibility and financial support to the utilities.

9. Nowhere in the record of the holding company proceedings does any party define the term "capital requirements." Nowhere in the record of the respective holding company proceedings does any party explicitly limit the term "capital requirements" to mean only the funds necessary to maintain or improve utility plant and equipment.

10. In the holding company authorization decisions, the Commission imposed a separate condition that states, as set forth in the SDG&E decision: "SDG&E shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in its most recent decision on SDG&E's capital structure. "

11. In the 1985 SDG&E holding company proceeding, ORA expressed its concern that the holding company structure would adversely affect the utility's capital structure and the utility's ability to provide adequate services.

12. In addressing ORA's concerns, SDG&E proposed the first priority condition. SDG&E witnesses testified regarding the priority of the utility's financial health and obligation to serve and that the utility's capital demands would be given first priority.

13. The decision in the Edison holding company proceeding states that the first priority condition adopted therein originated in the SDG&E decision and was identical to it.

14. Edison testified in its holding company proceeding that the utility's need for capital takes first priority and that the holding company would infuse capital into the utility.

15. In the PG&E holding company proceedings, PG&E witnesses testified that the utility's financial integrity and ability to satisfy its

obligation to serve would be preserved and the holding company would provide a financially distressed utility with a source of cash.

16. The first priority condition, requiring the holding companies to infuse all types of capital into their utility subsidiaries under certain conditions, was necessary to protect the public interest and maintain ratepayer indifference. This necessity was due, in part, to the transfer of utility assets to the holding companies when they were formed.

17. On September 20, 2001, PG&E filed its proposed *Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company* (the "Plan") together with its Disclosure Statement in In re Pacific Gas & Electric Company, Case No. 01-30923 DM, United States Bankruptcy Court, N.D. Cal.

18. PG&E and its parent, PG&E Corp, were both proponents of the Plan and Disclosure Statement submitted to the Bankruptcy Court on September 20, 2001.

19. On November 27, 2001, the Commission timely filed and served its Objection to PG&E's Disclosure Statement. We take official notice of PG&E's Plan and Disclosure Statement and of the Commission's Objection to PG&E's Disclosure Statement.

20. The Disclosure Statement fails to provide enough information to allow the Commission to analyze the consideration to be paid for such assets.

21. Implementation of the proposed Plan and Disclosure Statement in the on-going PG&E bankruptcy proceeding could unfairly benefit PG&E Corp., to the detriment of its utility subsidiary, PG&E.

22. Implementation of the proposed Plan and Disclosure Statement in the on-going PG&E bankruptcy proceeding could result in an

unacceptable diminishment of the ability of PG&E to serve its customers and to operate in a prudent and efficient manner.

Conclusions of Law

1. The Commission is the arbiter of the meaning of its own decisions.

2. In the context of Respondents' holding company decisions, when a utility's financial health is impaired and its ability to discharge its obligation to serve is consequently threatened, the first priority condition requires its holding company to give the utility preference over all competing potential recipients of capital resources.

3. The holding company authorization decisions' discussion of the first priority condition in broad terms of utility financial health supports a reading of the condition as requiring the holding company to infuse the utility with all types of capital necessary for the utility to fulfill its obligation to serve.

4. The "balanced capital structure" condition in each holding company decision requires the utility to maintain its own balanced capital structure pursuant to the ratio set by the Commission in the respective general rate cases.

5. According to SDG&E's interpretation—*i.e.*, that the first priority condition only requires the utility to retain earnings to maintain a balanced capital structure and meet its obligation to serve, and does not require an affirmative holding company obligation to infuse funds into the utility—the first priority condition would impose the same requirement as the balanced capital structure condition and make the first priority condition superfluous. Because the decision cannot be read as making one of the conditions superfluous, the first priority condition must impose a different

requirement, namely that the holding company must infuse capital into the utility when needed to meet its obligation to serve.

6. The Commission need not refer to the record of the holding company proceedings to determine the meaning of the first priority condition. Even so, the parties' testimony and briefs in those proceedings do not conflict with a broad reading of the condition.

7. In light of the overall concern expressed in the record that the holding company structure not adversely affect the utility's financial health and ability to meet its obligation to serve, references in the record to "capital investment" and "equity" must be read broadly.

8. The implementation of any scheme, whether under a bankruptcy reorganization plan or otherwise, pursuant to which a holding company would unduly benefit, to the detriment of its utility subsidiary and that utility's ratepayers, would be contrary to any reading of the first priority condition.

9. The first priority condition prohibits a holding company from acquiring the assets of a utility subsidiary for inadequate consideration.

10. The first priority condition prohibits a holding company from acquiring the assets from a utility subsidiary at any price, if such transfer of assets would impair the utility's ability to fulfill its obligation to serve or to operate in a prudent and efficient manner.

INTERIM ORDER

IT IS ORDERED that:

1. The first priority condition does not preclude the requirement that the holding companies infuse all types of "capital" into their respective utility subsidiaries where necessary to fulfill the utility's obligation to serve.

2. The first priority condition prohibits a holding company from (1) acquiring assets of its utility subsidiary for inadequate consideration, and (2) acquiring assets of its utility subsidiary at any price, if such acquisition would impair the utility's ability to fulfill its obligation to serve or to operate in a prudent and efficient manner.

3. PG&E Corp. is dismissed without prejudice as a respondent to these proceedings.

This order is effective today.

Dated ____________________________, at San Francisco, California.