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Decision 02-07-043 July 17, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation Whether Pacific Gas and Electric Company, Southern California SCE 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.	I.01-04-002 (Filed April 3, 2001)
In the Matter of the Application of Southern California SCE 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)

ORDER MODIFYING INTERIM OPINION DECISION 02-01-039 AND DENYING REHEARING, AS MODIFIED

I. SUMMARY

This decision modifies Interim Opinion D.02-01-039, which provides an initial interpretation of the "first priority" condition in the holding company systems of Pacific Gas and Electric Company (PG&E), Pacific Gas and Electric Corporation (PG&E Corp.), Edison International (EIX), Southern California SCE Company (SCE or Edison), Sempra Energy (Sempra), and San Diego Gas and Electric Company (SDG&E) (collectively, "Applicants"). The rehearing Applicants maintain that the first priority condition requires only that they maintain a certain level of capital expenditure or equity investment in the utilities' plant and equipment. We do not concur with this narrow interpretation, as it is not supported by the law, the holding company decisions, or the record. We find that the first priority condition does not preclude requiring holding companies to infuse capital of all types into their respective utility subsidiaries when necessary to fulfill the utility's obligation to serve.

This decision also disposes of separate requests by PG&E and its holding company, PG&E Corp., for official notice of various documents. In the interest of clarity, we made minor modifications to the opinion, including adding findings of fact and conclusions of law. As modified, the rehearing of D.02-01-039 is denied.

II. FACTS/BACKGROUND

On April 4, 2001, the Commission initiated an investigation into the three major California investor-owned energy utilities and their holding companies. On January 11, 2002, the Commission issued interim opinion D.02-01-039, which provided an initial interpretation of a provision that requires that the utilities be given first priority in the holding company systems. The "first priority" condition appeared originally in SDG&E's initial holding company proceeding that commenced in 1985.[1] The first priority condition, as it appeared in SDG&E's holding company decision, is the precursor of other such conditions in subsequent holding company decisions. In SDG&E's case, the first priority condition provides as follows:

> 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.[2]

SDG&E decided not to form its holding company system with Sempra at that time, but later reapplied for holding company authorization. It was granted in D.95-05-021, 59 CPUC2d 697 (May 10, 1995)(SDG&E Authorization 1). A second authorization was granted in D.95-12-018, 62 CPUC2d 626 (Dec. 6, 1995)(Authorization 2). On March 26, 1998, the Commission granted ENOVA Corp., SDG&E's former holding company, authority to merge with Pacific Enterprises to form Sempra in D.98-03-073, 184 P.U.R.4th 417.

PG&E's first priority condition differs slightly from the others. It first appeared in PG&E's holding company decision in D.96-11-017, 69 CPUC2d 167, 201 (Nov. 6, 1996)(PG&E Authorization 1) as follows: "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." In the

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[1] *Re San Diego Gas & Electric Co*. (March 28, 1986) 20 CPUC2d 660 (D.86-03-090).

[2] Sempra/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).

second authorization, PG&E's first priority condition provides 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, shall be given first priority by PG&E Corporation's Board of Directors.[3]

SCE was granted holding company authorization in D.88-01-063, 27 CPUC2d 347 (Jan. 28, 1988). Its first priority condition is as follows:

> 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 SCE's parent holding company and SCE.[4]

By Assigned Commissioner's Ruling (ACR) of April 30, 2001, the parties were permitted to file opening and reply briefs on the legal issues surrounding the first priority condition, including the issue of under what circumstances, if any, does the first priority condition require a holding company to infuse money into its utility subsidiary. Opening briefs were filed on May 17, 2001, and reply briefs on May 23, 2001.

On December 26, 2001, the Draft Decision was issued. Comments were due on January 4, 2002. Reply comments were not permitted. Following the issuance of the Interim Opinion, D.02-01-039, on January 11, 2002, on February 11, 2002, the Applicants submitted rehearing applications. PG&E and SCE and their respective holding companies filed separate applications, while Sempra and SDG&E (Sempra/SDG&E) filed a joint application. Applicants opposed the Interim Opinion on numerous grounds, including the following: 1) the decision's expansive interpretation of the first priority condition is contrary to its plain meaning and purpose; 2) definition of "capital" would conflict with ratepayer indifference standard; 3) "capital requirements" refers to equity investment; 4) the decision violates the ratepayer indifference standard by guaranteeing cash infusions; 5) the interpretation of the condition calling for an infusion

[3] PG&E Authorization 2 (April 22, 1999) 194 P.U.R.4th 1, 45 (D.99-04-068).

[4] Edison Authorization (1988) 27 CPUC2d 347, 376, Ordering Paragraph 12.

of capital would effect an unconstitutional taking in violation of Cal. Const. Art I, §19 and the Fifth Amendment of the U.S. Constitution; 6) due process is violated; 7) there is no majority decision as to the meaning of the first priority condition; 8) the expansive reading of the first priority condition violates PU Code § 451; 9) the decision is a revision of the first priority condition in violation of PU Code § 1708; and 10) the decision violates California Corporations Code § 300. PG&E reserved its rights to argue its federal claims in the appropriate federal forum. In addition, PG&E Corp. & PG&E filed requests for official notice of various documents.

On February 26, 2002, The Utility Reform Network (TURN) filed its response to the rehearing applications. TURN made numerous arguments, including the following: the first priority condition is a requirement, not a suggestion or statement of discretionary policy; the condition does not violate the California Corporations Code, as Sempra alleged; Commissioner Brown's concurrence does not void the core holding of the decision; the principles of compensatory ratemaking do not guarantee full recovery, and a full return, on all shareholder dollars; and the definition of capital is necessarily broad.

III. DISCUSSION

A. The Commission Is the Arbiter of the Meaning of its Decisions and its Interpretation Is Entitled to Great Weight.

PG&E Corp. contends that the Commission's interpretation of the first priority condition should be accorded little deference. (PG&E Corp., p. 9, n. 9) Case law says differently. It is well-established that a reviewing court should give deference to an agency's interpretation of the statutes it administers.[5] Where statutory language is ambiguous, the court must defer to the agency's interpretation of the statute if it is based on a permissible construction of the statute, and "may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an

[5] *Yamaha Corp. of America v. State Board of Equalization* (1998) 19 Cal. 4th 1, 11, *Mason v. Brooks* (9th Cir. 1988) 862 F.2d 190, 192.

agency."[6] In the course of adjudicating a dispute, the agency's statutory interpretation is entitled to *Chevron* deference so long as the agency has the power to make policy in the area.[7]

While not statutes *per se*, the first priority conditions are regulations adopted by an administrative agency to govern the behavior of utilities and their parent holding companies. The same rules of construction and interpretation that apply to statutes govern the interpretation of rules and regulations of administrative agencies.[8] Moreover, when an agency interprets regulations, rather than statutes, the U.S. Supreme Court states that there is a clearer case for showing deference to the agency:

> When the construction of an administrative regulation rather than a statute is in issue, deference is even more clearly in order. 'Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt…The ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation.[9]

The holding company decisions have consistently discussed the first priority condition in broad terms of utility needs and financial strength, and holding company responsibility and financial support to the utilities. Those decisions do not limit the

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[6] *Chevron, U.S.A. Inc. v. Natural Resources Defense Council, Inc*. (1984) 467 U.S. 837, 843-844.

[7] Kenneth C. Davis, *Admin. Law Treatise* §3.5 at 120 (1994).

[8] *Cal. Drive-In Restaurant Ass'n v. Clark* (1943) 22 Cal.2d 287, 292; *Miller v. United States* (1935) 294 U.S. 435.

[9] *Udall v. Tallman* (1965) 380 U.S. 1 at 16-17 (1965), citing *Bowles v. Seminole Rock Co.*, 325 U.S. 410, 413-414. *Accord U.S. v. Larionoff* (1977) 431 U.S. 864, 872; *Sierra Pacific Power Co. v. U.S. Environmental Protection Agency* (9th Cir. 1981) 647 F.2d 60, 66.

discussion in the narrow manner the utilities and the holding companies now urge.[10] The Commission's interpretation is consistent with the holding company cases in holding that 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.

B. The Interim Opinion's Interpretation of First Priority Condition Is Reasonable and Consistent with the Holding Company Decisions.

PG&E distorts the Commission's rationale in adopting the first priority condition by slanting the facts and by omitting essential aspects of the Commission's reasoning. In its rehearing application on pages 3-4, PG&E stated that the first priority condition was intended to address several concerns, selectively stating: "One rationale behind the First Priority condition was that upon formation of the holding company the utility would no longer have direct access to equity markets for common stock." Assuming that this is one rationale behind PG&E's urging the Commission to adopt the condition, it is not determinative of the Commission's intent in adopting the condition. The Commission was at all times focused on how ratepayers and the public interest could be protected, as set forth in PG&E's Authorization 1. For example, Conclusion of Law No. 2 in Authorization 1 states as follows: "PG&E's choice of business form touches on its public calling and is subject to Commission oversight to determine that changes in its form of organization and ownership will not impair the discharge of its duties."[11] Conclusion of Law No. 11 explained that "[t]he conditions discussed in Sections 6 [the Audit] and 7 [Further Conditions Required to Protect the Public Interest] of this decision and adopted in the Ordering Paragraphs 1 through 23 of this decision are necessary to

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[10] Even if the Commission's broad interpretation of the first priority condition diverges from prior decisions, the current interpretation should still be accorded due deference. The Court has said that an agency's "interpretation of its regulations is entitled to great deference even where…it has overruled or questioned its own prior interpretations." (*Sierra Pacific Power Co., supra*, p. 66.) That is not the case here.

[11] *In re PG&E* (November 6, 1996) 69 CPUC2d 167, 198 (D.96-11-017).

protect the public interest." Authorization 2 further reinforces the Commission's intent to protect ratepayers and the public interest. For example, Finding of Fact No. 8 observes that pursuant to PUHCA, 15 U.S.C. § 79 et seq., the Commission must certify to the Securities and Exchange Commission (SEC) that it has the authority and resources to protect ratepayers and that it intends to use that authority. That finding leaves open the possibility that the Commission could impose additional conditions to the SEC on a prospective basis.[12]

In interpreting another purported Commission concern, PG&E cited § 7.12 in Authorization 1 as support for its argument that the Commission's concern was focused on competition between PG&E and its affiliates for scarce capital:

> A related concern was that the holding company might have other options for its investment capital, in the unregulated subsidiaries that the holding company structure contemplated. PG&E Authorization 1, § 7.12 (noting ORA (sic)[then DRA] explanation that First Priority condition was necessary in case of a competition between PG&E and its affiliates for scarce capital). Thus, the First Priority condition states that the capital requirements of the utility would be given "first priority" by the parent company's Board of Directors when it evaluated competing demands for capital investment."[13]

There is more to the story than PG&E reports. PG&E omitted the portion of § 7.12 that addresses ratepayer protection and the obligation to serve. The full quote is as follows:

> DRA explains that to the extent that PG&E affiliates compete with PG&E for scarce capital, this condition is necessary to protect ratepayers by requiring the directors of PG&E and the holding company to place top priority on PG&E's utility obligation to serve. For this reason, DRA maintains that this condition is in the public interest. This condition is consistent with that which the Commission adopted for SCE (27 CPUC2d at 376, OP 12) and SEMPRA/SDG&E.

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[12] See *Re PG&E*, D.99-04-068, Finding of Fact No. 8, *mimeo*, p. 82 (194 P.U.R.4th 1).

[13] PG&E Rhg. App., p. 4.

(SEMPRA/SDG&E Holding Co. Decision, slip op. at p. 44, OP 6)[14]

For the reasons articulated in the preceding paragraph, the first priority condition was deemed reasonable and was adopted by the Commission.

Sempra/SDG&E claim that the Interim Opinion errs by distorting the holding company decisions. (Sempra/SDG&E at pp. 9-14) Yet, they acknowledge that "[t]he holding company conditions were carefully crafted to ensure that any financial distress of either the parent company or its non-utility subsidiaries would have no adverse effect on utility ratepayers." (Sempra/SDG&E, pp. 16-17) We agree. The Commission's overarching concern was always to protect ratepayers from potentially adverse impacts that could result from holding company reorganization, regardless of whether those impacts derived from diversification, cross subsidies, or some other cause.[15]

As the Interim Opinion notes, "[i]n 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." (Interim Opinion, *mimeo*, p. 12) In SDG&E's first holding company decision, the precursor of the other holding company decisions, the Commission stressed its desire to protect the utility's financial strength:

- Finding of Fact No. 30 states that "requiring SDO [the parent] to maintain a balanced capital structure in SDG&E *would protect the utility's financial strength*."

- Finding of Fact No. 31 states that "[r]equiring the SDG&E Board of Directors to set its dividend policy as though SDG&E were a comparable stand-alone utility *would protect the utility's financial strength."*

- Finding of Fact No. 32 states that "[p]rohibiting SDG&E from guaranteeing the obligations of SDO or any of SDO's subsidiaries without first obtaining the written consent of the Commission to do so *would protect the utility's financial strength."*

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[14] *Re PG&E(Authorization 1),* 69 CPUC2d 167, 194 (D.96-11-017); emphasis added.

[15] For a discussion of diversification, see *Re San Diego Gas & Electric Co.* (March 28, 1986) 20 CPUC2d 660, 671 (D.86-03-090); for cross subsidies, see *id*., p. 682.

- Finding of Fact No. 33 states "[r]equiring the capital needs of the utility, as determined to be necessary to meet its obligation to serve the public, to be given priority by the Boards of Directors of SDO and SDG&E *would protect the utility's financial strength*."[16]

In SDG&E's second holding company case, the Commission noted the Division of Ratepayer Advocates' (DRA's) focus on protecting the utility. *Re San Diego Gas & Electric Co.*, 62 CPUC2d 626, 634 (D.95-12-018)(December 6, 1995). Similarly, in PG&E's case, the focus at all times was on protecting the public interest and the utility's financial strength so that it would be able to fulfill its obligation to serve the public. Because of its concern that the utility's financial strength not be sapped by subsidizing PG&E's unregulated businesses, the Commission insisted on adequate internal controls and appropriate separation between the regulated and unregulated portions of PG&E's businesses. The Commission required that PG&E's "future operations [be] conducted pursuant to conditions that will be adequate to protect the public interest. To the extent that PG&E fails to meet this burden, we may add further conditions in order to protect the public interest, or reject the application."[17]

The holding company decisions also reflect concern for the ratepayers. In the SCE holding company decision, the Commission stated: "The one thing we must make sure of is that the activities of the holding company and its non-utility enterprises *do not adversely affect the ratepayers of the utility*." *Re Southern California SCE Co.*, 27 CPUC2d 347, 366 (D.88-01-063) (January 28, 1988); emphasis added. The Commission also noted TURN's concern that the "holding company structure will not adequately insulate SCE ratepayers from the increased risks or potential subsidies that may result from diversification efforts." *Id.* at 359. In PG&E's holding company case, the Commission was concerned that a holding company reorganization not "bring potential

[16] *Id.*, pp 688-689 (emphasis added).

[17] PG&E Authorization 2 (April 22, 1999) 194 P.U.R.4th 1, 91 (D.99-04-068), portion of Conclusion of Law 2.

dangers and costs to PG&E's ratepayers." *Re Pacific Gas & Electric Co.*, 69 CPUC2d 167, 185 (D.96-11-017)(November 6, 1996).

In sum, these are some examples, which demonstrate that the Commission's interpretation of the first priority condition in the Interim Opinion reflects a consistent concern, throughout the holding company decisions, for the utility's financial strength and the protection of ratepayers from the potential risks of a holding company reorganization.

C. "Capital," As Used in Holding Company Decisions, Is Broader than "Equity Capital."

To bolster their challenge to the Interim Opinion, the Applicants contest the Interim Opinion's interpretation of "capital," as not being limited to "equity capital." PG&E claims that the decision "embodies an abuse of discretion when it effectively holds that the First Priority condition's use of 'capital requirements' means the same as 'cash'."[18] PG&E Corp. also urges that since the recent SCE/EIX Memorandum of Understanding (MOU) interprets the first priority condition as relating to equity capital only, that interpretation is compelled by the holding company proceedings. (PG&E Corp., pp. 16-17.) SCE and its parent EIX assert that the term "capital requirements" refers to no more than equity investment. (SCE, pp.6-8.) Sempra/SDG&E also allege that a witness' testimony "makes plain that 'capital' used in the 'first priority' condition offered by SDG&E was intended to mean 'equity capital'." (Sempra/SDG&E, p. 20)

Despite this chorus of objections to the Commission's interpretation, the Applicants' very narrow reading of "capital" is without foundation. PG&E and the other Applicants failed to provide proof in the record that any of the holding decisions restricted the meaning of "capital" to "equity capital." As for PG&E Corp's reaching for the MOU as a basis for justifying its limited definition of capital, we note that the MOU is a settlement between SCE, EIX and the Department of Water Resources (DWR). The Commission is not a party to that settlement, nor is it bound by whatever agreement those

[18] PG&E Rhg. App., p. 8.

parties reach concerning the meaning of capital. Sempra/SDG&E, like PG&E, selectively cited irrelevant witness testimony that provides no basis for finding that the Commission ever subscribed to their narrow definition of capital.

The holding company decisions do not qualify or limit what kind of capital may be used to provide financial assistance to the utilities. The Interim Opinion notes that "[n]owhere in the record of the proceedings – including exhibits, filed testimony, and hearing testimony – does any party define the word 'capital' in the limited manner Respondents suggest."[19] No Applicant has refuted this assertion.

The Interim Opinion's definition of "capital" or "capital stock" is in keeping with the plain meaning of the word as defined in dictionaries, various statutes, and as used in case law. The Interim Opinion's definition of capital is consistent with the dictionary definition of "capital"or "capital stock," where the terms are used interchangeably. A business dictionary defines "capital" as follows: "any type of material wealth such as money, real estate, or precious metals, accumulated by individuals or organizations. In economic theory, capital is one of the major factors of production, the others being labor and property."[20] Under California Corporations Code §400, "capital stock" is frequently used to express property and assets of a corporation; it consists of consideration received or agreed to be received in exchange for all issued stock, whether the consideration takes the form of money paid, labor done, or property actually received. *Burton v. Burton*, 161 Cal.App.2d 572 (1958). "Capital stock" is money or property used to carry on a business. *People v. Home Ins. Co.*, 29 Cal. 533, 545 (1866); *Martin v. Zellerbach*, 38 Cal. 300, 308-309 (1869), which defines capital as money, property, or other valuable commodities with which business is transacted. These examples provide further proof that the Interim Opinion's definition of "capital" is reasonable and consistent with the ordinary meaning of the word.

[19] Interim Opinion, *mimeo* at 15.

[20] *Dictionary of Business Terms* by Wilbur Cross, Prentice Hall Press (1999), p. 50.

Accordingly, "capital" as used in the first priority condition includes money, property, any assets, or working capital if committed for a planned use.[21] Therefore, it is reasonable to define "capital," where not otherwise limited or qualified, as 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.[22]

1. The Commission Used "Capital" According to Its Ordinary Meaning, Not as Narrowly Used in General Rate Cases.

PG&E Corp. asserts that "capital" has a specific meaning within the context of the regulation of public utilities: "the rate of return for a regulated utility is the utility's cost of capital, 'with capital defined as the cost of debt plus a return on equity investment'." (PG&E Corp., p. 5, n. 6.) In support, it cites *Apple Valley Ranchos Water Company* (1999) 1999 Cal. PUC LEXIS 415 at *38, and *In the Matter of the Application of San Gabriel Valley Water Company* (1992) 43 CPUC2d 703, 1992 Cal. PUC LEXIS 335 at *22 (1992). Both are general rate cases. The reference to "capital" or "capital requirements" in a rate proceeding is technical and well-suited to the purpose for which it was intended. This is not a general rate case. The Interim Opinion states unequivocally 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."[23] The Commission was clearly making a distinction between the first priority condition and the "balanced capital structure" requirement.

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[21] See Interim Decision, *mimeo* at 10, citing *American Lawn Mower Co. v. U.S.*, 63-2 U.S. Tax Cas. (CCH) P9779, 1963 U.S. Dist. LEXIS 9471 at *16. This case states that "[a]ll of a corporation's capital may be considered working capital if committed for a planned use."

[22] Interim Opinion, *mimeo*, p. 36, Finding of Fact 5.

[23] Interim Opinion, *mimeo* at 11 and 15, n. 37. See also Conclusion of Law No. 5, which holds that the first priority condition and the "balanced capital structure" condition do not impose the same requirement, at the risk of one of them being superfluous.

In the holding company decisions, the "balanced capital structure" requirement is a separate condition requiring the utility to maintain its own balanced capital structure, pursuant to the ratio set by the Commission in the respective general rate cases. The first priority condition, on the other hand, is much broader and does not preclude the requirement that the holding companies infuse all types of capital into their utility subsidiaries when necessary to fulfill the utility's obligation to serve. Notwithstanding the unmistakable thrust of the first priority condition, the utilities and the holding companies argue for a narrow, technical definition of capital. However, the Commission never limited the term "capital" in the first priority condition to funds necessary solely for infrastructure investment, or in any other manner alleged by the Applicants.

PG&E Corp. further claims that the Interim Opinion attempts to justify its expansive reading of the term "capital" by citing inapposite and ancient cases. (PG&E Corp., p. 5, n. 6) PG&E Corp. singles out *Kohl v. Lilienthal*, 81 Cal. 378 (1889), as being ancient. The Interim Opinion correctly cited *Kohl's* definition of "capital" as "the money and property with which the company carries on its corporate business."[24] Good case law is good case law. *Marbury v. Madison*, which established the principle of judicial review, is as valid now as it was in 1803 when the U.S. Supreme Court issued it.[25] The date of a decision's issuance does not erode its significance or applicability.

Sempra/SDG&E contend the decision errs by failing to find that the record supports the proposition that "capital" meant equity investment. (Sempra/SDG&E, p. 18) They are misguided. The record does not support their narrow definition of capital. The Interim Opinion is based on the agency's interpretation of what the holding company decisions mean, not narrowly on what an individual proponent or opponent happened to advocate at a particular time.

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[24] Interim Opinion, *mimeo*, p. 31.

[25] *Marbury v.* Madison (1803) 5 U.S. 137.

Sempra/SDG&E admit that SDG&E "*did not initially propose that any conditions* be attached to the authorization for SDG&E to form a holding company structure." (Sempra/SDG&E at 18; emphasis added.) Sempra/SDG&E further assert that no party to the holding company proceeding addressed the circumstance where the utility suffered financial losses. They claim that "[t]here simply was no need to define the word 'capital' in such a way as to ensure that it could not be interpreted in the manner of the Decision because no party ever suggested that the first priority condition was meant to address a utility shortfall in revenues with which to cover operating expenses." (Sempra/SDG&E, p. 27, n. 27)

Simply because the parties failed to envision a circumstance where the first priority condition may apply does not negate its applicability. The Interim Opinion should not be held to the limited vision of the parties, particularly where the plain meaning of the first priority condition is broad enough to cover situations where the utility suffers financial losses. If the Commission were to adopt the Applicants' restrictive interpretation of the first priority condition, the condition would be so watered down as to be meaningless. The Applicants' persistence in using the same narrow interpretation of the first priority condition is self-serving and unsupported by the record.

2. The Meaning of First Priority Condition

Despite the Applicants' arguments to the contrary, the other terms in the first priority condition are very straightforward. As set forth in Finding of Fact No. 3, "first priority" means the highest preferential rating assigning rights to scarce products or materials. "Requirements" refers to need. (Interim Opinion, Finding of Fact No. 4) "Obligation to serve" includes all actions a utility must take to provide utility service to California ratepayers, and is not limited to maintaining infrastructure. (*Id.*, Finding of Fact No. 7) Therefore, should a utility's ability to discharge its obligation to serve be threatened due to lack of access to "capital," as broadly defined in the Interim Opinion, the first priority condition requires its holding company to give the utility preference over all competing potential recipients of capital resources. (*Id.* at 11.)

EIX argues that the first priority condition requires merely that the holding company shall give "first priority" to the equity capital needs of the utility if the utility lacks sufficient equity to support investments needed to satisfy its service obligations. (EIX, p. 3.) Sempra/SDG&E claim that the "first priority" language requires that "first priority" be "given only under certain circumstances 'as determined' by the Sempra Energy Board of Directors to be 'necessary' to meet SDG&E's obligation to serve." (Sempra/SDG&E, p. 6) PG&E also limits the first priority condition to the situation where a parent company's Board of Directors, in evaluating competing demands for capital investment, would give first priority to the utility. (PG&E, pp. 3-4) The Commission does not subscribe to these recent attempts to so limit the first priority condition that it would be rendered nearly useless.

The common thread permeating the holding company decisions is concern by the Commission for the financial health of utility operations and the desire that changes in the form of organization and ownership would not impair the utility's ability to carry out its duties.[26] The Commission focused on preserving the financial ability of the utilities to meet their obligation to serve under holding company reorganization. Therefore, the first priority condition provides assurance that regardless of diversification and the potential for cross-subsidization, the holding companies would give the utilities first priority over all competing potential recipients of capital resources, if the utilities' ability to discharge their obligation to serve was threatened. Thus, the Interim Opinion rightly concluded 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." (Interim Opinion, *mimeo*, p. 11.) Should the circumstances warrant it, the holding company is required to infuse capital into the utility so that the utility may meet that obligation.

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[26] *SDG&E Holding Company Decision* (1995) 62 CPUC.2d 626, 649 (D.95-12-018); *PG&E Holding Company Decision* (1996) 69 CPUC2d 167, 198 (D.96-11-017); *Edison Holding Company Decision* (1988) 27 CPUC2d 347 (D.88-01-063), pp. 371-372, Finding of Fact 14.

3. The Infusion of Capital

PG&E Corp. opposes the Commission's interpretation of the first priority condition, arguing that "[n]owhere does the language of this condition impose an absolute requirement to infuse capital of 'any type' whenever the Utility's access to capital is 'impaired'." (PG&E Corp., p. 5) PG&E similarly argues that the words of the first priority condition do not include a requirement to "infuse" anything. (PG&E, p.14) We do not subscribe to their reasoning, which ignores the purpose of the first priority condition, to ensure that the utility's capital needs are met.

PG&E advocates the use of another word - "consideration," which would further weaken the first priority condition: "[T]he words of the First Priority condition only require that first priority *consideration* be given to the utility's capital requirement needs." (PG&E, p. 14; emphasis in original.) However, our decisions make clear that the first priority condition is not precatory; it is mandatory.

Like PG&E, SCE and Sempra's interpretation of the first priority condition would make it entirely subject to the arbitrary discretion of the holding company. SCE contends that the condition "should be understood as informing the business judgement of the two companies' boards of directors."[27] Sempra/SDG&E explain that the "condition merely establishes a *general policy*" of providing capital when the Board determines it is necessary to do so to meet SDG&E's obligation to serve.[28] We agree with TURN that such an interpretation would render the first priority condition to be little more than a suggestion, rather than the requirement that it is. (TURN Rhg. Response, pp. 4-5.)

The requirement that capital be infused is reasonably discernible from the circumstances before us, despite PG&E's attempts to distort the record. PG&E asserts that the Interim Opinion erred in reasoning that the transfer of non-regulated assets from the utility to the parent company left the utility lacking a source of cash it could have

[27] SCE Rhg. App., p. 8.

[28] Sempra/SDG&E Rhg. App., p. 4; emphasis added.

used to make up for the short-fall between costs and rates. PG&E asserts that the Commission's reasoning is "wrong, because the ratepayers never had a right to the unregulated assets of the utility." (PG&E at 12.) As support for this statement, PG&E claims that "[t]he Commission has acknowledged that such earnings are, subject to the utility's obligations to provide quality service at reasonable rates, are 'rightfully the property of shareholders to dispose of as they see fit…'." [29] However, PG&E did not cite the full quote, which reads as follows:

> "[W]e are mindful that [fair returns on] investment, whether in the form of dividends or retained earnings, are rightfully the property of shareholders to dispose of as they see fit, *subject only to the constraint that in so doing the operations of the utility and the entitlements of its ratepayers to quality service at reasonable rates should not be jeopardized."*[30]

The omission of this very important qualification decimates PG&E's argument. An accurate reading of this passage signifies that to the extent that ratepayers' quality of service at reasonable rates is endangered, dividends or retained earnings may not necessarily be used by shareholders as they see fit.

Claiming that the case is inapposite, PG&E Corp. attacks the Interim Opinion's use of *Branch v. U.S.* (Fed. Cir. 1995) 69 F.3d 1571, as support that liability may be imposed on one business (the holding companies) for costs or needs incurred by another business (the utilities). (PG&E Corp. Rhg. at 19) PG&E Corp. missed the point entirely. The essential legal principle for which the case was cited was that a business that is part of an enterprise is liable for the losses caused by the failure of any other sister business within the same business enterprise. That principle is applicable to the situation before us. The court's rationale for placing the burden of bank failures on sister banks applies here, as well: 1) 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 (holding companies); 2) because holding companies have a measure of control over the success of

[29] PG&E Rhg. App., p. 12.

their subsidiaries; and 3) the risk that the bank holding companies would favor their subsidiaries was reduced by statute.[31] In this situation, that risk is reduced by the Commission and its regulatory authority, whose mission is to protect the public interest. In addition, we note that PG&E Corp's attempt to make the case that infusions of working capital, as opposed to equity capital, would work an unconstitutional "taking" fails, as we discuss later in this decision.

SCE acknowledges that "owners of small corporations (certainly unregulated ones) may indeed 'infuse working capital' into an enterprise in the hope of 'reap[ing] future benefits'." (SCE Rhg. App. at 19-20) However, SCE argues that the owners do so voluntarily, in amounts and on terms of their own choosing, subject only to the risk of equitable subordination to the claims of other creditors in bankruptcy. Theoretically, unregulated owners are free to do whatever they want to do within the bounds of the law, including infusing working capital voluntarily. The caveat is that to the extent that they have entered into a binding legal relationship with others, the law will not ignore the responsibilities or obligations incurred thereby.

In consideration of the foregoing, we find that the owners of companies which owe their very existence to a regulated utility and, which, as part of that transaction, agreed to give the utility's capital needs first priority are subject to the fulfillment of that condition. If such a company does not voluntarily infuse capital, of whatever kind is needed, the regulating entity may enforce the condition after determining that the circumstances warrant it. At a very minimum, this is the case, although other legal authority may also be brought to bear on the recalcitrant companies.

SCE further claims the Interim Opinion incorrectly uses the term "working capital" to refer to cash for operating expenses. (SCE Rhg. App. at 19-20, n. 6) SCE contends that working capital is an amount that is invested in the business. However,

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[30] *Re San Diego Gas & Electric* Co (1995) 62 CPUC2d 626 at 638; emphasis added.

[31] Interim Opinion, *mimeo*, p. 27, citing *Branch v. United States* (Fed. Cir. 1995) 69 F.3d 1571, 1580.

according to *Resource* by PG&E, working capital, as defined for regulatory purposes, is described as the inventories and funds required by a utility for its ongoing operations.[32] The working capital category includes materials and supplies inventories, gas line pack (for natural gas operations), and working cash. Working cash, sometimes referred to as cash working capital, *includes funds needed to pay for current operating expenses* and to provide a financial cushion, or margin of safety (emphasis added). We agree with TURN that "the financial health of a company cannot be measured simply by its investments in utilities, but also on its cash flow and whether sufficient capital is available to sustain the entire enterprise."[33]

D. Uncontemplated Circumstances Do Not Render the Commission's Interpretation of the First Priority Condition Invalid.

We do not accept Sempra/SDG&E's argument that since no party to the holding company proceeding addressed the circumstance where the utility suffered financial losses, those circumstances may not be included among situations that could trigger the first priority condition. Decisions or laws do not contemplate every conceivable set of facts that may fall within the ambit of a statute, regulation, or decision. Even if a decision or law does not contemplate circumstances that later occur, it still may be construed to include those circumstances. So says the U.S. Ninth Circuit, which recognizes that as a statute gains in age, "the quest is not properly for the sense originally intended by the statute, for the sense sought originally to be put into it, but rather for the sense which can be quarried out of in the light of the new situation."[34] Similarly, agency

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[32] *Resource, An Encyclopedia of Energy Utility Terms*, second edition (1992), PG&E, p. 493.

[33] Response of the Utility Reform Network to the Applications for Rehearing of D.02-01-039 on the Meaning of the First Priority Condition (TURN Rhg. Response), p. 13.

[34] *West Winds, Inc. v. M.V. Resolute* (9th Cir. 1983) 720 F.2d 1097, 1101-1102. See also *People v. Bostick* (1996) 46 Cal.App.4th 287, 297; *Olson-Mahoney Lumber Co. v. Dunne Investment Co*. (1916) 30 Cal.App. 332, 346.

decisions and regulations are broadly construed in order to accommodate new or unanticipated situations.

When the holding company decisions were issued, no one predicted that wholesale prices would skyrocket, the Federal Energy Regulatory Commission (FERC) would initially delay in helping to stabilize the market by imposing price caps, and that the largest investor-owned public utility in California would file for bankruptcy. Nor was it evident that a word such as capital, used in its ordinary sense, required definition. There was no intent or need to restrict the definition of "capital" to "equity capital," as the Applicants now urge. The holding company decisions discussed some of the dangers perceived in holding company reorganization, without purporting to discuss all possible, conceivable scenarios of what could happen. It was evident, however, that the Commission consistently construed the first priority condition in terms of protecting the utilities' financial strength so that they could fulfill their obligation to serve the public.

A significant factor not to be discounted as likely having some impact on the financial health of the utilities is the transfer of enormous sums of monies to the holding companies in the early years of the transition period, when the utilities received excess revenues due to the high frozen rates and other provisions of AB 1890. Without implying anything improper, the OII noted the billions of dollars that were transferred from the utilities to their holding companies during those years:

- From 1998 through September 2000, PG&E provided approximately $3.9 billion to PG&E Corporation in the form of $1.1 billion in dividends on common stock and $2.8 billion in common stock repurchases [Footnote omitted.]. Of the amounts disbursed, PG&E paid $125 million in dividends to its parent in the third quarter of 2000 alone. [Footnote omitted.]

- From 1998 through September 2000, SCE provided EIX approximately $2 billion in dividends on common stock. [Footnote omitted.] Of this amount, SCE paid over $90 million to its holding company in the third quarter of 2000 alone. [Footnote omitted.]

- From 1998 through September 2000, SDG&E provided Sempra Energy at least $763 million in dividends on common stock. [Footnote omitted.] Of the amount disbursed to its holding company from 1998 through September 2000, SDG&E

> paid at least $200 million to its parent in the third quarter of 2000 alone. [Footnote omitted.][35]

Pursuant to the first priority condition, the holding companies are obligated to infuse capital into the utilities, particularly after having been the recipients of utility monies that could have been used to maintain the utilities' financial health during lean times.

E. The Interim Opinion's Interpretation of the First Priority Condition Is Consistent with the Ratepayer Indifference Standard.

PG&E claims the Commission committed a fundamental legal error in its conclusion that the first priority condition is consistent with ratepayer indifference. (PG&E Rhg. App., pp. 11-13.) The Commission's interpretation may not be what the utilities and their holding companies desire; however, it is not legal error. As explained in the Interim Opinion, the "ratepayer indifference" standard is one that "left ratepayers indifferent to whether the utilities continued to be stand-alone companies, or whether they were reorganized under a holding company structure."[36] The Interim Opinion adheres to that standard.

1. The Interim Opinion Is True to the Ratepayer Indifference Standard.

The holding companies contend that if the utilities were stand-alone companies, individual shareholders would not be required to infuse working capital. They argue that, therefore, a requirement that the holding company make such infusions would benefit ratepayers, and thereby violate the ratepayer indifference standard. The holding companies' argument turns the ratepayer indifference standard upside down. In adopting this standard, the Commission's intent was to strike a balance that would neither benefit nor harm the ratepayers. For example, in Sempra/SDG&E's second holding company decision, the Commission rejected Commission Staff's proposal that

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[35] OII, *mimeo*, pp.6-7.

[36] Interim Opinion, *mimeo* at 28.

Sempra/SDG&E should be required to prove that the proposed reorganization would provide net benefits to the ratepayers.[37] In their rehearing application, Sempra/SDG&E criticize the Commission for rejecting a proposal in the SCE holding company decision to impose a "royalty" that would be credited to ratepayers. (Sempra/SDG&E Rhg. App., p. 13) At the same time, Sempra/SDG&E accuse the Commission of trying to bring about a ratepayer windfall "by providing a massive benefit to ratepayers that would not have been present had the utilities not formed holding companies in the first place." (Sempra/SDG&E Rhg. App., p. 15) The facts belie their arguments.

The Commission's rejection of the royalty provides some proof that the Commission did not intend to confer benefits on ratepayers. Rather, the Commission intended to adhere to the ratepayer indifference standard under which ratepayers remain indifferent to the holding company structure because they are neither harmed nor helped by that structure. The ratepayer indifference standard does not require the holding company or non-utility affiliates to become a guarantor. Rather, it obligates them to honor the first priority condition, and other conditions as well, to which they agreed in order to obtain Commission authorization for the holding company system.

The conditions under which the Commission approved the holding company structure impose a duty on the holding company to provide financial assistance to the utility should its ability to fulfill its obligation to serve be jeopardized. When a utility's assets have been transferred to the holding company, as they have been for all three utilities, the utility is left with less capital with which to operate. Should the holding company then infuse capital back into the utility, ratepayers would be indifferent to the holding company transfers and structure.

We affirm the Interim Opinion's interpretation of the operation of the ratepayer indifference standard in these circumstances. The only way for ratepayers to be indifferent to whether the utilities continue to be stand-alone companies, or whether they are reorganized under a holding company structure, is for them to remain no worse or

[37] *Re San Diego Gas & Electric* (1995) 62 CPUC2d 626, 635 (D.95-12-018).

better off under either structure. The decision reasonably interpreted ratepayer indifference to mean that the transfer of the utility's assets to the holding company, leaving the utility with fewer assets upon which to rely in times of need, made it necessary to require that the holding companies infuse capital into the utilities in times of need in order to rebalance the scales and make ratepayers indifferent to the continuing asset transfers that formation of the holding company system would require.[38]

2. The Interim Opinion Does Not Violate PU Code § 818.

Sempra/SDG&E claim that the first priority condition cannot be reconciled with the ratepayer indifference standard because a stand-alone utility could never obtain cash from its shareholders to pay its day-to-day operating expenses. (Sempra/SDG&E, p. 16) They argue further that PU Code § 818 forbids a utility from issuing stock for operating expenses.[39] Their argument is that if a stand-alone utility cannot issue stock to cover operating expenses, then neither can the parent company infuse the utility with cash for this purpose. We do not find this argument persuasive. If, by this argument, the holding companies are putting themselves in the shoes of the utilities, they are defeating their jurisdictional challenges to this proceeding. PU Code § 818 applies to utilities. Furthermore, it is the public utility, not the Commission, that could be in violation of § 818, if it fails to secure an order from the Commission authorizing the issuance of stocks and stock certificates, or other evidence of indebtedness for operating expenses.

[38] See Interim Opinion, *mimeo* at 30.

[39] PU Code § 818 provides that no public utility may issue stocks and stock certificates, or other evidence of ownership or indebtedness, payable at periods of more than 12 months after its date, for operating expenses or income, unless it shall first have secured an order from the commission authorizing the issuance.

F. The Commission's Interpretation of the First Priority Condition, A Legal Issue, Does Not Violate PU Code § 1708, Nor Need the Commission Refer to the Record of the Holding Company Proceedings.

Sempra/SDG&E claim that the Commission has "effectively" modified the holding company decisions in violation of PU Code § 1708.[40] (Sempra/SDG&E Rhg. App., pp. 28-30) There is no merit to this allegation. The Commission has not altered a single word in those decisions. It has simply considered the legal question; i.e., under what circumstances, if any, does the first priority condition require a holding company to infuse money into its utility subsidiary? (See Assigned Commissioner Ruling at 2.) The Interim Opinion is strictly a legal interpretation of the first priority condition, as the following indicates:

> This decision interprets a provision of a previously issued Commission decision. It does not rule on any factual issue relating to the past behavior of any of the Respondents. However, in their various comments, the Respondents have cited a whole range of purely speculative outcomes that assume one or more sets of factual determinations that this decision does not make. It is not necessary for this Commission to address or rebut such factual speculations in a decision that is based entirely on legal analysis and considerations of public policy.[41]

Because the Interim Opinion is not fact-driven, we deny Sempra/SDG&E's request for hearings. Additionally, any claims of lack of substantial evidence are without merit. As the Interim Opinion properly concluded, it is not necessary to refer to the record of the holding company proceeding to determine the meaning of the first priority condition.[42]

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[40] PU Code § 1708 provides in pertinent part that "[t]he commission may at anytime, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order or decision made by it."

[41] Interim Opinion, *mimeo* at 35.

[42] See Interim Opinion, *mimeo* at 40, Conclusion of Law No. 6.

G. The Interim Opinion Is a Majority Opinion.

Much is made by the utilities and the holding companies regarding Commissioner Brown's concurrence. SCE argues that there is no majority opinion because Commissioner Brown's concurring opinion is in fact an opinion concurring and dissenting. (SCE Rhg. App. at 11-14) Sempra/SDG&E similarly argue that there is no majority opinion because Commissioner Brown's concurring opinion creates uncertainty as to the decision's holding regarding the meaning of the first priority condition. (Sempra/SDG&E Rhg. App., pp. 30-32) Their attempts to dilute the decision's holding by parsing every word of Commissioner Brown's concurrence fails because their arguments are specious. Indeed, Sempra/SDG&E themselves rely on a plurality opinion as authority to attack the Interim Opinion as not being a majority opinion.[43]

The fact of the matter is that Commissioner Brown was part of the majority of three Commissioners who voted for the Interim Opinion. He concurred in the Interim Opinion, even if he believes some language in it should be modified. He affirms the core principles upon which the decision was based. He specifically articulated his belief that "a First Priority condition requires the holding company to do more than look to the capital assets or investment in infrastructure." (Interim Opinion, Brown Concurring opinion.) This is directly counter to the Applicants' position that capital requirements refer only to equity capital. At the same time, the Commissioner does not believe that the first priority condition means that the holding company has an unlimited responsibility to keep cash flowing to the utility where the Commission has failed to allow compensatory utility rates. We agree with TURN that this statement "merely restates the obvious fact that the Commission must continue to adhere to Constitutional limitations on its activities and may not use the first priority condition as a substitute for compensatory

[43] Sempra/SDG&E Rhg. App., pp. 30-31. Sempra/SDG&E cites *Marks v. U.S.* (1977) 430 U.S. 188, 193 (quoting *Gregg v. Georgia* (1976) 428 U.S. 153, 169 n. 15 (plurality opinion).

ratemaking."[44] The Commission is addressing ratemaking issues simultaneously in another proceeding, as the Applicants are all aware.

Commissioner Brown interprets the first priority condition "to mean that both the holding company and the company must maintain the utility's financial condition so that it can serve its customers." (Interim Opinion, Brown Concurring opinion.) Read accurately, the recognition of the holding company's obligation to maintain the utility's financial condition includes, rather than excludes, the holding company's duty to infuse the utility with capital, in whatever form, so that the utility can fulfill its obligation to serve. This is the core of the decision and, on this point, there is no doubt of a solid majority. Commissioner Brown also signals his assent by expressing his belief that "the First Priority Condition means that a holding company is prohibited from transferring to itself the assets of the utility for less than proper consideration or for any value if the transfer would impair the utility's obligation to serve." (*Ibid*.)

H. The Interim Opinion Does Not Effectuate A "Taking" of Private Property.

PG&E, its holding company, and EIX contend that the Interim Opinion's expansive interpretation of the First Priority condition would result in an unconstitutional taking of property without just compensation, in violation of the Fifth and Fourteenth Amendments to the U.S. Constitution. (PG&E Rhg App., pp. 22-23; PG&E Corp. Rhg. App., pp. 17-20; EIX Rhg. App., p. 3) Their theory is that an unconstitutional taking would result from requiring the utilities and holding companies to contribute capital for a public use without the opportunity to recover that capital, as well as receive a reasonable return on the investment. In particular, PG&E Corp. argues that the infusion of "working capital" (cash for operating expenses), as opposed to "equity capital" (investment in plant and equipment), would effectuate a "taking." This argument has no merit. There is nothing necessarily special about working capital, as "[c]orporate owners regularly infuse working capital into the corporations they own, with the expectation that by doing so,

[44] TURN Rhg. Response, pp. 6-7.

they will reap future benefits by, for example, returning an ailing corporation to profitability."[45] Capital requirements of a utility include the need for working capital. Without sufficient working capital, equity capital may be jeopardized; therefore, shareholders should not be precluded from infusing working capital into the utilities, if necessary, because they stand to benefit from a thriving going concern.

PG&E Corp. contends that any regulation that would force it to spend money without guaranteeing a reasonable rate of return is prohibited by the Constitution; however, the cases upon which it relies are inapposite. The Supreme Court has long established that public utilities are not guaranteed a fair rate of return:

> The due process clause of the Fourteenth Amendment safeguards against the taking of private property, or the compelling of its use, for the service of the public without just compensation…But it does not assure to public utilities the right under all circumstances to have a return upon the value of the property so used.[46]

The Court further stated that the "due process clause has been applied to prevent governmental destruction of existing economic values. It has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces."[47] Rates became unstabilized due to a variety of economic factors, including a dysfunctional market, the rate freeze imposed by AB 1890, and FERC's delay in implementing price caps. On these grounds, the Commission cannot be held to have violated due process.

The Applicants contend that state action, which results in a failure to recover their capital investments, amounts to a taking. The U.S. Supreme Court differs with this assertion. In *Duquesne Light Company v. Barasch* (1989) 488 U.S. 299, the Court held that a state scheme of utility regulation does not take property simply because it disallows

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[45] Interim Decision, *mimeo*, p. 24, n. 68, citing *In re Lifschultz Fast Freight* (7th Cir. 1997) 132 F.3d 339, 342.

[46] *Pub. Service Comm'n of Montana v. Great Northern Utilities Co.* (1933) 289 U.S. 130, 135.

[47] *Market Street Ry. Co. v. RR Comm'n of Calif.* (1945) 324 U.S. 548, 567.

recovery of capital investments that are not used and useful in service to the public. The Court explicitly rejected the notion that even if an investment was prudent, its recovery is mandated by the Constitution. The Court reasoned that so long as the end result of the ratemaking process is a rate of return that is not so low as to be confiscatory, the treatment of particular components of the rate did not violate the Constitution.

PG&E Corp. asserts that *Brooks-Scanlon v. RR Comm'n of Louisiana* (1920) 251 U.S. 396 is dispositive of the takings issue. (PG&E Corp. Rhg. App., pp. 18-20) We disagree, and find another line of cases to be dispositive. In *Missouri Pacific Ry. Co. v. Kansas* (1910) 216 U.S. 262, the Court held that if a railroad continues to exercise the power conferred on it by a charter from a state, the state may require it to fulfill an obligation imposed by the charter even though fulfillment may cause a loss. (*Missouri Pacific Ry. Co., supra* at 276, 278.) In *Alabama PSC v. Southern Ry Co.* (1951) 341 U.S. 341, 352, the Court noted that "[i]t has long been settled, however, that a requirement that a particular service be rendered at a loss does not make such a service confiscatory and thereby an unconstitutional taking of property. The same principle was echoed in *Chicago, M.St.P. & P.R.Co. v. Bd. of RR Comm'n.* (1953) 255 P.2d 346, where a railroad company was ordered to continue providing certain lines of passenger service, even though the service was operating at a loss. The court said: "It has long been settled that a requirement that a particular service be rendered at a loss does not make a service confiscatory and thereby an unconstitutional taking of property."[48]

The holding companies achieved their legal relationship with the utilities, and exercise the powers of, and enjoy the benefits of, a parent company as a result of the Commission's approval in the holding company decisions. If the holding company continues to exercise the authority conferred on it by the Commission, the Commission may require it to fulfill the first priority condition, even if the fulfillment causes a loss. There is no taking.

[48] *Chicago v. Bd. of RR Comm'rs, supra*, p. 351.

I. The Commission Did Not Violate § 451.

SCE claims that the Commission's expansive interpretation of the first priority condition violates PU Code § 451 "because the need for infusions of 'working capital' and cash for operating expenses can only arise if the Commission has failed to discharge its statutory and constitutional duty to provide for 'just and reasonable' rates, *i.e.*, rates which cover operating expenses and provide a return of and on invested capital." (SCE Rhg. App., p. 14) SCE also found a violation of § 451 in another sense "because its effect will be to raise SCE's cost of capital unnecessarily, a cost which must be passed along to ratepayers, causing them to pay higher rates that would have been avoided." (*Id*. at 15.) SCE's arguments are without foundation. The Commission did not violate § 451, a statute which places an obligation to serve on the utilities.[49]

SCE is misguided and overly simplistic in stating that the need for infusions *can only arise* if the Commission failed to provide for just and reasonable rates. SCE's contention does not consider the underlying factors that played a role in contributing to the utility's financial instability. Under AB 1890, a statutory rate freeze was in effect. The Commission raised rates on an interim basis in January 2001, and then on a permanent basis in March, after changes in the law were enacted by the legislature.

PG&E claims that the "Interim Opinion is an attempt by the Commission to place upon the holding company the responsibility for having driven PG&E bankrupt by failing to allow compensatory rates." (PG&E Rhg. App., p. 28) The rate freeze about which the utilities complain derives from legislation that they actively lobbied for, not from Commission practice.[50] AB 1890 froze retail electric rates at the level in effect on

[49] PU Code § 451 requires *every public utility* to furnish and maintain adequate, efficient, just and reasonable service as necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public.

[50] PG&E even claimed to have "developed" the statute in an annual report to shareholders. (OII, *mimeo*, p. 5)

June 10, 1996 until the end of a "transition period."[51] For the holding companies to now complain about the application of the first priority condition shows the essential need for the Commission to protect the public interest. The utilities do not merely exist as "cash cows" for the holding companies, they provide essential public services for millions of California ratepayers.

J. Due Process and Prejudgment

1. The Legal Issue Posed in the OII Does Not Preclude an Examination of the Relationship Between the First Priority Condition and PG&E's Bankruptcy Proceedings.

PG&E and its holding company claim that the Interim Opinion violates their due process rights. PG&E Corp. specifically objects to the Interim Opinion's statement the "PG&E Corp.'s bankruptcy Plan raises the inference of a first priority condition violation." (PG&E Corp. at 23, citing Interim Opinion at 6) Its argument is that the relationship between the first priority condition and the bankruptcy proceedings was not raised in these OII proceedings. PG&E Corp. has completely missed the mark. The Assigned Commissioner's Ruling asked the parties to brief the following issue: "Under what circumstances, if any, does the 'first priority' condition require a holding company to infuse money into its utility subsidiary?" (ACR at 2.) The question is an open one, not limited to any particular situation, but inclusive of any circumstance that could be a contributing factor to triggering the requirement that a holding company infuse money into its utility subsidiary.

The legal issue easily encompasses the situation at issue here, where the utilities claimed they were brought to the brink of bankruptcy, with PG&E voluntarily filing for bankruptcy, and the parent companies failing to provide them with capital,

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[51] See PU Code § 367 and § 368(a). The rationale was to freeze the rates, which then were higher than the utilities' current or projected operating costs, so that the excess rates would provide the utilities a reasonable opportunity to recover their stranded costs. The rate levels would remain in effect until the earlier of March 31, 2002, or the date upon which the Commission-authorized costs have been fully recovered.

despite having been funneled billions of dollars by the utilities. (OII, pp. 5-8) A consideration of the impact of these asset transfers on the utilities is not the exclusive province of either the bankruptcy court, or PG&E's Plan of Reorganization. An examination of the relationship between the bankruptcy, and near bankruptcy, of the utilities and any obligation by the holding companies to provide financial assistance after having benefited from the largesse provided by the utilities is in order here at the Commission. If the first priority condition means anything at all, it means that these circumstances merit an examination of whether the first priority condition is triggered. While the Interim Opinion did not conclusively find that any Applicant violated the first priority condition, the relationship between the first priority condition and the bankruptcy proceedings should be examined. This OII is the vehicle for doing so, without litigating the bankruptcy, which is taking place in another forum. The examination of whether the first priority condition has been triggered cannot ignore the fact that PG&E is in bankruptcy. It would be like the proverbial elephant in the room that no one mentions, but everyone knows is there.

In sum, we will not litigate the bankruptcy in this proceeding; however, the Interim Opinion justifiably addresses it as one of various factors that may have played a role in further jeopardizing the utility's financial health and bringing into question whether the first priority condition is implicated.

2. The Commission Did Not Prejudge Whether the First Priority Condition Has Been Violated.

PG&E contends that the Commission prejudged "both the interpretation of the First Priority condition *and* a violation of it." (PG&E Rhg. App., p. 29) This argument has no merit. PG&E's alleged proof of prejudgment consists of a pleading filed in the bankruptcy court, and another filing before FERC. The Commission has not prejudged the first priority condition or any alleged violation. In point of fact, in this proceeding, the Commission has not made a final determination that any utility or holding company violated the first priority condition. (Interim Opinion, *mimeo* at 2, 35.)

To clarify that there has been no final determination of any violation of the first priority condition, we add it to the findings of fact.

PG&E's claim that the Commission has prejudged its interpretation of the first priority condition by making statements in other forums is a very thin reed upon which to base an argument. The Commission is entitled to advance the most effective legal arguments it can make in other forums, which are separate, distinct, and not a part of this OII. Parties may argue in the alternative in the same proceeding, and may surely do so in different proceedings. By doing so, the Commission has not prejudged its interpretation of the first priority condition in this proceeding.

PG&E Corp. also claims that the Interim Opinion violated basic procedural due process guarantees by prejudging without notice the relationship between the first priority condition in the bankruptcy proceedings, arguing that the issue was never raised in these OII proceedings. (PG&E Corp. Rhg. App., p. 2, 23-24) For the reasons already stated, we do not find any merit in this argument. The legal question before the parties is broad enough to encompass any circumstance that could trigger a requirement by a holding company to infuse money into the utility subsidiary. Bankrupcy and near bankruptcy of a utility are circumstances that cannot reasonably be ignored where the issue is under what circumstances should a holding company be required to render financial assistance to the utility.

PG&E and its holding company contend that their due process rights were violated by biased decisionmakers who prejudged the issues. PG&E cites *Withrow v. Larkin* (1975) 421 U.S. 35 in support thereof. (PG&E Rhg. App., p. 29) The quote concerning biased decisionmakers is taken out of context and bears no relationship to the actual outcome of the case. In *Withrow*, a physician, who was accused of unethical conduct, sued to enjoin a hearing by the medical board, contending that the board's role as investigator and adjudicator violated due process. The district court enjoined the hearing, the Court of Appeals affirmed, and the U.S. Supreme Court granted certiorari. At the U.S. Supreme Court, neither bias nor a due process violation was found. The Court reversed the lower courts, holding that it does not violate due process for a medical

board to both investigate and adjudicate. It is no violation of due process for an administrative agency to perform multiple functions. Therefore, PG&E Corp's accusation that "the Commission has acted as advocate, judge, and interested party simultaneously, ignoring PG&E Corporation's due process rights" is without merit. (PG&E Corp. Rhg. App., pp. 24) The same response applies to PG&E's nearly identical claim. (PG&E Rhg. App., pp. 31-32) The Court stated further that in the absence of contrary evidence, "state administrators 'are presumed to be men of conscience and intellectual discipline, capable of judging a particular controversy on the basis of its own circumstances'."[52]

3. The Parties Had Adequate Time to Comment on the Draft Decision.

The Applicants fail to provide any authority to support the argument that the comment period for the Draft Decision was insufficient. The Draft Decision was issued on December 26, 2001; comments were due on January 4, 2002. Due to public necessity caused by the time pressures of the PG&E bankruptcy proceedings, the 30-day period for comments was reduced to nine days. The Applicants are all aware that the state and the energy utilities have been in a time of crisis, and that it has been necessary to expedite many of the decisions that Commission has issued. PG&E Corp's refusal to accept this justification on the ground that the Reorganization Plan was already before the bankruptcy court for many months reads more into the Interim Opinion than is warranted. (PG&E Corp. Rhg. App. at 25) The Interim Opinion did not specify which aspect of the bankruptcy proceedings caused the time pressures.

The Applicants had ample opportunity to do legal analyses and submit comments on the preliminary legal issues, including the first priority condition. The ACR of April 30, 2001, required the parties to comment on two legal issues, one of which was: "Under what circumstances, if any, does the "first priority" condition require a holding company to infuse money into its utility subsidiary." Opening briefs were

[52] *Withrow, supra*, p. 55, citing *United States v. Morgan* (1941) 313 U.S. 409, 421.

submitted on May 17th and reply briefs on May 23, 2001. The comments submitted on January 4, 2002 did not differ appreciably from the briefs submitted in May, 2001. The Applicants had ample opportunity to be heard on the legal issues surrounding the first priority condition.

4. Imputing Improper Motives to the Commission Is Meritless.

In alleging that the Commission timed the issuance of the Interim Opinion as part of a broader litigation strategy, PG&E points to no relevant authority holding that the Commission's acting upon such a litigation strategy breaches statutory or constitutional law. (PG&E Rhg. App., pp. 30-31) As a participant in various actions in different forums, the Commission would be wise to have a broad strategy. The Supreme Court has long held that:

> The decisions of this court from the beginning lend no support whatever to the assumption that the judiciary may restrain the exercise of lawful power on the assumption that a wrongful purpose or motive has caused the power to be exerted.[53]

So long as a government action is legally valid and adequately supported, allegations of improper motives on the part of the government body are not relevant to a legal review of that action.[54] Furthermore, we will not second-guess the Attorney General's timing or strategy in going forward with his litigation.

Sempra/SDG&E also suggest improper motives in our dismissal without prejudice of PG&E Corp. from this proceeding, but not Sempra. (Sempra/SDG&E at 32.) Again, there is neither smoke nor fire, nor anything nefarious afoot. The Commission is engaged in litigation on various fronts and must make many judgment calls in deciding how to allocate its limited resources for maximum efficiency. Where, in

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[53] *McCray v. United States* (1904) 195 U.S. 27 at 56; *accord Arizona v.* California (1931) 283 U.S. 423, 455.

[54] *U.S. v. O'Brien* (1968) 391 U.S. 367, 382; *New Orleans Public Service, Inc. v. Council of New Orleans* (5th Cir. 1990) 911 F.2d 993, 1004.

connection with pending litigation, the Commission deliberates how it will proceed or how it will allocate its resources, the Commission need not disclose the mental processes by which such decisions are reached.[55] Moreover, since the Commission dismissed PG&E Corp. without prejudice, PG&E Corp. is not foreclosed from petitioning the Commission for subsequent inclusion in these proceedings, if it so chooses. The allegation of improper motives, without more, does not prove Sempra/SDG&E's case.

K. California Corporations Law Is Not Violated.

Sempra/SDG&E argue that the obligation on Sempra to infuse capital to SDG&E is inconsistent with California Corporations law by preventing its board of directors from fulfilling its statutory fiduciary obligation to shareholders, in violation of §300(a) of that code. (Sempra/SDG&E, pp. 5-6.) This code section provides generally that "the business and affairs of the corporation shall be managed and all corporate powers shall be exercised by or under the direction of the board." Their claim is that the first priority condition could interfere with the freedom of the board of directors to allocate resources and otherwise manage corporate affairs. This argument is as weak as it is self-serving. TURN said it best: "Corporate directors may not decide to make a deal on one day, only to subsequently claim that performance would infringe upon their sovereign rights and fiduciary duties." (TURN Rhg. Response, p. 6.)

In a regulatory environment, the Commission has the authority to have a say in matters ordinarily left to management and the board of directors in an unregulated environment. Although the Commission prefers to leave management of the utility to its managers, if consistent with the public interest:

> Government regulation of public utilities is necessarily a halfway house between public ownership and unfettered private control of the providers of essential services. We as regulators must often monitor decisions that would ordinarily be management's sole responsibility.[56]

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[55] See *County of Los Angeles v. Superior Court* (2000) 82 Cal.App.4th 819, 835.

[56] *Re SDG&E* (1986) 20 CPUC2d 660, 670.

Pursuant to the Commission's constitutional and statutory authority over public utilities, those functions are not unlawfully invaded. These functions flow out of the state's exercise of the police power in the regulation of public utilities. (*Southern Pac. Co. v.* PUC (1953) 41 Cal.2d 354, 367.) In view of a direct grant of authority from the Legislature to regulate public utilities, the Corporations Code is not deemed to be violated when the Commission exercises this authority. With respect to Sempra, it owes its very creation to conditions imposed by the Commission when it issued its holding company decision. The Commission has the authority to impose those conditions, which Sempra had the option of accepting or rejecting, as was done after the Commission approved SDG&E's Authorization 1.

L. Official Notice

PG&E and its holding company request that the Commission take official notice of a number of items. In neither request do PG&E or PG&E Corp. establish the relevancy or materiality of the items for which they seek official notice. They simply list the items.

1. PG&E Corp's Request

PG&E Corp., by special appearance, requests official notice of the following: 1) Exhibit A - Commission press release dated January 10, 2002, expressing support for the lawsuit filed against PG&E Corp. filed by the Attorney General; 2) Exhibit B - the Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company Proposed by Pacific Gas and Electric Company and PG&E Corporation, N.D. Cal. Bankr. Case No. 01-30923 DM (the "Bankruptcy Case")(Docket No. 3505, filed Nov. 27, 2001 at 18:3-5 and n. 20; 3) Exhibit C - the Declaration of Loretta M. Lynch in Further Support of the Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization (filed Jan. 8, 2002) at 7:9-21; and 4) Exhibit D - Press articles with various quotes from the Los Angeles Times, October 2, 2001 and the San Francisco Chronicle, Oct. 31, 2001.

PG&E Corp. made its request pursuant to Rule 72 of the Commission's Rules of Practice and Procedure. Rule 72 provides in pertinent part as follows: "If any matter contained in a document on file as a public record with the Commission is offered in evidence, unless directed otherwise by the presiding officer, such document need not be produced as an exhibit, but may be received in evidence by reference, *provided that the particular portions of such document are specifically identified and are competent, relevant and material*." (Cal.Code Regs., tit. 20; emphasis added.)

We do not take official notice of Exhibits A and D since PG&E Corp. failed to establish that the press release or newspaper clippings are relevant and material in its request for official notice. Furthermore, we have already stated that allegations of improper motives are not relevant to a legal review of government action. The request for official notice of Exhibit B is superfluous since the Commission has already taken official notice of the Commission's Objection to PG&E's Disclosure Statement in the Interim Opinion. (See Interim Opinion, Finding of Fact No. 19.)

We look to the ACR of April 30, 2001 to determine whether to take official notice of PG&E Corp's Exhibit C. The ACR provides that: "The parties may refer to material in the records of the holding company decisions, or any other matter of which the Commission has taken or may take official notice, in briefing these matters." Since the Commission has already taken official notice of Exhibit B, and since Exhibit C is intertwined with Exhibit B, we take official notice of Exhibit C.

2. PG&E's Request

PG&E requests the inclusion of Exhibits A through H, as follows: 1) Exhibit A – the Commission's Objection to the Proposed Disclosure Statement for Plan of Reorganization under Chapter 11; 2) Exhibit B – Errata to the Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization under Chapter 11; 3) Exhibit C - Motion to Intervene Out-of-Time, Protest, Request to Vacate Decision Or in the Alternative, Request for Rehearing of the California Public Utilities Commission (filing before FERC); 4) Exhibit D - Complaint for Restitution, Civil Penalties, Injunction, Appointment of Receiver (CGC-02-403289) filed by the Attorney General; 5) Exhibit E

– Rebuttal Testimony of Gary Harpster On Behalf of Office of Ratepayer Advocates in A.95-10-024 (1998); 6) Exhibit F – Office of Ratepayer Advocates' Opening Brief in A.95-10-024 (November 10, 1998); 7) Exhibit G – Testimony of Stanley W. Hulett; and 8) Exhibit H – Declaration of Kenneth K. Chew.

PG&E requested official notice pursuant to both Rule 72 and 73. Rule 73 of the Commission's Rules of Practice and Procedure provides that "[o]fficial notice may be taken of such matters as may be judicially noticed by the courts of the State of California." (Cal.Code Regs., tit. 20) 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 §§452 (c) and (d)). Courts may take judicial notice of the records and files of state agencies, including those of the Commission. (*See Pratt v. Coast Trucking, Inc.* (1964) 228 Cal. App. 2d 139, 143-44.)

We have already taken official notice of what constitutes PG&E's Exhibits A and B for the same reasons we noticed PG&E Corp's Exhibit C. Since PG&E's Exhibits E and F are excerpts of documents, we take notice of the complete documents, pursuant to the completeness doctrine.[57] We believe this makes for a fair and impartial understanding of the documents. We note also that portions of these documents were referenced in the Interim Opinion. We decline to take official notice of PG&E's Exhibits C, D, G and H because, in its request, PG&E did not establish the relevancy and materiality of these items to this proceeding. Fleeting references to improper motives in the rehearing application do not establish relevancy, nor do recent statements from partial declarants.

In sum, we take judicial notice of PG&E's Corp's Exhibit C (Declaration of Loretta Lynch in Further Support of the Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization), and PG&E's Exhibits E (Rebuttal Testimony of

[57] See *U.S. v. Brown* (9th Cir. 1984) 720 F.2d 1059.

Gary Harpster) and F (Office of Ratepayer Advocates' Opening Brief). We also notice PG&E's Exhibits E and F in their complete form.

We make the distinction that taking official notice of the existence of documents should not be confused with taking notice of the truth of the contents. We are mindful that judicial notice of the truth of the content of a court or agency file is proper only "when the existence of the record itself precludes contravention of that which is recited in it…." *Columbia Casualty Co. v. Northwestern Nat'l Ins. Co.* (1991) 231 Cal. App. 3d 457, 473 (court may not properly take judicial notice of content of court papers filed in support of motion for summary judgment). Judicial notice of a document's content is inappropriate in other instances because the truth of a document's content is reasonably subject to dispute or constitutes hearsay. *Id. See also Garcia v. Sterling* (1985) 176 Cal. App. 3d 17, 22 ("Although the existence of statements contained in a deposition transcript filed as part of the court record can be judicially noticed, their truth is not subject to judicial notice.").

Thus, a court and, therefore, the Commission may take judicial/official notice of the existence of each document in a court or agency file, but can only take judicial notice of the truth of facts asserted in documents such as orders, findings of fact, conclusions of law, and judgments. *See Magnolia Square Homeowners Ass'n v. Safeco Ins. Co. of America* (1990) 221 Cal. App. 3d 1049, 1056 (citing *Day v. Sharp* (1975) 50 Cal. App. 3d 904) (judicial notice of allegations in a complaint proper because allegations not offered to prove their truth, but that plaintiff had notice of matters alleged); *People v. Buckley* (1986) 185 Cal. App. 3d 512, 525 (judicial notice of preliminary hearing transcript used to show that excluded testimony was duplicative of earlier testimony).

IV. CONCLUSION

We have reviewed each and every allegation of legal error raised in the rehearing applications, and are of the opinion that legal error has not been demonstrated. Therefore, we deny rehearing. However, in the interest of clarity, we modify and add findings of fact and conclusions of law.

Therefore, **IT IS ORDERED** that:

1. The following is added as Finding of Fact No. 23:

   The Commission has made no final determination that any utility or holding company violated the first priority condition, or that any particular remedy should follow.

2. Conclusion of Law No. 5 is modified to read:

   The "balanced capital structure" requirement is distinct from the first priority condition, which imposes a different requirement – namely that the holding company must infuse capital into the utility when needed to meet its obligation to serve.

3. The request by PG&E for official notice of its Exhibits E and F is granted. We notice the complete documents.

4. The request by PG&E Corp. for official notice of its Exhibit C is granted.

5. The rehearing of D.02-01-039 is denied in all other respects.

This order is effective today.

Dated July 17, 2002 at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

I abstain.

/s/ Michael R. Peevey
Commissioner