

Decision **DRAFT DECISION OF ALJ BUSHEY** (Mailed 7/26/2005)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Riley Property Holdings LLC, Riley Mezzanine Corp., CB Riley Investor LLC, Cerberus Partners, L.P., Cerberus Associates, L.L.C., LNR Property Corporation, and Valencia Water Company (U342-W) for authorization of Riley Property Holdings LLC, Riley Mezzanine Corp., CB Riley Investor LLC, Cerberus Partners, L.P., and Cerberus Associates, L.L.C. to acquire indirect control over Valencia Water Company.

Application 04-12-016
(Filed December 16, 2004)

OPINION CONDITIONALLY APPROVING APPLICATION

Summary

In this decision we conditionally approve the transfer of 50% indirect control of Valencia Water Company (Valencia) from LNR Property Corporation (LNR) to Riley Mezzanine I Corporation (Riley I).

Background

In Decision (D.) 04-01-051, the Commission approved the transfer of indirect control of Valencia from Newhall Land and Farming Company to Lennar Corporation and LNR. The Commission imposed a series of conditions on its approval of the transaction which required, among other things, that Valencia ratepayers be insulated from any financial effects of the transaction and that Valencia maintain its high standard of customer service and community involvement.

LNR, and its indirect 50% ownership of Valencia, is the subject of the instant application.¹ On December 16, 2004, LNR Property Holdings Ltd. f/k/a Riley Property Holdings, LLC, Riley Mezzanine Corp., CB Riley Investor L.L.C., Cerberus Partners, L.P., Cerberus Associates LLC, LNR, and Valencia filed this application seeking Commission authorization for Riley Mezzanine Corporation to acquire LNR. The other entities are upstream owners of Riley Mezzanine Corporation.

Protests to the application were filed by Public Citizen, Water for All (Public Citizen), The Friends of the Santa Clara River (Friends), and the Angeles Chapter of the Sierra Club (Sierra Club). Public Citizen stated that it is a national consumer rights organization and requested that the Commission hold evidentiary hearings on how the proposed merger would benefit Valencia's ratepayers. Public Citizen also stated that Valencia has a "poor track record of weak public accountability and environmental mismanagement."

Friends urged "a careful review of all aspects of this matter" by the Commission, particularly whether Valencia was in compliance with the D.04-01-051 conditions. Friends stated their belief that Valencia is not complying with condition 8, which requires that Valencia maintain or improve practices and policies for addressing the ammonium perchlorate pollution problem. Friends also expressed concern that preferential treatment for new service extensions may be granted to real estate development projects owned by the parent companies. The Sierra Club echoed these concerns, as well as noting concerns with out-of-state ownership.

¹ Lennar's indirect interest in Valencia is not affected by this transaction, and Lennar will continue to be subject to the conditions in D.04-01-051.

The applicants replied to the protests. They contended that the protests failed to raise any substantive issues regarding Riley Mezzanine's acquisition of LNR and indirect control of Valencia.

On February 17, 2005, the Assigned Commissioner and Administrative Law Judge issued a ruling requiring the protestants and applicants to submit additional information. The ruling's questions are reproduced in italic below, followed by the response.

Questions to Protestants

1. *Please articulate any specific effect on ratepayers from the proposed transaction, and describe proposed evidence that will demonstrate this effect. Specifically identify any disputed issues of material fact that require evidentiary hearings.*

Public Citizen responded that the acquisition of California-American Water Company by RWE/Thames Water resulted in substantial rate increases for some customers, and that the benefits of the acquisition had not been passed on to ratepayers. Public Citizen also stated that Valencia "is not moving towards environmentally responsible water management practices." Public Citizen contended that the proposed acquisition by a "highly speculative, investor-driven land development company" would undermine stability and accountability at Valencia.

Friends and the Sierra Club responded jointly that two disputed issues of material fact require evidentiary hearings: (1) the possibility that a change of control had occurred prior to Commission approval, and (2) the possibility that the proposed change of control would impact ratepayers. Friends and Sierra Club stated that copies of operating agreements between the applicants would be essential to resolve these issues.

2. *Please state any new conditions required by the unique facts of this proposed transaction.*

Public Citizen stated that conditions should be imposed requiring applicants to disclose the identity of all investors, improve conservation and reclamation practices, and document that the development of the Newhall Ranch project will not adversely impact ratepayers. Friends and the Sierra Club stated that it was not possible to propose new conditions until the operating agreements are released.

Questions to Applicants

1. *Page 2 of the application states that NWHL Investment LLC “was merged” with LandSource Communities Development LLC (LandSource) effective November 30, 2004. Please state whether Pub. Util. Code § 854 applied to this transaction and, if so, whether applicants complied with it.*

Applicants responded that no change of control in NWHL Investment, or Valencia, occurred because LandSource was merged into NWHL Investment. NWHL was the surviving corporate entity, which remained under the ownership of Lennar and LNR. Similarly, no change of control occurred when NWHL Investment changed its name to LandSource.

2. *Please explain how the interim agreement under which LNR relinquishes to Lennar its 50% indirect control over Valencia will not compromise compliance with the conditions set out in D.04-01-051.*

Applicants stated that pursuant to the interim agreement, LNR transferred its voting authority over LandSource (and thus, Valencia) to Lennar, the other Commission-approved indirect owner of Valencia. Accordingly, indirect control of Valencia is and has remained at all times with the entities approved by the

Commission. Applicants stated that they remain committed to full and complete compliance with the conditions set in D.04-01-051.

On May 10, 2005, the applicants filed an amendment to the application that changed the intermediate entities in the post-transaction line of control. Ultimate ownership and control will remain in Cerberus, but seven new or reorganized partnerships or corporations will replace three of the original intermediate entities. The specific changes are set out in Attachment A to today's decision. A Cayman Islands limited partnership and a Bermuda exempted company are among the new intermediate entities.

The original and additional applicants all agreed to comply fully with the conditions imposed by the Commission in approving the Lennar transaction in D.04-01-051.

On June 9, 2005, Sierra Club protested the amendment and stated that it wanted to "ensure that community water resource needs will remain important to a corporation that headquartered in Miami, Florida, incorporated in Delaware, registered off-shore and is now 75% owned by a company registered in the Cayman Islands." Sierra Club also reiterated issues raised in its first protest.

Friends also protested the amendment and raised a similar concern about entities registered off-shore having no incentive to "ensure a sustainable water supply for current and future ratepayers." The Santa Clarita Organization for Planning and the Environment also protested the amendment and incorporated all of the Sierra Club's arguments without raising any new issues.

On June 23, 2005, replying to the new protests, the applicants stated that the substitution of different transactional intermediaries will have no practical effect on Valencia's provision of water service.

Description of the Proposed Transfer of Control

Valencia is a Commission-regulated Class A water company and is a wholly owned subsidiary of the Newhall Land and Farming Company (Newhall). Valencia provides service in the Santa Clarita Valley area of Los Angeles County.

Newhall is a California limited partnership with its principal place of business in Valencia, California. Newhall owns substantial agricultural property in Madera and Ventura counties, but its primary activity is real estate development. Newhall founded Valencia to provide water service in certain of its developments.

LandSource is a joint venture between LNR and Lennar, with each owning, directly or indirectly, a 50% interest in Newhall and, thus, Valencia. LNR and Lennar are in the business of real estate investment and management, and are more fully described in D.04-01-051.²

Cerberus is a Delaware limited partnership with its principal place of business in New York, New York. It is a global private investment firm that, through its affiliates, manages more than \$14 billion in capital. At the conclusion of the proposed transfer of control, Cerberus, through corporate intermediaries, the Miller³ Family trusts and partnerships, and interests owned by LNR

² To enable Cerberus to complete its acquisition of LNR prior to Commission approval of the change of control in Valencia, LNR temporarily transferred its indirect 50% control of Valencia to Lennar, the Commission-approved owner of the other 50%. This is the interim agreement discussed above (Question 2 to applicants). With today's approval of the Riley/LNR transaction, the 50% control reverts to Riley.

³ Prior to the consummation of the transaction, Stuart Miller was the Chairman of LNR's Board of Directors, and personally and through family owned entities, owned

Footnote continued on next page

executives will indirectly own LNR, the indirect owner of 50% of Valencia. Applicants state that the overall transaction is valued at approximately \$4.2 billion. The proposed lines of ownership and control are set out in Attachment B to today's decision.

Standard of Review for this Acquisition

Commission authorization pursuant to §§ 851 and 854⁴ is necessary in order for the applicants to assume indirect control of Valencia. The Commission has previously determined that such approval will only be granted where the proposed transfer of control is in the public interest. The Commission may use the standards set out in § 854(b) and (c) to “inform” its public interest determination. (Decision (D.) 02-12-068, *mimeo.* at 9.) Due to the nature of the proposed transfer, which is an indirect change of control several corporate ownership steps removed from the utility holding company, where the holding company has little, if any, day-to-day involvement with the public utility, the primary focus of our evaluation will be the transfer's effects on ratepayers.

Applicability of § 854 to the LandSource and Interim Agreements

We will first address the applicability of § 854 to the LandSource and interim agreements. Pursuant to § 854, Commission authorization is required for any entity to “control either directly or indirectly any public utility.” As further explained by the applicants, the merger of LandSource into NWHL Investment and subsequent name change did not effect a change of control because NWHL

sufficient interests in LNR and Lennar to give him effective voting control of both companies.

⁴ All citations are to the Public Utilities Code unless otherwise indicated.

Investments, albeit with a new name, retained its indirect control over Valencia. Similarly, no change of control occurred when the interim agreement temporarily transferred control of LNR's interest in Valencia to Lennar. In D.04-01-051, the Commission granted LNR and Lennar such authority, and did not restrict the ownership ratios. Accordingly, Lennar is authorized to control Valencia as required by § 854. We conclude, based on these unique facts, that § 854 did not apply to the interim agreement.

Proposed Conditions of Approval

The applicants have repeatedly stated that they are in full compliance with the conditions adopted by the Commission in D.04-01-051, and that the new owners of LNR intend to continue such compliance.

The conditions require, among other things, that the transaction will have no effect on the Commission's authority over Valencia. Valencia is required to continue to offer its customers high quality public utility water service, and to maintain its high level of community involvement.

Significant restrictions are imposed on all transactions between Valencia and the corporate affiliates. Financial transactions are particularly limited, and annual reports are required. Ratemaking requirements are also imposed, with all costs of the acquisition excluded from Valencia's rate base. The conditions are in Attachment C to today's decision.

Issue Raised by Protestants

Protestants primarily focused on the role that the Cerberus companies might have in decision-making at Valencia, but were unable to articulate any specific effect on ratepayers from the proposed transfer.

Public Citizen challenged Valencia's water management practices. The Commission, however, reviews and approves each Class A water utility's Water

Management Plan as part of the utility's general rate cases. Accordingly, the Commission's authority over Valencia's water management practices will be unchanged by the transfer. Similarly, the Commission will continue to oversee Valencia's efforts to address the perchlorate pollution problem.

Public Citizen also argued that acquisition by a land development company would undermine stability and accountability for Valencia. Land development companies, however, have always owned Valencia. Newhall, a land development company, created Valencia, and in D.04-01-051, the Commission approved the acquisition of Newhall by two other, larger land development entities, Lennar and LNR. No specific untoward effect on ratepayers has been attributed to this type of ownership.

Friends and Sierra Club focused on the operating arrangements between the ownership interests. Our standards, however, require that we review effects on ratepayers. The applicants stated that day-to-day operations at Valencia would not be affected by the transaction, and that the current Newhall and Valencia management teams will remain in place. Applicants contend that ratepayers would not be affected by the transaction.

Regardless of the operating arrangements among the upstream owners of Valencia, the Commission retains complete authority over Valencia's public utility operations, including its rates, as well as substantial power to "do all things . . . which are necessary and convenient in the exercise of [its] jurisdiction." (*See* § 701.) Thus, while the owners may have agreements in place, the Commission has final authority over any public utility effects in California.

In addition, our conditions of approval require Valencia to (1) maintain and store its books and records in California, (2) maintain offices in its service territory, and (3) retain Valencia's high level of customer service and community

involvement. These conditions apply to Valencia regardless of the country of registration of any upstream, indirect, partial owners. The applicants have represented that the entities in the ownership chain with registrations outside the United States have taken all reasonable steps to ensure that they are and will remain in full compliance with all Federal law and regulations applicable to such entities doing business and owning property in the United States.

We are satisfied that the conditions imposed on Valencia are sufficient to protect Valencia's ratepayers.

Evaluation of Public Interest

To determine whether this proposed transfer is in the public interest, we look primarily to its effect on ratepayers. LNR, a real estate firm, currently indirectly owns a 50% interest in Valencia. After the transaction, Cerberus, the current major LNR shareholder, and certain LNR executives will indirectly own a 50% interest in Valencia. In short, Valencia will change from being owned by two real estate development firms, Lennar and LNR, to being owned by Lennar and a large investment firm, Cerberus, and a current LNR investor and executives. As noted above, we have previously found that Newhall has little day-to-day involvement with Valencia.

The protestants have not demonstrated any specific impact on ratepayers of the transaction. Virtually all of the Conditions are designed to ensure that ratepayers are fully insulated from any effects of the transaction. Conditions 12, 13, 14, and 15 impose strong ratemaking prohibitions on LNR and Cerberus costs being included in Valencia's revenue requirement. Condition 6 requires that Valencia maintain its high quality customer service and community involvement, and Condition 7 prohibits closing local offices.

Based on the Conditions, and Newhall's limited role in Valencia's operations, we conclude that ratepayers will not be materially affected by this transfer. Valencia will remain a stand-alone public utility water company, with all services being provided by its own personnel and departments. In contrast to some merger acquisitions, these applicants do not plan for operational consolidations to achieve cost reductions, and Valencia is a modest component of LNR's assets.⁵

Our inquiry into this transfer, however, does not end with ratepayers. We look also to whether it will adversely affect employees or the state and local economies. Condition 5 prohibits any adverse changes to Valencia's employee policies, and Condition 11 requires that all collective bargaining agreements be honored. These requirements are sufficient to ensure that employees will not be adversely affected.

Turning to state and local economies, we are aware of the role that mergers and acquisitions play in enabling businesses to grow and prosper. While we have no desire to impede business development, our duty to public utility customers requires that we balance the need to protect these customers with the overall objective of enhancing economic development. We are satisfied that the conditions we impose in today's decision strike that the balance.

Therefore, we find that the proposed change of indirect control of Valencia, as conditioned by this decision, is in the public interest.

⁵ Valencia's net revenues of \$2.6 million are 2.3% of LNR's \$110 million 2003 net revenues.

Need for Hearing

As there are no disputed issues of material fact to resolve in evidentiary hearings, we determine that a hearing is not needed and that, pursuant to Rule 6.6 of the Commission's Rules of Practice and Procedure, Article 2.5 of the

Rules ceases to apply to this proceeding. *Ex parte* contacts, however, will continue to be covered by Rule 7(c).

California Environmental Quality Act

It can be seen with certainty that no significant effect on the environment could result from our granting the requested authorization. Thus, the requested transfer of control is a “project” that qualifies for an exemption from CEQA pursuant to § 15061(b)(3) of the CEQA guidelines.

Comments on Draft Decision

The draft decision in this matter was mailed to the parties in accordance with § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Applicants filed comments suggesting minor technical corrections, which have been incorporated.

Assignment of Proceeding

Susan Kennedy is the Assigned Commissioner, and Maribeth A. Bushey is the assigned ALJ in this proceeding.

Findings of Fact

1. Under the proposed transaction, the Cerberus firms, Miller family, and LNR investors will obtain indirect ownership and control of 50% of Newhall, the owner of Valencia.
2. After the transfer is completed, Valencia will continue to be the operating public utility providing water utility service under the Commission’s jurisdiction in the areas where it is authorized to do so.
3. All applicants agreed to continue to abide by the conditions imposed on Lennar and LNR in D.04-01-051.

4. The Conditions set out in Attachment C are appropriate to ensure that Valencia continues to serve its customers in compliance with California law and Commission policy.

5. Valencia's ratepayers will not be materially affected by the transfer.

6. Having Valencia's representatives available locally is an important aspect of customer service.

7. With the conditions we impose, this transfer will not adversely affect Valencia's service quality, and will be fair and reasonable to Valencia's employees.

8. The Commission will have access to Valencia and its affiliated companies' books and records as necessary in the Commission's judgment to facilitate the Commission's obligation to regulate.

9. Evidentiary hearings are not necessary.

Conclusions of Law

1. Pursuant to § 854, the Commission has broad authority to approve or deny applications for transfers of utility ownership or control. Implicit in this authority is the right to place reasonable conditions upon the transferor or transferee, should the need for conditions arise. The right to impose these conditions carries with it the right to enforce the conditions at the Commission in Commission proceedings.

2. Pursuant to § 854, the Commission must determine whether the proposed transaction is in the public interest, and the Commission may use the standards set out in § 854(b) and (c) to inform its public interest determination.

3. The Commission has complete authority over any and all Valencia service territory expansions.

4. Conditions 17 and 18 prohibit any favoritism by Valencia to its affiliated land development companies.

5. The Commission has sufficient authority over Valencia's rates and operations to ensure that the out-of-state owners of Newhall cause no untoward effects on ratepayers.

6. The Commission has broad authority to inspect Valencia's books and records, and the Conditions imposed in this decision implements that authority.

7. The Conditions balance ratepayer protections and economic development.

8. Valencia is not entitled to recover either the acquisition premium or any transaction-related costs in current or future rates.

9. The requested acquisition and transfer of control is a "project" that qualifies for an exemption from CEQA pursuant to § 15061(b)(3) of the CEQA guidelines.

10. As conditioned by this decision, the transfer is in the public interest.

11. The transfer should be approved subject to the conditions set out in Attachment C to this decision.

12. In order to provide certainty to the parties in their business dealings, this decision should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The application of LNR Property Holdings, Ltd., (a Bermuda exempted company), Riley Holdco Corp., Riley Mezzanine I Corp., Riley Mezzanine II Corp., Riley Mezzanine III Corp., CB Riley Investor L.P. (a Cayman Islands exempted limited partnership), CB Riley Investor GP LLC, Cerberus Partners, L.P., Cerberus Associates, L.L.C., LNR Property Corporation, and Valencia Water

Company is granted subject to the conditions set forth in Attachment C to this decision.

2. Application 04-12-016 is closed.

This order is effective today.

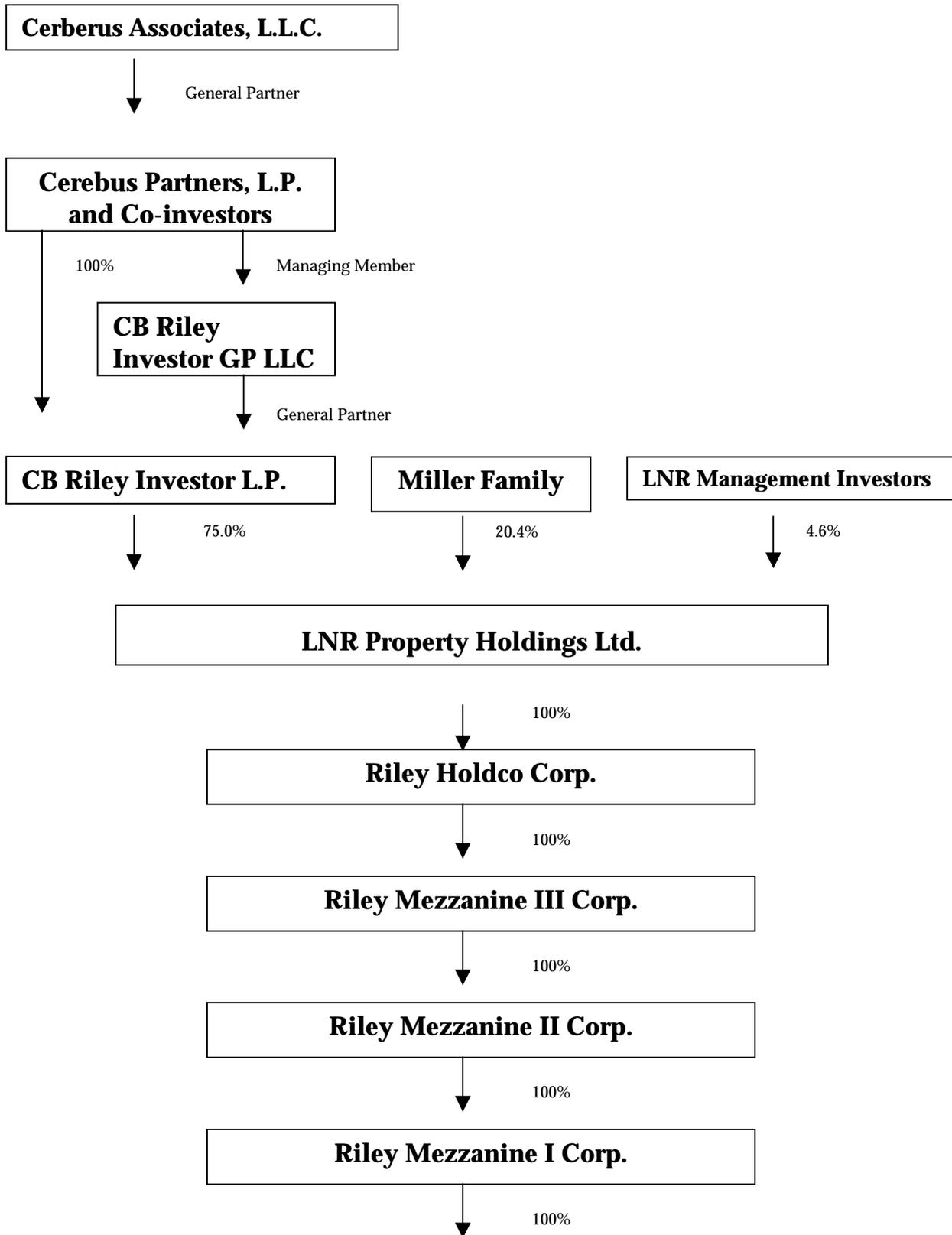
Dated _____, at San Francisco, California.

ATTACHMENT A

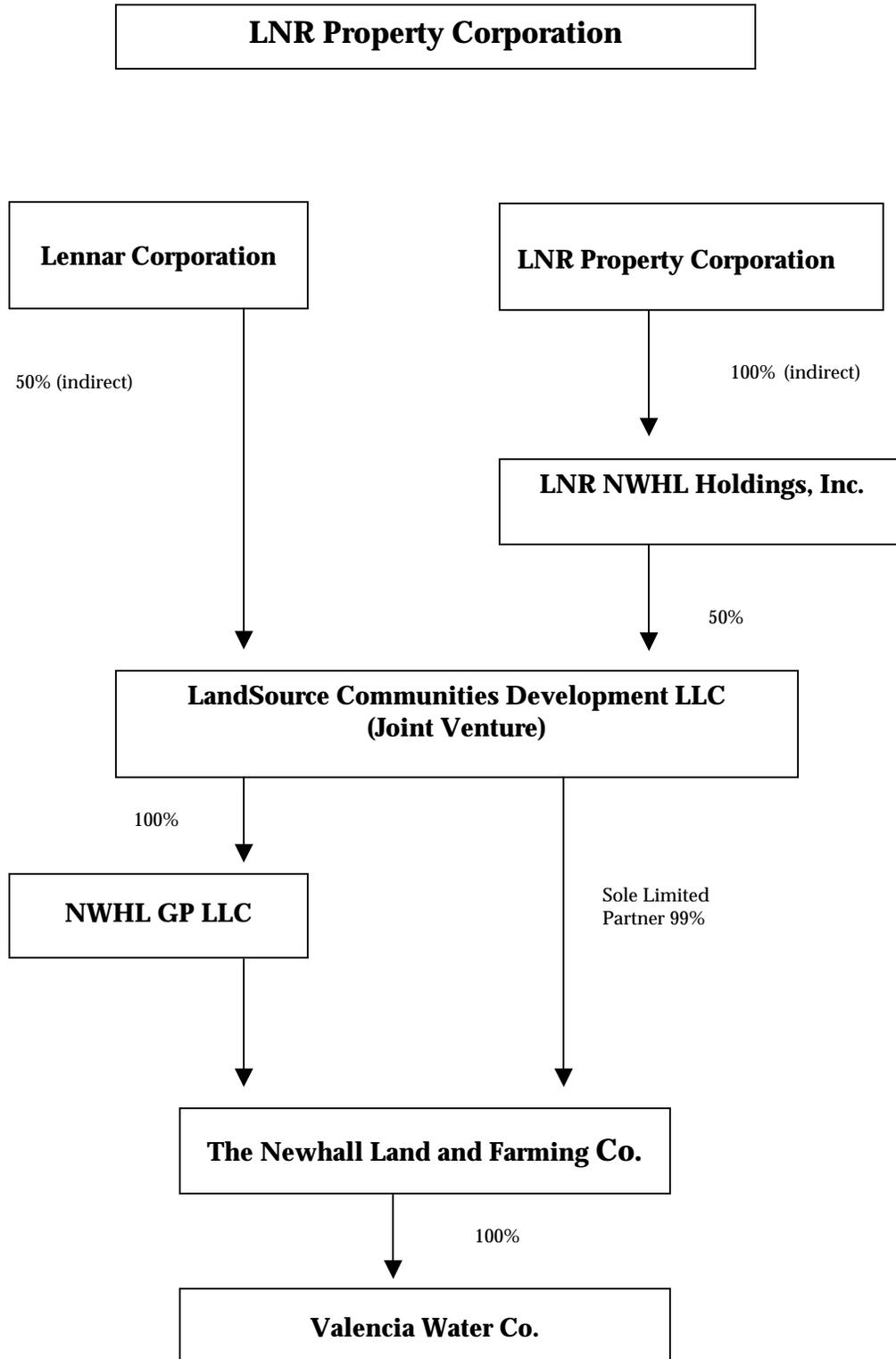
- Riley Property Holdings LLC, an applicant in this proceeding, has been continued as LNR Property Holdings Ltd., a Bermuda exempted company (LNR Holdings). This is the same entity, but it has been reincorporated in a different jurisdiction under the applicable conversion statutes in the relevant jurisdictions.
- Riley Mezzanine Corp., another applicant in this proceeding, has been dissolved. Its intermediate position in the line of ownership and control over LNR and Valencia has been assumed by four newly created entities: Riley Mezzanine I Corp., a Delaware corporation, which is wholly owned by Riley Mezzanine II Corp., a Delaware corporation, which in turn is wholly owned by Riley Mezzanine III Corp., a Delaware corporation, which in turn is wholly owned by Riley Holdco Corp., a Delaware corporation (Riley Holdco). Riley Holdco is wholly owned by LNR Holdings.
- CB Riley Investor LLC, an applicant in this proceeding, has been converted into CB Riley Investor L.P., a Cayman Islands exempted limited partnership, the sole general partner in which is CB Riley Investor GP LLC, a Delaware limited liability company. Cerberus is the managing member of CB Riley Investor GP LLC, just as it previously was the managing member of CB Riley Investor LLC.

(END OF ATTACHMENT A)

POST-TRANSFER LINES OF OWNERSHIP AND CONTROL



POST-TRANSFER LINES OF OWNERSHIP AND CONTROL



**POST-TRANSFER LINES OF
OWNERSHIP AND CONTROL**

(END OF ATTACHMENT B)

ATTACHMENT C
Conditions of Approval of Transfer of Control

1. The transfer of control shall have no effect on the Commission's authority over Valencia's provision of public utility service to the public.
2. Valencia shall comply with all applicable California and federal laws and administrative regulations.
3. All owners, direct and indirect, of Newhall shall ensure that Valencia has adequate capital to fulfill all of its public utility service obligations. The term "capital" encompasses "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," and is not limited to mean only "equity capital, infrastructure investment, or any other term that does not include, simply, money or working cash." Decision 02-01-039, Findings of Fact 5 and 6, 2002 Cal. PUC LEXIS 5 *57.
4. Valencia shall continue to maintain its books and records in accordance with all Commission rules. Valencia's books and records shall be maintained and housed in California.
5. The transfer of control may not adversely affect Valencia policies with respect to service to customers, employees, operations, financing, accounting, capitalization, rates, depreciation, maintenance, or other matters relating to the public interest or utility operations.
6. There shall be no adverse impact on customer service as a result of the transaction. Newhall and its owners shall maintain Valencia's commitment to high quality public utility water service and community involvement.

7. Valencia shall maintain its business headquarters in California together with fully operational local offices as appropriate to maintain the high quality of customer service and community involvement. Valencia shall not close any of its offices as a result of this transaction.

8. Valencia shall maintain or improve its practices and policies for addressing the ammonium perchlorate pollution plume in Valencia's groundwater source.

9. The transfer of control shall not result in changes to the existing management and officers of Valencia.

10. Operational control of Valencia shall continue to be exercised by Valencia's board of directors and management.

11. There shall be no changes in any existing union agreement as a result of the transaction. All collective bargaining agreements will be honored.

12. No additional layer of management overhead may be allocated to Valencia as a result of the transaction. Newhall and its upstream owners' costs may not be included in Valencia's revenue requirement absent a compelling demonstration of benefit to Valencia and its customers.

13. None of the outstanding debt, owed and recorded as liabilities on the regulated books of Valencia, may be adversely affected by the transfer of control. There shall be no changes in the income statement, balance sheet or financial position of Valencia used for ratemaking purposes as a result of the transfer of control.

14. The ratepayers of Valencia shall not incur, directly or indirectly, any transaction costs or other liabilities or obligations arising from the transfer of control. Valencia shall not incur any additional indebtedness, issue any additional securities, or pledge any assets to finance any part of the purchase price paid by the new owners.

15. The premium paid, as well as all transaction-related costs, including external advisors, early termination costs, change in control payments, or retention bonuses paid to Valencia employees as a result of the transfer of control, shall not be “pushed down” to Valencia or otherwise reflected in Valencia’s accounting records used for ratemaking purposes, and there shall be no attempt to recover such costs in any future rate proceeding.

16. Cerberus and its affiliates shall take no actions that would impair Valencia’s ability to fulfill its public utility obligation to serve or to operate in a prudent and efficient manner.

17. Valencia may not grant preferences to an affiliated firm’s real estate development when evaluating whether Valencia can or will extend water service to the development.

18. Valencia shall comply with the Affiliated Interest Transaction Rules set out on pages 4, 5 and 6.

AFFILIATED INTEREST TRANSACTION RULES

These Affiliated Interest Transaction Rules set forth the practices to be observed by Valencia Water Company (Valencia).

Definitions:

Affiliated company or companies: all entities that are under direct or indirect common ownership or control with Valencia, including any holding companies.

Cost: all fully allocated capital and expense amounts including all management, administration, overhead, and indirect allocations.

Property: any right or thing to which an entity has legal or equitable title.

Real Property: any interest in real estate including leases, easements, and water rights.

1. *Access to Officers and Employees.* The officers and employees of Valencia and its affiliated companies shall be available to appear and testify in any proceeding before the Commission involving Valencia. If in the proper exercise of Commission staff's duties, Valencia cannot supply appropriate personnel to address staff's reasonable concerns, then the appropriate staff of the relevant Valencia affiliated companies shall be made available to staff.
2. *Access To Books and Records.* Valencia and its affiliated companies will provide the Commission, its staff, and its agents with access to the relevant books and records of such entities in connection with the exercise by the Commission of its regulatory responsibilities.
3. *Annual Report.* Valencia shall file with the Commission each year, and include in all general rate case filings, a report that includes a summary of all transactions between Valencia and its affiliated companies for the previous calendar year. Valencia shall maintain such information on a monthly basis and make such information available to the Commission's staff upon request. To the extent not covered by an existing affiliated transaction agreement, the summary shall include a complete description of each transaction and an accounting of all costs associated with each transaction although each transaction need not be separately identified where multiple transactions occur in the same account. These transactions shall include (a) services provided by Valencia to any affiliated company; (b) services provided by any affiliated company to Valencia; (c) assets transferred from Valencia to any affiliated company; (d) assets transferred from any affiliated company, to Valencia; (e) employees transferred from Valencia to any affiliated company; (f) employees transferred from any affiliated company to Valencia; and (g) financing arrangements and transactions between Valencia and any affiliated company.
4. *Issuance of Debt for Affiliated Companies.* Debt of Valencia's affiliated companies shall not be issued or guaranteed by Valencia without prior approval by the Commission.
5. *Accounting.* Valencia shall maintain its accounting records in accordance with Generally Accepted Accounting Principles and, where appropriate, the Commission's Uniform System of Accounts.
6. *Allocation of Common Costs.* Valencia and each of its affiliated companies shall allocate costs between them in such a manner that ratepayers of Valencia will not subsidize any affiliate of Valencia. Valencia shall include and explain its methodology in its general rate case filings.
7. *Unregulated Operations and Transfer of Employees.*

a. Valencia shall not use its employees or officers to provide unregulated services if such use would adversely affect Valencia or its ratepayers.

b. To the extent Valencia chooses to use its employees or officers to provide unregulated services, Valencia shall carefully account for all such employee and officer time. In each general rate case application, Valencia shall submit a report showing all such employee and officer time on an annual basis for each year since the last general rate case.

c. Valencia shall not use its property to sell unregulated goods if such use would adversely affect Valencia or its ratepayers.

d. To the extent Valencia chooses to use its property to sell unregulated goods, Valencia shall carefully account for all such property use and tabulate the fully allocated cost. In each general rate case application, Valencia shall submit a report showing all such use on an annual basis for each year since the last general rate case.

8. *Transfer Of Property Other Than Real Property From Valencia.* All transfers of property other than real property or payment of dividends from Valencia to any affiliated company shall be in writing and priced at the higher of cost or fair market value. Valencia shall record any revenue resulting from the transfer of any such property in a memorandum account for further disposition by the Commission.

9. Valencia shall develop a verifiable and independent appraisal of fair market value for any property that is transferred to any affiliate under Paragraph 8 above. The Commission's staff will have access to all supporting documents used in the development of the fair market value.

10. *Transfers Of Property Other than Real Property to Valencia.* All transfers of any property other than real property to Valencia from any affiliated company shall be in writing and priced at the lower of cost or fair market value. Valencia shall obtain and retain sufficient cost data from the affiliate to support the price charged. Valencia shall obtain explicit Commission authorization prior to including the costs or expenses of any such property in its revenue requirement or rate base.

11. *Pricing Of Services From Valencia To Affiliated Companies.* All services provided by Valencia to an affiliated company shall either be pursuant to a Commission-approved tariff or be in writing and priced to recover all costs associated with such service that have been included in Valencia's revenue requirement for its last general rate case.

12. *Pricing Of Services From Affiliated Companies To Valencia.* Except for common costs allocated in the manner described in Paragraph 6, all services provided by an affiliate to Valencia shall be pursuant to a written services agreement. All services provided by the affiliate shall be priced at the lower of the affiliate's incremental cost to provide the service or the fair market value of the service. Copies of all such service agreements shall be included in all general rate case filings and shall also include a full accounting of all services forecasted for the test year including the affiliated company's cost analysis and supporting documentation.

13. *Transfers of Real Property from Valencia to an Affiliate.* Valencia shall not transfer to an affiliate any real property necessary or useful in its provision of public utility service to the public. Valencia shall obtain Commission authorization prior to transferring to an affiliate any real property that was at any time included in Valencia's rate base.

14. *Transfers of Real Property from an Affiliate to Valencia.* Valencia shall not include in its rate base or revenue requirement the costs or expenses associated with any real property obtained from an affiliate, except for fees and costs paid to third parties incidental to obtaining and recording title to real property, absent a Commission decision specifically approving the acquisition and adopting specific ratemaking treatment.

15. *Confidentiality.* Any records or other information of a confidential nature furnished to the Commission pursuant to these Rules that are individually marked confidential are not to be treated as public records and shall be treated in accordance with Public Utilities Code section 583 and the Commission's General Order 66-C.

16. *Physical Separation of Valencia from Affiliated Companies.* To the greatest extent feasible, Valencia shall maintain its offices, facilities, and employees in locations physically separate from affiliated companies. Where such separation is not feasible, Valencia shall create and implement stringent management and accounting policies to ensure that Valencia's public utility functions are not affected by the proximity of the affiliates, and that all affiliate costs are paid by the affiliate.

(END OF ATTACHMENT C)