COM/LYN/hkr ** **Mailed 4/4/2001**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation whether Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and their respective holding companies, PG&E Corporation, Edison International, and Sempra Energy, respondents, have violated relevant statutes and Commission decisions, and whether changes should be made to rules, orders, and conditions pertaining to respondents' holding company systems.	FILED PUBLIC UTILITIES COMMISSION APRIL 3, 2001 SAN FRANCISCO OFFICE INVESTIGATION 01-04-002

ORDER INSTITUTING INVESTIGATION

I. Summary

We issue this Order Instituting Investigation to determine whether respondent utilities and their respective holding companies have complied with relevant statutes and Commission decisions in the management and oversight of their companies. As more fully set forth below, we are concerned that respondents' management and Board of Directors actions, including but not limited to (1) the utilities' transfer of billions of dollars to their holding companies since deregulation of the electric industry commenced, including during times when the utilities were experiencing financial distress; (2) the failure of the holding companies to financially assist the utilities when needed, leaving the utilities with insufficient reserves to address or mitigate their need

for capital; (3) the transfer by the holding companies of billions of dollars in assets to unregulated subsidiaries;[1] and (4) the actions of some of the holding companies to "ring fence" their unregulated subsidiaries, have violated Commission decisions, rules, or orders, and/or applicable statutes.

We also will determine whether additional rules, conditions, or changes are needed to adequately protect ratepayers and the public from dangers of abuse stemming from the holding company structure.

In conjunction with opening this proceeding, we reopen the respective proceedings authorizing holding company formation, and consolidate them together with this docket for the purpose of addressing the issues raised in this proceeding.

II. Background

In the 1980's and 1990's, respondent utilities – Pacific Gas and Electric Company (PG&E), Southern California Edison Company (Edison), and San Diego Gas & Electric Company (SDG&E) – sought the Commission's permission to change their corporate structure and become part of a holding company system. The Commission has issued the following decisions approving the formation of PG&E Corporation, Edison International (EIX), Enova Corporation, and Sempra Energy as holding companies:

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

[1] As used in this document, "unregulated subsidiaries" refers generally to all of the subsidiaries and affiliates of respondent holding companies other than respondent utilities.

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

Edison- D.88-01-063, 27 CPUC2d 347 (Jan. 28, 1988) (Edison Authorization).

Because of the potential for abuse arising from the holding company structure,[2] the Commission's authorizations for the formation of respondent holding companies depended on respondents' compliance with a set of carefully considered conditions. The utilities and/or parent companies were required to pass, and file with this Commission, board resolutions agreeing to the conditions as a prerequisite to the Commission's permission to form the holding company structure.[3] The parties executed these agreements as required.

Among the conditions we imposed, of particular relevance to this proceeding are the following:

- The holding company must give "first priority" to the capital needs of its utility subsidiary to meet its obligation to serve;[4]

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[2] See generally, section 1 of the Public Utility Holding Company Act (PUHCA), 15 U.S.C. § 79a (detailing potential abuses); SDG&E Authorization II, D.95-12-018, 62 CPUC2d at 634. The three respondent holding companies presently are exempt under section 3(a)(1), 15 U.S.C. § 79c(a)(1), from most of PUHCA's provisions.

[3] See Edison Authorization, 27 CPUC2d at 376, Ordering Paragraph 2; SDG&E Authorization II, 62 CPUC2d at 651-652, Ordering Paragraph 14; PG&E Authorization I, 69 CPUC2d at 202, Ordering Paragraph 25; see also Re Pacific Enterprises, 184 P.U.R.4th at 498, Ordering Paragraph 4.

[4] **PG&E:** "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." PG&E Authorization II, 194 P.U.R.4th at 45, Ordering paragraph 8, 1999 Cal.

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- The utility must maintain a dividend policy "as though it were a comparable stand-alone utility company."[5]

The SDG&E and PG&E decisions also give the Commission authority to conduct comprehensive audits of the entire holding company system at shareholder expense to verify compliance with the conditions imposed by the decisions, as well as other rules and regulations. Similarly, the Commission has general authority to audit Edison's holding company system under Sections 314 and 797 of the Public Utilities Code. This proceeding does not take the place of the comprehensive audits referred to above, and the Commission anticipates initiating such audits during the timeframe set out in the decisions.

III. Utility and Holding Company Actions

In 1996, the California State Legislature enacted Assembly Bill (AB) 1890, in order to bring competition to California's electric generation market. At that time, the utilities projected billions of dollars in "stranded costs" – costs that the

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PUC LEXIS 242, at 151. See also PG&E Authorization I, 69 CPUC2d at 201, Ordering paragraph 17.

Edison: "The capital requirements of the utility, as determined to be necessary to meet its obligation to serve, shall be given first priority by the Board of Directors of Edison's parent holding company and Edison." Edison Authorization, 27 CPUC2d at 376, Ordering paragraph 12.

SDG&E: "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." SDG&E Authorization 2, Ordering paragraph 6, 62 CPUC2d at 651; see also Sempra Merger Authorization, Ordering paragraph 2(b) & Attachment B(IV)(5), 184 P.U.R.4th at 498, 502.

[5] See PG&E Authorization I, Ordering paragraph 15; 69 CPUC2d at 201; Edison Authorization, Ordering paragraph 10, 27 CPUC2d at 376; SDG&E Authorization II, Ordering paragraph 5, 62 CPUC2d at 651; see also Sempra Merger Authorization, Ordering paragraph 2(b) & Attachment B(IV)(4), 184 P.U.R.4th at 498, 502.

utilities might not be able to recover in the normal course of business in the newly competitive market. See Cal. Pub. Util. Code § 367. AB 1890 was designed, in part, to give the utilities an opportunity to recover those stranded costs. To that end, AB 1890 froze the retail electric rates at the level in effect on June 10, 1996, until the end of a "transition period." See Cal. Pub. Util. Code §§ 367, 368(a). The rationale behind AB 1890 was that because the frozen rates were higher than the utilities' then-current or projected operating costs, the excess gave the utilities a reasonable opportunity to recover their stranded costs, as well as their other costs (e.g., distribution, transmission, and the cost of power that they have to purchase) by March 31, 2002. See Cal. Pub. Util. Code § 367. This statute was enacted with the cooperation and support of respondents. For example, PG&E stated in an annual report to shareholders that it had "developed" the statute.[6]

During the first years of the transition period, the utilities and their respective holding companies received billions of dollars in excess revenues due to the high frozen rates and other provisions of AB 1890. For example:

* PG&E has received $2.9 billion in up-front cash proceeds from rate reduction bonds,[7] and over $9 billion in headroom and other transition cost revenues.[8]

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[6] See PG&E Corp. March 5, 1998 SEC Form 10-K, Exhibit 13, 1997 Annual Report to Shareholders, at 20.

[7] December 1998 Agreed upon Special Procedures Audit of Transition Cost Balancing Accounts and Headroom Revenues for the six months ended June 30, 1998, prepared by Mitchell & Titus, LLP and Barrington-Wellesley Group, Inc. for this Commission (at III-34) (Agreed Upon Special Procedures Audit); see also D.01-01-018, slip op. at 13.

[8] See D.01-01-018, slip op. at 13. The difference between frozen rates and the authorized costs of providing service (i.e., revenue requirements and Commission-

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* Edison has received $2.5 billion in up-front cash proceeds from rate reduction bonds,[9] and over $7 billion in headroom and other transition cost revenues.[10]

* SDG&E received at least $900 million in headroom revenue and other transition cost revenues. SDG&E also received $658 million in up-front cash proceeds from the issuance of rate reduction bonds.[11]

Much of these funds were transferred from the utilities to their respective holding companies.[12] Specifically:

* 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.[13] Of the amounts disbursed, PG&E paid $125 million in dividends to its parent in the third quarter of 2000 alone.[14]

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approved costs and obligations) is referred to as headroom. See id. at 17, Finding of Fact 7.

[9] See December 1998 Agreed Upon Special Procedures Audit at III-34; see also D.01-01-018, slip op. at 13.

[10] See D.01-01-018, slip op. at 13.

[11] See sum of revenues in SDG&E's Monthly TCBA reports through June 30, 1999, on file with the Commission; December 1998 Agreed Upon Special Procedures Audit, at III-34.

[12] By describing these fund transfers, we do not mean to imply that they necessarily were improper. Such transfers only become problematic, as discussed below, in the event that the utilities experience or anticipate experiencing financial distress.

[13] PG&E Corp.'s 1999 Annual Report to Shareholders, PG&E Co. Statement of Consolidated Stockholders' Equity, at 35; PG&E Corp. Nov. 1, 2000 SEC Form 10-Q, Liquidity and Financial Resources, Cash Flows From Financing Activities.

[14] PG&E Corp. Nov. 1, 2000 SEC Form 10-Q, Liquidity and Financial Resources, Cash Flows From Financing Activities; PGE&E Corp. Aug. 2, 2000 SEC Form 10-Q, Liquidity and Financial Resources, Cash Flows From Financing Activities.

* From 1998 through September 2000, Edison provided EIX approximately $2 billion in dividends on common stock.[15] Of this amount, Edison paid over $90 million to its holding company in the third quarter of 2000 alone. [16]

* From 1998 through September 2000, SDG&E provided Sempra Energy at least $763 million in dividends on common stock.[17] 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.[18]

The holding companies did not retain most of these funds, but instead disbursed them in a variety of ways:

* From 1998 through September 2000, PG&E Corporation paid out approximately $1.3 billion in dividends to shareholders and repurchased approximately $1.9 billion worth of common stock.[19] There also is evidence that PG&E Corporation disbursed over $800 million to its unregulated subsidiaries between 1997 and 1999.[20] PG&E has informed the

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[15] Edison 1999 Annual Report to Shareholders, Consolidated Statement of Changes in Common Shareholders' Equity, at 18; Edison Nov. 14, 2000 SEC Form 10-Q, at 7.

[16] Edison Nov. 14, 2000 SEC Form 10-Q, Consolidated Statement of Cash Flows, at 7.

[17] SDG&E March 29, 2000 SEC Form 10-K, 1999 Annual Report, Management's Discussion and Analysis of Financial Conditions and Results of Operations, at 17; SDG&E Nov. 13, 2000 SEC Form 10-Q, Condensed Statements of Consolidated Cash Flows.

[18] SDG&E Nov. 13, 2000 and Aug. 14, 2000 SEC Form 10-Q, Condensed Statements of Consolidated Cash Flows.

[19] PG&E Corp. 1999 Annual Report to Shareholders, PG&E Corp. Statement of Consolidated Common Stock Equity, at 30; PG&E Corp. Nov. 1, 2000 SEC Form 10-Q, Liquidity and Financial Resources, Cash Flows From Financing Activities.

[20] See BWG Audit Report at VI-4 to VI-6. (In ongoing rate stabilization proceedings, A.00-11-038 et al., this Commission has engaged independent auditors to separately evaluate PG&E's and Edison's financial condition and claims of insolvency. Within the scope of PG&E's audit, the Barrington-Wellesley Group, Inc. (BWG) reviewed PG&E's

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Commission that PG&E Corporation subsequently acted to shield the assets of these subsidiaries, using a technique called "ring fencing."[21] According to PG&E, as a result of the ring fencing, the assets of PG&E Corporation's ring fenced subsidiaries are unavailable to assist the utility. See Transcript of proceedings in Application (A.) 00-11-038/A.00-11-056 /A.00-10-028 (hereinafter "TR") at 1566, 1602-03.

* From 1998 through September 2000, EIX paid out approximately $1 billion in dividends to shareholders, and repurchased approximately $1.2 billion worth of common stock.[22] There also is evidence that between January 1, 1996 and November 30, 2000, EIX disbursed $2.5 billion to the Mission Group, an unregulated subsidiary.[23] Edison took steps to shield the assets of some of the Mission Group's subsidiaries through the "ring fencing" mechanism.[24]

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financial position, as well as that of its holding company and affiliates. See BWG audit at I-1. Within the scope of Edison's audit, KPMG, LLP reviewed Edison's financial data, and where applicable, the similar records of EIX and Edison's other affiliated companies in the Mission Group. See KPMG audit at I-1.

These audits have been released as public documents and are being addressed in the rate stabilization proceedings. To the extent the audits are applicable to this proceeding, the Commission may take official notice of them, as well as the related record developed in the rate stabilization proceedings. See Rule 73 of the Commission's Rules of Practice and Procedure.

[21] See Feb. 8, 2001 letter from Mark Huffman to Administrative Law Judge Walwyn in A.00-11-038 et al.

[22] EIX 1999 Annual Report to Shareholders, Consolidated Statements of Changes in Common Shareholders' Equity, at 47; EIX Nov. 14, 2000 SEC Form 10-Q, Consolidated Statements of Cash Flows, at 4.

[23] See KPMG Audit Report at VII-2.

[24] See EIX January 15, 2001 SEC Form 8-K, at 5.

* From 1998 through September 2000, Sempra paid out approximately $888 million in dividends to shareholders and repurchased approximately $726 million worth of common stock.[25]

Dramatic increases in wholesale energy prices starting in the summer of 2000 have caused PG&E, Edison, and SDG&E to accumulate large amounts of debt, because their recent operating costs have exceeded their recent revenues. As a result of this accumulated debt, each utility has applied to the Commission for emergency rate increases, and each has claimed that its financial condition either threatens to impair, or has impaired, its ability to serve and operate. PG&E and Edison have also claimed that they face imminent bankruptcy without an immediate rate increase. By way of example only:

PG&E:

August 2000 — PG&E Corporation retains bankruptcy counsel. See TR at 1559.

Fall 2000 — PG&E states that it is "very concerned about having adequate liquidity." TR at 1559.

Oct. 4, 2000 — PG&E states: "The TRA balance currently includes over $2 billion in uncollected wholesale power costs, and the undercollection balance is continuing to increase at a rate of hundreds of millions of dollars per month. . . . The amount of such uncollected costs in PG&E's TRA was approximately zero at the end of May 2000, approximately $700 million at the end of June 2000, approximately $1.2 billion at the end of July 2000, and approximately $2.2 billion at the end of August 2000." Emergency Petition Of Pacific Gas And Electric Company For

[25] Sempra Energy 1999 Annual Report to Shareholders, Statements of Consolidated Cash Flows, at 42; Sempra Energy Nov. 13, 2000 SEC Form 10-Q, Condensed Statements of Consolidated Cash Flows, at 5.

Expedited Modification Of Decisions 99-10-057 and 00-03-058, at 3-4 (Oct. 4, 2000).

Nov. 22, 2000 PG&E files application for rate increase, stating: "Despite the cooler fall weather, wholesale electricity prices remain sky high, with no immediate relief in sight, either in the marketplace or from regulators. PG&E's undercollected power costs under the AB 1890 rate freeze soared from $2.2 billion at the end of August, 2000, to over $3.4 billion at the end of October, 2000." Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan, at 3 (A.00-11-056, filed Nov. 22, 2000).

Dec. 26, 2000 PG&E states that it expects to use up all cash reserves within 3-7 weeks. Pacific Gas and Electric Company Rate Stabilization Plan Supplemental Testimony at 2-3 (filed Dec. 26, 2000 in A.00-11-038/A.00-11-056/A.00-10-028).

Jan. 2, 2001 PG&E Corporation files SEC Form 8-K, stating that the utility "must either raise substantial sums of new capital or default on its payment obligations."

Jan. 10, 2001 PG&E announces that it is suspending payment of its 4th quarter 2000 common stock dividend. PG&E Corp. Jan. 10, 2001 SEC Form 8-K.

Jan. 12, 2001 PG&E states that it is deferring construction and maintenance because of liquidity problems. Response of Pacific Gas and Electric Company to Inquiry of Administrative Law Judge Regarding Release of Contractors and Hiring Hall Employees (filed Jan. 12, 2001 in A.00-11-038/A.00-11-056/A.00-10-028).

Feb. 1, 2001 PG&E states that it has defaulted on $437 million of maturing commercial paper, and notes that it is unable to make full payments due to the ISO and the PX. PG&E Corp. Feb. 1, 2001 SEC Form 8-K.

Feb. 6, 2001 Three qualifying facilities (QFs) sue PG&E for having made only partial payment for the facilities' December 2000 power deliveries and for having notified the QFs it was unable to pay

the full amount due under the power purchase agreements. See PG&E Corp. Feb. 14, 2001 SEC Form 8-K.

Feb. 26, 2001 PG&E considers itself to be in an emergency financial situation. TR at 1580.

March 2, 2001 PG&E Corporation arranges for $1 billion loan; its announcement does not indicate that any of that money will be used to assist PG&E. See PG&E Corp. March 2, 2000 news release.

March 5, 2001 PG&E claims that despite enactment of AB1X-1, it "remains backed against the abyss. In spite of the enactment of Assembly Bill (AB) 1x-1 during the legislature's current emergency legislative session, PG&E continues to incur additional power costs, including potentially over $1.5 billion in January and February of this year. Credit markets remain closed to PG&E. PG&E remains unable to pay its bills, and owes billions of dollars to its lenders and creditors. PG&E is in default to these lenders and creditors (and in technical default to several of its remaining lenders, as well) and therefore remains outside of involuntary bankruptcy only because of the good graces of those lenders and creditors." Opening Brief of Pacific Gas and Electric Company, filed March 5, 2001, in A.00-11-038/A.00-11-056/A.00-10-028, at 1.

Edison:

Nov. 14, 2000 Edison states that its "liquidity is being materially and adversely affected" by high wholesale energy costs. Edison Nov. 14, 2000 SEC Form 10-Q, at 32.

Nov. 16, 2000 Edison seeks immediate rate increase and states that as of September 31, 2000, the undercollection in Edison's TRA was $2.4 billion. See Application of Southern California Edison Company for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs, at 8 (A.00-11-038, filed November 16, 2000).

Dec. 4, 2000 — Edison files declaration in federal court, claiming that because of mounting debt, it has frozen hiring and suspended "discretionary equipment purchases and service contracts, new facility construction, and upgrades." It further claims that without rate increases, further cutbacks would be necessary, which "could jeopardize reliability of services provided by SCE." Declaration of James Scilacci in Support of Southern California Edison Company's Opposition to Defendants' Motion to Transfer Venue (dated Dec. 4, 2000) (filed in Southern California Edison Company v. Lynch, No. 00-12056-RSWL (United States District Court for the Central District of California), ¶ 3.

Dec. 6, 2000 — Edison files declaration in federal court claiming that as of October 31, 2000, its cumulative undercollection of wholesale power costs was $2.64 billion, and that Edison projects the undercollection to rise to $3.7 billion by December 31, 2000. See Declaration of James Scilacci (dated Dec. 6, 2000) (filed in Edison v. Lynch), ¶¶ 9-11.

Dec. 14, 2000 — Edison files declaration in federal court claiming that energy wholesalers are refusing to sell Edison energy because of its growing debt. See Supplemental Decl. of Stephen E. Frank in Support of Southern California Edison Company's Showing of Exigent Circumstances (dated Dec. 14, 2000) (filed in Edison v. Lynch), ¶¶ 3-7; see also id., ¶ 8 (referring to Edison's financial condition as an "emergency").

Jan. 5, 2001 — In letter to Edison employees, Edison Vice President Dick Rosenbaum states that Edison has implemented cash conservation measures, and that it "is inevitable that reductions of this magnitude will have great impact on . . . reliability . . . ." Attachment C to Edison Response To CCUE Emergency Motion (A.00-11-038) (January 5, 2001).

Jan. 15, 2001 — EIX files SEC Form 8-K, stating that due to increasing undercollections, Edison has begun cost-cutting measures that will "require lower service levels for customers" and "reduce near-term capital expenditures to levels that will not sustain operations in the long term," and noting that it may be forced

into bankruptcy.

Jan. 18, 2001 Edison files SEC Form 8-K, stating that Edison has suspended payment on a variety of obligations as they have become due, including payments to the PX, and dividends on its common and preferred stock.

Jan. 22, 2001 Edison files motion in federal court seeking order for immediate rate increase. Edison claims it has used up all existing credit, it is unable to get additional credit, it faces the "imminent prospect of involuntary bankruptcy," and an immediate rate increase is "urgently needed to prevent imminent irreparable harm" to "public health and safety." Memorandum of Points and Authorities in Support of Plaintiff Southern California Edison Company's Motion for Preliminary Injunction (Jan. 22, 2001) at 1-2 (filed in Edison v. Lynch).

SDG&E:

Oct. 24, 2000 SDG&E states that its growing accumulated debt, or "undercollection," "jeopardize[s] its ability to continue to provide safe, reliable utility service." Application of San Diego Gas & Electric Company, A.00-10-045 (Oct. 24, 2000) at 5.

Jan. 24, 2001 SDG&E requests immediate rate increase, stating that if Commission does not immediately grant it authority to implement a "rate surcharge," its growing debt will "jeopardize customer welfare." Application of San Diego Gas & Electric Company, A.01-01-044, (Jan. 24, 2001) at 4; see also id. at 9 (describing SDG&E "cash conservation" efforts and their effect on its ability to provide adequate customer service).

Feb. 14, 2001 SDG&E states that it has an immediate need for cash "in order to maintain service to its customers." Petition of San Diego Gas & Electric Co. (U 902-M) for Modification of D.01-02-011 (Feb. 14, 2001) at 2; see also id. at 3 (SDG&E "needs to be able to borrow money promptly to ensure that it has the financial capacity to maintain normal service to its customers").

Feb. 20, 2001 SDG&E states that absent additional funds, it will be "unable to sustain its on-going financial obligations needed to continue to serve utility customers." Application of San Diego Gas & Electric Co. (U 902-M) for Rehearing of Decision No. D.01-02-011 (Feb. 20, 2001) at 12; see also id. at 6 (need for cash "to continue to be able to serve is utility customers"); 8 (same); 10 (growing debt "endanger[s] SDG&E's ability to meet its on-going obligations needed to provide utility service").

IV. Order Instituting Investigation

This Commission has jurisdiction over respondents by virtue, inter alia, of their acceptance of those conditions that governed the formation of the respective holding companies. In addition, many provisions of the Public Utilities Code give the Commission broad authority to act to protect ratepayers in a variety of circumstances, to enforce the Constitution, statutes, and the Commission's rules, orders, and decisions, and to remedy violations thereof. These provisions include, but are not limited to, Public Utilities Code § 451 [requiring public utilities 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]; § 701 [Commission may do all things necessary and convenient to exercise its power and jurisdiction to regulate public utilities]; § 761 [Commission may adopt order or rule to remedy unjust or unreasonable practices of a public utility]; § 798 [provides for remedies against a utility that makes imprudent payments to its holding company]; and §§ 2101 – 2113 [authority to enforce Constitution, statutes, and violations of Commission orders, rules, and decisions].

Common law also provides the Commission with authority to disregard corporate forms in a variety of circumstances in order to carry out the Commission's responsibilities. See, e.g., General Telephone Co. v. P.U.C., 34 Cal. 3d 817 (1983).

Finally, under Public Utilities Code Section 1708, upon proper notice to the parties and with opportunity to be heard as in the case of complaints, the Commission may rescind, alter, or amend any order or decision made by it. The Commission recognizes this authority in the context of its holding company decisions. For example, in PG&E Authorization II, the Commission noted its authority to impose additional conditions if necessary, and specifically provided that parties could raise the need for additional conditions in the future. See PG&E Authorization II, 194 P.U.R.4th 1, 12-13 (April 22, 1999).

A. Investigation into past violations

1. Infusions of capital

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

Accordingly, respondent holding companies are directed to demonstrate why their evident failure to provide sufficient capital to their utility subsidiaries to alleviate or mitigate the subsidiaries' need for capital during that time period did not violate, and does not continue to violate, the "first priority" condition cited above. Similarly, respondent utilities are directed to demonstrate that they made demands on their respective holding companies to infuse needed

capital, and if they cannot so demonstrate, why their failure to make such demands did not violate, and does not continue to violate, Section 451 of the Public Utilities Code. As part of our investigation, respondents are directed to produce the information and documents specified in Attachment A hereto.

2. Ring fencing

As described above, starting in December 2000, PG&E Corporation took steps to "ring fence" several of its unregulated subsidiaries, and has stated that as a result of this ring fencing, the assets of those subsidiaries are no longer available to assist PG&E. In addition, although the organizational documents PG&E has provided the Commission to date do not so indicate, news reports suggest that the ring fencing transactions restrict the payment of dividends by one or more of the ring fenced entities to PG&E Corporation, thus decreasing PG&E Corporation's available cash to directly assist the utility.

Similarly, as described above, in or about December 2000 EIX took steps to ring fence its unregulated subsidiary, Edison Mission Energy (EME), apparently rendering EME's assets unavailable to assist Edison in times of financial need. In addition, the ring fencing transactions restrict the payment of dividends by EME to EIX, thus apparently decreasing EIX's available cash to directly assist Edison in times of need.[26]

We will investigate whether these actions violate the "first priority" condition described above. Accordingly, respondent holding companies are directed to produce information and documents, and to demonstrate why the ring fencing actions described above do not violate the "first priority" condition.

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[26] See also EIX Jan. 15, 2001 SEC Form 8-K (describing dividend restrictions), at 5.

3. Payment of dividends at time of financial distress

As noted above, all three utilities paid dividends to their parent holding companies in the third quarter of 2000. PG&E and Edison did so despite having growing undercollections, at a time when they were repeatedly and publicly announcing their precarious financial condition, as detailed above. Not long after the payment of the dividends, Edison announced that it was in imminent danger of bankruptcy, cut back on maintenance and construction, and later suspended payments on a variety of obligations. PG&E similarly began to defer payment or default on outstanding liabilities, and began to defer construction and maintenance projects.

SDG&E paid third quarter 2000 dividends despite the recent imposition of a rate ceiling, the dramatic rise in wholesale energy costs, and SDG&E's accumulation of debt, which SDG&E stated would adversely affect its ability to meet its obligation to serve.

We will investigate whether these dividend payments violated, inter alia, the condition imposed in our holding company decisions that the utility maintain a dividend policy "as though it were a comparable stand-alone utility company,"[27] and/or Sections 451 and 798 of the Public Utilities Code. Accordingly, the three respondent utilities are directed to produce the related documents and information specified in Attachment A hereto, and to demonstrate why their payment of third quarter dividends under such circumstances did not violate the statutes and conditions cited above.

[27] See PG&E Authorization I, Ordering paragraph 15; 69 CPUC2d at 201; Edison Authorization, Ordering paragraph 10, 27 CPUC2d at 376; SDG&E Authorization II, Ordering paragraph 5, 62 CPUC2d at 651.

4. Other violations

The investigations described above are not exclusive, and if evidence comes to light of any additional suspected violations of any law, or of any order, decision, rule, regulation, direction, demand, or requirement of the Commission or any commissioner, these proceedings may be expanded to include investigation of those potential violations as well.

B. Investigation into needed changes going forward

The events and potential violations described above suggest that it is time to re-examine the current adequacy of the conditions contained in the holding company authorization decisions cited above. Accordingly, in this proceeding, we will determine whether additional rules, conditions, or other changes are needed to protect ratepayers and the public from dangers of abuse of the holding company structure. Specifically, we will investigate whether we should modify, change, or add conditions to the holding company decisions, make further changes to the holding company structure, alter the standards under which we determine whether to authorize the formation of holding companies, otherwise modify the decisions, or recommend statutory changes to the Legislature.

By way of example only, and without limitation on the ability of the Commission or any party to these proceedings to propose other conditions, rules, or changes, we will consider:

* Changes or additions to reporting or approval requirements regarding changes in the structure of the holding company systems, such as “ring fencing.”

* Changes or additions to reporting or approval requirements regarding the distribution or transfer of funds or other assets from the holding companies to their unregulated subsidiaries.

* Changes or additions to reporting or approval requirements regarding the distribution or transfer of funds or other assets from the utilities to the holding companies.

* Restrictions on the holding companies' assumption of debt for purposes unrelated to strengthening their regulated utility subsidiary.

* Modification of the provisions for comprehensive audits of the entire holding company system, as found in the PG&E and SDG&E holding company decisions, to permit the same audits on a regular, recurring basis, and to extend those provisions to apply to Edison and its holding company system as well.

* Changes to the standard of review to impose on holding company formation, requirements, and oversight.

It is now time to raise these issues.[28] Not only is it important to determine whether any prior violations of our holding company decisions or other laws have occurred, but it is also critical to take steps to ensure that healthy utility companies can continue to function in a way that balances both ratepayer and shareholder interests.

V. Preliminary Scoping Memo

The scope of this proceeding will include all issues raised in this order, but will not be limited to these issues. Any party may suggest related issues (i.e., issues involving the relationship between the holding companies and their utility subsidiaries) for the Commission's consideration.

[28] Although PG&E Authorization II states its preference for raising these issues in the Commission's re-examination of our affiliate transaction rules, this issue is squarely raised in this OII which includes California's three investor-owned electric utilities.

The rules and procedures implementing many of the reforms contained in Senate bill (SB) 960 are found in Article 2.5 of the Rules of Practice and Procedure (Rules), which are posted on the Commission's website. Pursuant to Rule 4(a), the rules in Article 2.5 shall apply to this proceeding. As per the provisions of SB960, the present investigation is classified as a quasi-legislative proceeding and is expected to require a hearing.

The assigned Administrative Law Judge will convene a prehearing conference (PHC) to develop a service list for this proceeding and to further delineate issues related to scope and schedule for this proceeding.

Any person who objects to the categorization of this investigation must file an appeal no later than ten days after the date of this OII, pursuant to Rule 6.4(a).

The temporary service list is attached to this order and shall be used for service until a service list for this proceeding is established at the PHC. Persons who want to become a "party" to this proceeding shall appear at the PHC, or at the formal hearing, and fill out the "Notice of Party/Non-Party Status" form (appearance form).

Those persons who do not want to be parties, and only want notice of the hearings, rulings, proposed decisions, and decisions may either appear at the PHC or the formal hearing and fill out an appearance form, or they may mail a written request to the Process Office requesting that they be added to the service list for information only.

Those persons employed by the State of California who are interested in this proceeding may be added to the "state service" section of the service list either by appearing at the prehearing conference or at the formal hearing and filling out an appearance form, or they may mail a written request to the Process Office requesting that they be added to the state service list. All of the names

appearing on the state service list shall be served with all documents that parties may submit or file in connection with this proceeding.

The Process Office shall develop an initial service list based on the appearances at the first PHC. This initial service list shall be posted on the Commission's website, www.cpuc.ca.gov, as soon as it is practicable.

Any party interested in participating in this investigation who is unfamiliar with the Commission's procedures should contact the Commission's Public Advisor Office in Los Angeles at (213) 649-4782, or in San Francisco at (415) 703-2074.

VI. Ex Parte Communications

In a quasi-legislative proceeding, ex parte communications are permitted without restriction, pursuant to Pub. Util. Code. Section 1701.4(b) and Rule 7(d).

IT IS ORDERED that:

1. An investigation is instituted on the Commission's own motion into whether respondents have violated relevant statutes and Commission decisions as described above, and whether changes should be made, inter alia, in the Commission's rules, regulations, conditions, or orders respecting respondent utilities and their holding companies. As a result of this investigation, the Commission may impose remedies, prospective rules, or conditions, as appropriate.

2. Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company, as well as their respective parent holding companies, PG&E Corporation, Edison International, and Sempra Energy, are made respondents to this Order Instituting Investigation (OII).

3. The following proceedings are reopened and consolidated with this OII for purposes of addressing the issues raised in this proceeding: Application (A.) 87-05-007 [Edison's holding company application]; A.94-11-013 [SDG&E's

holding company application]; A.95-10-024 [PG&E's holding company application]; A.96-10-038 [Enova/Pacific Enterprises merger application]. This OII is the lead docket and all filings shall be made in this docket.

4. The Commission takes official notice of documents included in Attachment B. These documents shall be indexed and placed in the proceeding's formal file, and shall be made part of the record in this docket.

5. No later than 10 days from the date of issuance of this order, respondents shall produce and file in this docket all documents and information specified in Attachment A, below. Respondents shall also serve these documents and information on the Commission's Executive Director and General Counsel, as well as on such other persons as may be ordered by the assigned Administrative Law Judge. In lieu of serving copies of these documents and information on other individuals on the attached temporary service list, respondents may serve a Notice of Availability, pursuant to the process described in Rule 2.3(c) of the Commission's Rules of Practice and Procedure.

6. No later than 20 days from the issuance of this order, respondents shall file and serve any motions or objections related to this order.

7. No later than 30 days from the date of issuance of this order, respondents shall file and serve prepared testimony demonstrating why they are not in violation of the applicable laws, orders, decisions, decrees, rules, directions, demands, or requirements of this Commission as more fully described in this order, and suggesting any changes or additions to the conditions contained in the Commission's holding company authorizations, or other rules, regulations, or orders pertaining to respondents' holding company systems.

8. The category of the investigation is quasi-legislative as that term is defined in Rule 5(c) of the Commission's Rules of Practice and Procedure.

9. The temporary service list is attached and shall be used for service of all documents until a service list for this proceeding is established. An initial service list for this proceeding shall be created by the Process Office and posted on the Commission's website (www.cpuc.ca.gov) as soon as it is practicable after the first prehearing conference. Parties may also obtain the service list by contacting the Commission's Process Office at (415) 703-2021.

10. Persons interested in this proceeding shall follow the procedures described in this investigation to get on the service list.

11. A prehearing conference shall be scheduled at a date and time to be determined by the assigned Administrative Law Judge for the purpose of establishing a service list for this consolidated proceeding, setting a further schedule, and addressing other procedural issues. Interested persons may file prehearing conference statements or a response to this order as directed by the Administrative Law Judge, stating any objections to the order regarding the need for hearings, issues to be considered, or proposed schedule. Service shall be made in the manner described in Ordering Paragraph 12.

12. Until a service list is established at the prehearing conference, all documents that must be served in connection with this docket shall be served on all parties listed in paragraphs 13 and 14 below, as well as on the offices of all five Commissioners, and the assigned Administrative Law Judge. A temporary service list is attached.

13. The Executive Director shall cause this Order to be served by certified mail on all respondents' designated agents for service in California as follows: for PG&E: Leslie H. Everett, 77 Beale Street, San Francisco, CA 94105; for PG&E Corporation: Leslie H. Everett, One Market, Spear Tower, Ste. 2400, San Francisco, CA 94105; for Edison: Vicki Kaiser, 2244 Walnut Grove Avenue, Rosemead, CA 91770; for Edison International: Vicki Kaiser, 2244 Walnut

Grove Avenue, Ste. 369, Rosemead, CA 91770; for SDG&E: Steven D. Davis, 101 Ash Street, San Diego, CA 92101-3017; and for Sempra Energy: Thomas C. Sanger, 101 Ash St., San Diego, CA 92101-3017.

14. Because action in this proceeding may modify past Commission decisions set forth in this order, and because we reopen the respective utilities' holding company cases, the Executive Director shall serve this order on the parties to the following proceedings: A.87-05-007 [Edison's holding company application]; A.94-11-013 [SDG&E's holding company application]; A.95-10-024 [PG&E's holding company application]; A.96-10-038 [application of Pacific Enterprises and Enova Corporation for a Merger]. Additionally, the Commission's Process Office shall serve parties to the following proceedings with this order: Rulemaking 97-04-011/Investigation 97-04-012 [Affiliate Transaction Proceeding]; and A.00-11-038 et al. [rate stabilization proceedings].

This order is effective today.

Dated April 3, 2001, at San Francisco, California.

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

Commissioner Richard A. Bilas, being necessarily absent, did not participate.

I will file a concurrence.

/s/ HENRY M. DUQUE
Commissioner

ATTACHMENT A

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Pursuant to Ordering Paragraph 5, above, respondents are directed to produce, file, and serve the following information and documents within the time, and in the manner, specified in that Ordering Paragraph. Unless otherwise specified, each request is made to all six respondents:

1. All presentations to and minutes of meetings of their respective boards of directors relating to the payment or non-payment of dividends by respondent utilities to their respective holding companies from January 1, 2000 to present.

2. All presentations to and minutes of meetings of their respective boards of directors relating to the distribution or transfer of funds or other assets from the utilities to the holding companies, or vice versa, between 1996 and the date of this order.

3. All communications between the holding companies and their respective utility subsidiaries relating to the utilities' payment or non-payment of dividends from January 1, 2000 to present.

4. All communications between the holding companies and their respective utility subsidiaries relating to the distribution or transfer of funds or other assets from the utilities to the holding companies, or vice versa, between 1996 and the date of this order.

5. Edison, PG&E, and SDG&E are directed to inform the Commission when, if it all, it retained bankruptcy counsel and/or financial advisors with insolvency expertise during 2000 or 2001, and produce all presentations to and minutes of meetings of their respective boards of directors relating to the decision whether or not to retain bankruptcy counsel during 2000 or 2001.

6. Respondent holding companies are directed to describe, and produce supporting documentary evidence, relating to all current restrictions on

distributions or transfers of funds or other assets from their subsidiaries to themselves, and from themselves to their respective utility subsidiaries. Such documentary evidence shall include, but not be limited to, all organizational documents implementing any ring fencing transaction and all presentations to, and minutes of, meetings of their respective boards of directors relating to any ring fencing transaction.

7. Respondent holding companies are directed to describe, and produce supporting documentary evidence, of any distributions or transfers of funds or other assets from themselves to any subsidiary, including respondent utilities, between 1996 and the date of this order.

8. Respondent utilities are directed to describe all planned or required construction or maintenance, or any other actions that may affect service and/or reliability, that they have eliminated or deferred between January 1, 2000 and the date of this order.

9. Respondent holding companies are directed to produce documentary evidence showing whether they have provided infusions of capital to respondent utilities at any time between June 2000 and the date of this order, and, if so, the date, amount, and purpose of such infusion.

10. Respondent utilities are directed to produce documentary evidence showing whether they made demands on their respective holding companies to infuse needed capital.

11. Copies of all credit agreements, debt instruments, and similar documents that purport to limit the ability of the unregulated subsidiaries to pay dividends, or limit the ability of respondent holding companies and/or their unregulated subsidiaries to transfer funds or assets to respondent utilities, or to assume liabilities for obligations of respondent utilities.

(END OF ATTACHMENT A)

ATTACHMENT B

List of Official Notice Items

Commission Decisions

D.88-01-063, 27 CPUC2d 347 (Jan. 28, 1988)

D.95-05-021, 59 CPUC2d 697 (May 10, 1995)

D.95-12-018, 62 CPUC2d 626 (Dec. 6, 1995)

D.96-11-017, 69 CPUC2d 167 (Nov. 6, 1996)

D.98-03-073, 184 P.U.R.4th 417 (March 26, 1998)

D.99-04-068, 194 P.U.R.4th 1 (April 22, 1999)

D.01-01-018 (Jan. 4, 2001)

Commission Filings & Letters

PG&E Emergency Petition For Expedited Modification of Decisions 99-10-057 and 00-03-058 (Oct. 4, 2000)

PG&E Emergency Application to Adopt Rate Stabilization Plan (A.00-11-056, Nov. 22, 2000)

PG&E Response to ALJ Inquiry Re. Release of Contractors and Hiring Hall Employees (Jan. 12, 2001)

PG&E Letter to ALJ Walwyn in A.00-11-038 et al. (Feb. 8, 2001)

PG&E Opening Brief in A.00-11-038 / A.00-11-056 / A.00-10-028 (March 5, 2001)

Southern California Edison Application To Institute Rate Stabilization Plan (A.00-11-038, Nov. 16, 2000)

SDG&E Monthly Transition Cost Balancing Account Reports (January 1998 – June 1999)

Southern California Edison Response to CCUE Emergency Motion, Attachment C (A.00-11-038 et al., Jan. 12, 2001)

SDG&E Application, A.00-10-045 (Oct. 24, 2000)

SDG&E Application, A.01-01-044 (Jan. 24, 2001)

SDG&E Petition for Modification of D.01-02-011 (Feb. 14, 2001)

SDG&E Application for Rehearing of Decision D.01-02-011 (Feb. 20, 2001)

Commission Testimony

A.00-11-038 / A.00-11-056 / A.00-10-028

Federal District Court Filings

Southern California Edison Co. v. Lynch, No. CV-00-12056-RSWL-(Mcx) (United States District Court for the Central District of California)

Utility Reports & Public Releases

PG&E Corp. 1999 Annual Report to Shareholders

PG&E Corp. News Release Re. $1 Billion Loan (March 2, 2001)

Southern California Edison 1999 Annual Report to Shareholders

Edison Int'l 1999 Annual Report to Shareholders

Sempra Energy 1999 Annual Report to Shareholders

Audits

CPUC Agreed Upon Special Procedures Audit (Mitchell & Titus, LLP and Barrington-Wellesley Group, Inc. (Dec. 1998)

Barrington Wellesley Group, Inc. Audit of PG&E Corporation & Affiliates (A.00-11-038 et al., Jan. 29, 2000)

KPMG, LLP Audit of Edison International & Affiliates (A.00-11-038 et al., Jan 29, 2000)

Securities and Exchange Commission Filings

PG&E Corp. Form 10-K (March 5, 1998)

PG&E Corp. Form 10-Q (Nov. 1, 2000)

PG&E Corp. Form 10-Q (Aug. 2, 2000)

PG&E Corp. Form 8-K (Jan. 2, 2001)

PG&E Corp. Form 8-K (Jan. 10, 2001)

PG&E Corp. Form 8-K (Feb. 1, 2001)

PG&E Corp. Form 8-K (Feb. 14, 2001)

Southern California Edison Form 10-Q (Nov. 14, 2000)

Edison Int'l Form 10-Q (Nov. 14, 2000)

Edison Int'l Form 8-K (Jan 15, 2001)

Edison Form 8-K (Jan 16, 2001)

Edison Form 8-K (Jan 18, 2001)

SDG&E Form 10-K (Mar. 29, 2000)

SDG&E Form 10-Q (Nov. 13, 2000)

SDG&E Form 10-Q (Aug. 14, 2000)

Sempra Energy Form 10-Q (Nov. 13, 2000)

(END OF ATTACHMENT B)

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********** APPEARANCES **********

Gerald Lahr
ABAG POWER
101 8TH STREET
OAKLAND CA 94607
(510) 464-7908
jerryl@abag.ca.gov
For: ASSOCIATION OF BAY AREA GOVERNMENTS (ABAG)

Katherine S. Poole
ADAMS BROADWELL JOSEPH & CARDOZO
651 GATEWAY BLVD., SUITE 900
SOUTH SAN FRANCISCO CA 94080
(650) 589-1660
kpoole@adamsbroadwell.com
For: The Coalition of California Utility Employees

Marc D. Joseph
Attorney At Law
ADAMS BROADWELL JOSEPH & CARDOZO
651 GATEWAY BOULEVARD, SUITE 900
SOUTH SAN FRANCISCO CA 94080
(650) 589-1660
mdjoseph@adamsbroadwell.com
For: The Coalition of California Utility Employees

William P. Adams
ADAMS ELECTRICAL SAFETY CONSULTING
716 BRETT AVENUE
ROHNERT PARK CA 94928-4012
(707) 795-7549
For: SELF

Ron Knecht
ADVOCATES FOR THE PUBLIC INTEREST (API)
1465 MARLBOROUGH AVENUE
LOS ALTOS CA 94024-5742
(650) 968-0115
ronknecht@aol.com
For: Consumers for the Public Interest

James Weil
AGLET CONSUMER ALLIANCE
PO BOX 1599
FORESTHILL CA 95631
(530) 367-3300
jweil@aglet.org
For: AGLET CONSUMER ALLIANCE

Barbara R. Barkovich
BARKOVICH AND YAP, INC.

Michael Aguirre
Attorney At Law
AGUIRRE & MEYER
1060 8TH AVENUE, SUITE 300
SAN DIEGO CA 92101
(619) 235-8636
julesan@aol.com
For: RATEPAYERS / UCAN

Michael Alcantar
Attorney At Law
ALCANTAR & KAHL LLP
1300 SW 5TH AVENUE., SUITE 1750
PORTLAND OR 97201
(503) 402-9900
mpa@a-klaw.com
For: Cogeneration Association of California

Evelyn Kahl
Attorney At Law
ALCANTAR & KAHL, LLP
120 MONTGOMERY STREET, SUITE 2200
SAN FRANCISCO CA 94104
(415) 421-4143
ek@a-klaw.com
For: Energy Producers and Users Coalition

Edward G. Poole
Attorney At Law
ANDERSON & POOLE
601 CALIFORNIA STREET, SUITE 1300
SAN FRANCISCO CA 94108
(415) 956-6413
epoole@adplaw.com
For: Western Manufactured Housing Communities Association

Daniel W. Douglass
Attorney At Law
ARTER & HADDEN LLP
5959 TOPANGA CANYON BLVD., STE 244
WOODLAND HILLS CA 91367
(818) 596-2201
douglass@arterhadden.com
For: ALLIANCE OF RETAIL MARKETS and WESTERN POWER TRADING FORUM

Robert Berry
AUTOMATED POWER EXCHANGE
5201 GREAT AMERICA PARKWAY
SANTA CLARA CA 95054
(408) 517-2109
berry@apx.com
For: AUTOMATED POWER EXCHANGE

John Jimison
Attorney At Law

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A8705007/A9411013/A9510024/A9610038/R9704011/A0011038

31 EUCALYPTUS LANE
SAN RAFAEL CA 94901
(415) 457-5537
brbarkovich@earthlink.net
For: California Large Energy Consumers Association (CLECA)

Catherine E. Yap
BARKOVICH AND YAP, INC.
114 RICARDO AVENUE
PIEDMONT CA 94611
(510) 652-9778
ceyap@earthlink.net

Reed V. Schmidt
BARTLE WELLS ASSOCIATES
1889 ALCATRAZ AVENUE
BERKELEY CA 94703
(510) 653-3399
rschmidt@bartlewells.com
For: California City County Streetlight Association (CAL-SLA)

Marco Gomez
Attorney At Law
BAY AREA RAPID TRANSIT DISTRICT
800 MADISON STREET, 5TH FLOOR
OAKLAND CA 94607
(510) 464-6058
mgomez1@bart.gov
For: Bay Area Rapid Transit District

Roger Berliner
BERLINER, CANDON & JIMISON
1225 19TH STREET, N.W., SUITE 800
WASHINGTON DC 20036
(202) 955-6067
rogerberliner@bcjlaw.com
For: Internal Services Department of Los Angeles County (LACISD)

John Burkholder
BETA CONSULTING
2023 TUDOR LANE
FALLBROOK CA 92028
(760) 723-1831
burkee@cts.com
For: CITY OF LONG BEACH

Edward C. Remedios
BHR & ASSOCIATES
33 TOLEDO WAY
SAN FRANCISCO CA 94123-2108
(415) 474-7253
ecrem@ix.netcom.com
For: BHR & Associates

BRADY & BERLINER
1225 19TH STREET, N.W. STE 800
WASHINGTON DC 20036
(202) 955-6067
johnj@bradyberliner.com
For: CITY OF VERNON

Roger A. Berliner
BRADY & BERLINER
CALIFORNIA ENERGY POLICY ADVISOR
2560 NINTH ST. STE 316
BERKELEY CA 94710
(510) 549-6926
For: WATSON COGENERATION COMPANY

Maurice Brubaker
BRUBAKER & ASSOCIATES
1215 FERN RIDGE PARKWAY, STE. 208
ST. LOUIS MO 63141-2000
(314) 275-7007
mbrubaker@consultbai.com

Ron Knecht
CALIF PUBLIC INTEREST RATEPAYER GROUP
1465 MARLBAROUGH AVENUE
LOS ALTOS CA 94024-5742
(650) 968-0115
ronknecht@aol.com
For: Self

Woychik
CALIFORNIA COMPETITION NETWORK
9901 CALODEN LANE, STE 1
OAKLAND CA 94605
(510) 635-2359
estrategy@compuserve.com

Fernando De Leon
Attorney At Law
CALIFORNIA ENERGY COMMISSION
1516 9TH STREET, MS-14
SACRAMENTO CA 95814
(916) 654-3870
jtachera@energy.state.ca.us
For: CALIFORNIA ENERGY COMMISSION

Robert Pernell
CALIFORNIA ENERGY COMMISSION
1516 9TH STREET
SACRAMENTO CA 95829
(916) 654-5036
rpernell@energy.state.ca.us
For: CALIFORNIA ENERGY COMMISSION (CEC)

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A8705007/A9411013/A9510024/A9610038/R9704011/A0011038

Scott Tomashefsky
CALIFORNIA ENERGY COMMISSION
1516 9TH STREET, MS-22
SACRAMENTO CA 95814
(916) 654-4896
stomashe@energy.state.ca.us

Karen Norene Mills
Attorney At Law
CALIFORNIA FARM BUREAU FEDERATION
2300 RIVER PLAZA DRIVE
SACRAMENTO CA 95833
(916) 561-5655
kmills@cfbf.com
For: California Farm Bureau Federation

Ronald Liebert
Attorney At Law
CALIFORNIA FARM BUREAU FEDERATION
2300 RIVER PLAZA DRIVE
SACRAMENTO CA 95833
(916) 561-5657
rliebert@cfbf.com
For: California Farm Bureau Federation

Ed Yates
CALIFORNIA LEAGUE OF FOOD PROCESSORS
980 NINTH STREET, SUITE 230
SACRAMENTO CA 95814
(916) 444-9260
ed@clfp.com
For: California League of Food Processors

Lisa G. Urick
Attorney At Law
CALIFORNIA POWER EXCHANGE CORPORATION
200 S. LOS ROBLES AVENUE, SUITE 400
PASADENA CA 91101-2482
(626) 537-3328
lgurick@calpx.com
For: CALIFORNIA POWER EXCHANGE

Francisco V. Chavez
3534 FIRST AVENUE
SACRAMENTO CA 95817

Jennifer Chamberlin
CHEVRON ENERGY SOLUTIONS
345 CALIFORNIA ST., 32ND FLOOR
SAN FRANCISCO CA 94104
(415) 733-4661
jnnc@chevron.com
For: Chevron Energy Solutions

Theresa Mueller
Deputy City Attorney
CITY AND COUNTY OF SAN FRANCISCO
1 DR. CARLTON B. GOODLETT PLACE
SAN FRANCISCO CA 94102
(415) 554-4640
theresa_mueller@ci.sf.ca.us
For: City & County of San Francisco

Ronald V. Stassi
Public Service Department
CITY OF BURBANK
164 WEST MAGNOLIA BOULEVARD
BURBANK CA 91502
(818) 238-3651
bjeider@earthlink.net

Bill Mc Callum
CITY OF FRESNO
5607 W. JENSEN AVENUE
FRESNO CA 93607
(559) 498-1728
bill.mccallum@ci.fresno.ca.us
For: CITY OF FRESNO

Bernard Palk
Public Service Department
CITY OF GLENDALE
141 NORTH GLENDALE AVENUE 4TH LEVEL
GLENDALE CA 91206
(818) 548-2107
slins@ci.glendale.ca.us

Rufus Hightower
Department Of Water & Power
CITY OF PASADENA
150 SOUTH LOS ROBLEST ST., SUITE 200
PASADENA CA 91101
(626) 744-4425

Casey Gwinn
City Attorney
CITY OF SAN DIEGO
1200 3RD AVE., STE 1620
SAN DIEGO CA 92101
(619) 236-6220
casey@cityatty.sannet.gove

Deborah Berger
T. MC ATTEER
CITY OF SAN DIEGO
1200 THIRD AVE. STE 1100
SAN DIEGO CA 92101
dbb@sdcity.sannet.gov
For: CITY OF SAN DIEGO

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Frederick Ortlieb
Deputy City Attorney
CITY OF SAN DIEGO
1200 THIRD AVENUE, 11TH FLOOR
SAN DIEGO CA 92101
(619) 236-6220
fmo@sdcity.sannet.gov
For: CITY OF SAN DIEGO

Steven Gold
Office Of The City Attorney
CITY OF SAN DIEGO
1200 THIRD AVENUE
SAN DIEGO CA 92101-4181

William S. Shaffran
Dept City Attorney
CITY OF SAN DIEGO
201 C STREET STE 500
SAN DIEGO CA 92101

Traci Bone
Deputy City Attorney
CITY / COUNTY OF SAN FRANCISCO
SAN FRANCISCO CITY ATTORNEY'S OFFICE
CITY HALL, ROOM 234
SAN FRANCISCO CA 94102
(415) 554-4257
For: ENSERCH ENERGY SERVICES, INC.

Richard H. Mcelroy
Vice President, W. Marketing
COASTAL GAS MARKETING COMPANY
101 W. BROADWAY, STE 1970
SAN DIEGO CA 92101-8201
(619) 702-9501

June M. Skillman
COMPLETE ENERGY SERVICES, INC.
650 E. PARKRIDGE AVENUE, UNIT 110
CORONA CA 92879
(909) 280-9411
jskillman@prodigy.net

Bill Powers
CONGRESS OF CALIFORNIA SENIORS
1228 N STREET, SUITE 29
SACRAMENTO CA 95814
(916) 442-4474
bpowers@seniors.org
For: CONGRESS OF CALIFORNIA SENIORS

Howard Owens
HOYT MINKOFF
CONSUMER FEDERATION OF CALIFORNIA
1228 N STREET, SUITE 29
SACRAMENTO CA 95814
(916) 554-7621
howens@seniors.org
For: CONSUMER FEDERATION OF CALIFORNIA

Howard Choy
Energy Management Division Manager
COUNTY OF LOS ANGELES
INTERNAL SERVICES DEPARTMENT
1100 NORTHEASTERN AVENUE
LOS ANGELES CA 90063
(323) 881-3939
hchoy@isd.co.la.ca.us
For: COUNTY OF LOS ANGELES

Nicholas W. Fels
COVINGTON & BURLING
1201 PENNSYLVANIA AVENUE, N.W.
WASHINGTON DC 20044-7566
For: ENOVA CORPORATION

Patrick Mcguire
TOM BEACH
CROSSBORDER ENERGY
2560 NINTH STREET, SUITE 316
BERKELEY CA 94710
(510) 649-9790
patrickm@crossborderenergy.com
For: Watson Cogeneration Company

R. Thomas Beach
CROSSBORDER ENERGY
2560 NINTH STREET, SUITE 316
BERKELEY CA 94710
(510) 649-9790
tomb@crossborderenergy.com

Ray Czahar
5650 GRAVENSTEIN HIGHWAY - RTE 116 NORTH
FORESTVILLE CA 95436
(707) 887-2522
rczahar@aol.com
For: Self

Ray Czahar
5650 GRAVENSTEIN HIGHWAY-RTE 116 NORTH
FORESTVILLE CA 95436
(707) 887-2522
rczahar@aol.com

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Edward W. O'Neill
BENJAMIN M. REZNIK
Attorney At Law
DAVIS WRIGHT TREMAINE LLP
ONE EMBARCADERO CENTER, SUITE 600
SAN FRANCISCO CA 94111-3834
(415) 276-6500
edwardoneill@dwt.com
For: WESTERN GAS RESOURCES INC.

Lindsey How-Downing
Attorney At Law
DAVIS WRIGHT TREMAINE LLP
ONE EMBARCADERO CENTER, STE 600
SAN FRANCISCO CA 94111-3834
(415) 276-6500
lindseyhowdowning@dwt.com
For: CALPINE CORPORATION

Norman J. Furuta
Attorney At Law
DEPARTMENT OF THE NAVY
900 COMMODORE DRIVE, BLDG. 107
SAN BRUNO CA 94066-5006
(650) 244-2100
furutanj@efawest.navfac.navy.mil
For: Federal Executive Agencies

Stanton J. Snyder
Deputy City Attorney
DEPARTMENT OF WATER & POWER
111 N. HOPE STREET, ROOM 340
LOS ANGELES CA 90012-2694
(213) 367-4540
ssnyder@legal.ladwp.com

Dan L. Carroll
Attorney At Law
DOWNEY BRAND SEYMOUR & ROHWER, LLP
555 CAPITOL MALL, 10TH FLOOR
SACRAMENTO CA 95814
(916) 441-0131
dcarroll@dbsr.com
For: CALIFORNIA INDUSTRIAL USERS

Philip A. Stohr
Attorney At Law
DOWNEY, BRAND, SEYMOUR & ROHWER
555 CAPITOL MALL, 10TH FLOOR
SACRAMENTO CA 95814-4686
(916) 441-0131
pstohr@dbsr.com
For: California Industrial Users;Western Hub Properties

Thomas M. Berliner
Attorneys At Law
DUANE MORRIS & HECKSCHER
100 SPEAR STREET, SUITE 1500
SAN FRANCISCO CA 94105
(415) 371-2200
tmberliner@duanemorris.com
For: Sacramento Municipal Utility District

Colin L. Pearce
DUANE, MORRIS & HECKSCHER
100 SPEAR STREET, SUITE 1500
SAN FRANCISCO CA 94105
(415) 371-2215
clpearce@duanemorris.com
For: Sacramento Municipal Utility District (SMUD)

Carolyn A. Baker
DUKE ENERGY NORTH AMERICA
980 NINTH STREET, 16TH FLOOR
SACRAMENTO CA 95814
(916) 449-9623
cabaker@duke-energy.com

Karen Hekkema
Regional Office Manager
DUKESOLUTIONS, INC.
5000 EXECUTIVE PARKWAY, SUITE 300
SAN RAMON CA 94583
(925) 327-7300
For: Duke Louis Dreyfus

Donald R. Allen
JOHN COYLE
Attorneys At Law
DUNCAN & ALLEN
SUITE 300
1575 EYE STREET, N.W.
WASHINGTON DC 20005-1175
For: IMPERIAL IRRIGATION DISTRICT

Wallace L. Duncan
Attorney At Law
DUNCAN WEINBERG MILLER PERMBROKE
1615 M STREET, N.W., STE 800
WASHINGTON DC 20036
(202) 467-6370
dwmp@dwmpdc.com
For: SOUTHERN CA PUBLIC POWER AUTHORITY

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John Morris
ECONOMISTS, INC.
SUITE 400
1200 NEW HAMPSHIRE AVENUE, N.W.
WASHINGTON DC 20036
For: CITY OF SAN DIEGO

Edward H. Comer
JOHANNES W. WILLIAMS
Vice President-Law
EDISON ELECTRIC INSTITUTE
701 PENNSYLVANIA AVE., N.W.
WASHINGTON DC 20004
(202) 508-5615

John Mathis
V.P.&Associate General Counsel
EDISON MISSION ENERGY
555 12TH STREET NW, STE 640
WASHINGTON DC 20004

James Mccotter
PHILIP ENDOM
Regulatory Analyst
EL PASO NATURAL GAS COMPANY
SUITE 2400
650 CALIFORNIA STREET
SAN FRANCISCO CA 94108
(415) 765-6400

Christopher T. Ellison
Attorney At Law
ELLISON & SCHNEIDER
2015 H STREET
SACRAMENTO CA 95814-3109
(916) 447-2166
kam@eslawfirm.com
For: INDEPENDENT ENERGY PRODUCERS ASSOCIATION / DEPT OF GENERAL SVCS.

Lynn M. Haug
ANDY BROWN
Attorney At Law
ELLISON & SCHNEIDER
2015 H STREET
SACRAMENTO CA 95814-3109
(916) 447-2166
lmh@eslawfirm.com
For: East Bay Municipal Utility District (EBMUD)

Andrew B. Brown
Attorney At Law
ELLISON, SCHNEIDER & HARRIS
2015 H STREET
SACRAMENTO CA 95814
(916) 447-2166

Douglas K. Kerner
Attorney At Law
ELLISON, SCHNEIDER & HARRIS
2015 H STREET
SACRAMENTO CA 95814
(916) 447-2166
dkk@eslawfirm.com
For: Independent Energy Producers Association

Diane I. Fellman
Attorney At Law
ENERGY LAW GROUP LLP
1999 HARRISON STREET, SUITE 2700
OAKLAND CA 94612-3572
(415) 703-6000
difellman@energy-law-group.com
For: PacificCrockett Energy, Inc.

Andrew J. Skaff
Attorney At Law
ENERGY LAW GROUP, LLP
1999 HARRISON STREET, 27TH FLOOR
OAKLAND CA 94612
(510) 893-1000
askaff@energy-law-group.com
For: New York Mercantile Exchange / Dynegy, Inc.

Carolyn Kehrein
ENERGY MANAGEMENT SERVICES
1505 DUNLAP COURT
DIXON CA 95620-4208
(707) 678-9586
cmkehrein@ems-ca.com
For: Energy Users Forum

E. Gregory Barnes
ENOVA CORPORATION
PO BOX 129400
101 ASH STREET, 11TH FLOOR
SAN DIEGO CA 92101
(619) 699-5019

Jeffrey Dasovich
Director
ENRON CORPORATION
19TH FLOOR
101 CALIFORNIA STREET
SAN FRANCISCO CA 94111
(415) 782-7800
JDASOVIC@EES.ENRON.

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A8705007/A9411013/A9510024/A9610038/R9704011/A0011038

abb@eslawfirm.com
For: CALIFORNIA DEPARTMENT OF GENERAL SERVICES (DGS)

Patrick Mcdonnell
ENSERCH ENERGY SERVICES
SUITE 290
711 GRAND AVENUE
SAN RAFAEL CA 94901
pmcdonne@wenet.net
For: Enserch Energy Services

Nancy Ryan
ENVIRONMENTAL DEFENSE
5655 COLLEGE AVENUE
OAKLAND CA 94618
(510) 658-8008
nryan@environmentaldefense.org
For: Environmental Defense

John R Fielder
Vice President
2244 WALNUT GROVE AVE
ROSEMEAD CA 91770
fieldejr@sce.com

James D. Squeri
Attorney At Law
GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP
505 SANSOME STREET, SUITE 900
SAN FRANCISCO CA 94111
(415) 392-7900
jsqueri@gmssr.com
For: California Retailers Association

Jeanne M. Bennett
Attorney At Law
GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP
505 SANSOME STREET, SUITE 900
SAN FRANCISCO CA 94111
(415) 392-7900
jbennett@gmssr.com
For: Alliance for Retail Markets and Enron Corporation

Jeffrey P. Gray
Attorney At Law
GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP
505 SANSOME STREET, STE 900
SAN FRANCISCO CA 94111
(415) 392-7900
jsqueri@gmssr.com
For: Nutrosweet Kelco Company

Regina M. Deangelis
Attorney At Law
GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP
505 SANSOME STREET, STE 900
SAN FRANCISCO CA 94111
(415) 392-7900
For: ENRON CORP

Thomas J. Macbride, Jr.
Attorney At Law
GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP
505 SANSOME STREET, SUITE 900
SAN FRANCISCO CA 94111
(415) 392-7900
tmacbride@gmssr.com
For: CITY OF VERNON

Richard H. Counihan
GREENMOUNTAIN.COM
50 CALIFORNIA STREET, SUITE 1500
SAN FRANCISCO CA 94111
(415) 439-5310
rick.counihan@greenmountain.com
For: GREEN MOUNTAIN ENERGY RESOURCES

Irene K. Moosen
GRUENEICH RESOURCE ADVOCATES
582 MARKET STREET, SUITE 1020
SAN FRANCISCO CA 94104-5305
(415) 834-2300
imoosen@gralegal.com
For: UNIV. OF CALIFORNIA / CA STATE UNIVERSITIES / GOLDEN STATE POWER COOPERATIVE

Jody S. London
Attorney At Law
GRUENEICH RESOURCE ADVOCATES
582 MARKET STREET, SUITE 1020
SAN FRANCISCO CA 94104
(415) 834-2300
jlondon@gralegal.com
For: University of California / California State University

Gil Guevara
PO BOX 1681
SANTA MARIA CA 93456
For: AMERICAN G.I. FORUM OF CA CONSUMER EDUCATION & ADVOCACY PROG.

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Michael B. Day
Attorney At Law
GOODIN MACBRIDE SQUERI RITCHIE & DAY LLP
505 SANSOME STREET, SUITE 900
SAN FRANCISCO CA 94111-3133
(415) 392-7900
mday@gmssr.com
For: ENRON ENERGY SERVICES, INC., ENRON NORTH AMERICA

David R. Branchcomb
HENWOOD ENERGY SERVICES
SUITE 300 NORTH
2710 GATEWAY OAKS DRIVE
SACRAMENTO CA 95833
(916) 569-0985
dbranchcomb@hesinet.com

Kevin Woodruff
Principal Consultant
HENWOOD ENERGY SERVICES, INC.
2710 N. GATEWAY OAKS DR 300
SACRAMENTO CA 95833-3505

James Hodges
4720 BRAND WAY
SACRAMENTO CA 95819
(916) 451-7011
hodgesjl@pacbell.net
For: TELACU and Maravilla Foundation

Tom Dalzell
Attorney At Law
IBEW LOCAL 1245
3063 CITRUS CIRCLE
WALNUT CREEK CA 94598
(510) 933-6060
tmd9@pge.com

James F. Mordah
Power Department
IMPERIAL IRRIGATION DISTRICT
333 EAST BARIONI BLVD.
IMPERIAL CA 92251
(619) 339-9144

Jan Smutny-Jones
Association
INDEPENDENT ENERGY PRODUCERS
1112 I STREET, STE. 380
SACRAMENTO CA 95814-2896
(916) 448-9499
smutny@iepa.com

Morten Henrik Greidung
HAFSLUND ENERGY TRADING, LLC
101 ELLIOT AVE., SUITE 510
SEATTLE WA 98119
(206) 436-0640
mhg@hetrading.com
For: HAFSLUND ENERGY TRADING, LLC

William B. Marcus
JBS ENERGY, INC.
311 D STREET, SUITE A
WEST SACRAMENTO CA 95605
(916) 372-0534
bill@jbsenergy.com
For: TURN (EXPERT WITNESS)

Edward W. O'Neill
JEFFER, MANGELS, BUTLER & MARMARO LLP
ONE SANSOME STREET, 12TH FLOOR
SAN FRANCISCO CA 94104-4430
(415) 398-8080
ewo@jmbm.com
For: MOJAVE PIPELINE CO.

Norman A. Pedersen
Esquire
JONES DAY REAVES & POGUE
555 WEST FIFTH STREET, SUITE 4600
LOS ANGELES CA 90013-1025
(213) 243-2810
napedersen@jonesday.com
For: Commonwealth Energy Corporation and Automated Power Exchange Inc. & Frito Lay, Inc.

Gregory Klatt
Attorney At Law
JONES DAY REAVIS & POGUE
555 W. FIFTH STREET, SUITE 4600
LOS ANGELES CA 90013-1025
(213) 243-2373
gklatt@jonesday.com
For: SOUTHERN CALIFORNIA UTILITY POWER POOL (SCUPP)

Mark C. Moench
KERN RIVER GAS TRANSMISSION COMPANY
PO BOX 58900
SALT LAKE CITY UT 84158-0900
(801) 584-7059
mark.c.moench@wgp.twc.com
For: KERN RIVER GAS TRANSMISSION

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Judith Alper
INDEPENDENT POWER CORPORATION
150 W 20TH AVENUE
SAN MATEO CA 94403-1341

Mark A. Baldwin
INTERSTATE GAS SERVICES, INC.
2600 KITTYHAWK ROAD, SUITE 101
LIVERMORE CA 94550
(925) 243-0350
igsinc@ix.netcom.com

Yvonne Ladson Webb
LADSON ASSOCIATES
870 MARKET STREET, SUITE 765
SAN FRANCISCO CA 94102
(415) 296-8387
yladso19@idt.net
For: PASADENA WATER & POWER DEPARTMENT

Hugh Larkin
LARKIN & ASSOCIATES, INC.
15728 FARMINGTON ROAD
LIVONIA MI 48154
(313) 522-3420

Susan E. Brown
Attorney At Law
LATINO ISSUES FORUM
785 MARKET STREET, 3RD FLOOR
SAN FRANCISCO CA 94103-2003
(415) 284-7224
joseh@lif.org
For: LATINO ISSUES FORUM

Alan R. Watts
Attorney At Law
LAW OFFICES OF ALAN R. WATTS
529 HILDA COURT
ANAHEIM CA 92806-4304
(714) 635-8885
awattslaw@earthlink.net
For: Southern California Public Power Authority

C. Susie Berlin
Attorney At Law
LAW OFFICES OF BARRY F. MC CARTHY
2105 HAMILTON AVENUE, SUITE 140
SAN JOSE CA 95125
(408) 558-0950
sberlin@mccarthylaw.com
For: NORTHERN CALIFORNIA POWER AGENCY

Andy Wuelliner
KIRKWOOD GAS AND ELECTRIC COMPANY
PO BOX 1
KIRKWOOD CA 95646

Ron Knecht
1465 MARLBAROUGH AVENUE
LOS ALTOS CA 94024-5742
(650) 968-0115
ronknecht@aol.com
For: SELF

Christopher A. Hilen
Attorney At Law
LEBOEUF LAMB GREENE & MACRAE LLP
ONE EMBARCADERO CENTER, SUITE 400
SAN FRANCISCO CA 94111
(415) 951-1141
chilen@llgm.com
For: RELIANT ENERGY POWER GENERATION, INC.

Emilio E. Varanini, I I I
Attorney At Law
LIVINGSTON & MATTESICH
1201 K STREET, STE 1100
SACRAMENTO CA 95814
(916) 442-1111
gvaranini@lmlaw.net

Ed Perez
Assistant City Attorney
LOS ANGELES CITY ATTORNEY'S OFFICE
CITY HALL EAST
200 NORTH MAIN STREET, ROOM 1800
LOS ANGELES CA 90012
For: JAMES K. HAHN, CITY ATTORNEY

John W. Leslie
Attorney At Law
LUCE FORWARD HAMILTON & SCRIPPS, LLP
600 WEST BROADWAY, SUITE 2600
SAN DIEGO CA 92101
(619) 699-2536
jleslie@luce.com
For: SHELL ENERGY SERVICES, LLC

Steven Moss
M.CUBED
673 KANSAS STREET
SAN FRANCISCO CA 94107
(415) 643-9578
smoss@hooked.net
For: WESTERN MOBILHOME PARK ASSOCIATION

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Barry F. Mccarthy
LAW OFFICES OF BARRY F. MCCARTHY
2105 HAMILTON AVENUE, STE 140
SAN JOSE CA 95125
(408) 558-0950
office@mccarthylaw.com
For: Southern California Public Power Authority

William H. Booth
LAW OFFICES OF WILLIAM H. BOOTH
1500 NEWELL AVENUE, 5TH FLOOR
WALNUT CREEK CA 94596
(925) 296-2460
wbooth@booth-law.com
For: California Large Energy Consumers Assn.

Terry J. Houlihan
Attorney At Law
MCCUTCHEN DOYLE BROWN & ENERSEN LLP
3 EMBARCADERO CENTER, 18TH FLOOR
SAN FRANCISCO CA 94111
(415) 393-2022
thoulihan@mdbe.com
For: RELIANT ENERGY POWER GENERATION, INC.

Patricia R. Williams
MERVYN'S CALIFORNIA
22301 FOOTHILL BOULEVARD
HAYWARD CA 94541
(510) 727-5905
pat.williams@dhcmail.com
For: Mervyn's/Target Stores Division of Dayton Hudson Corporation

Kevin Mc Spadden
Attorney At Law
MILBANK TWEED HADLEY & MCCLOY
601 SOUTH FIGUEROA, 30TH FLR.
LOS ANGELES CA 90017
(213) 892-4563
kmcspadd@milbank.com
For: MILBANK, TWEED, HADLEY & MC CLOY

Scott T. Steffen
Attorney At Law
MODESTO IRRIGATION DISTRICT
1231 ELEVENTH STREET
MODESTO CA 95354
(209) 526-7387
scottst@mid.org
For: MODESTO IRRIGATION DISTRICT (MID)

Peter W. Hanschen
P. HANSCHEN
Attorney At Law
MORRISON & FOERSTER LLP

Melanie S. Best
MARRON, REID & SHEEY
601 CALIFONRIA STREET
SAN FRAN ISCO CA 94108

David J. Byers
Attorney At Law
MCCRACKEN, BYERS & HAESLOOP
840 MALCOLM ROAD, SUITE 100
BURLINGAME CA 94010
(650) 259-5979
btenney@landuselaw.com
For: California City County Streetlight Association (CAL-SLA)

Robert B. Weisenmiller
Phd
MRW & ASSOCIATES, INC.
1999 HARRISON STREET, STE 1440
OAKLAND CA 94612-3517
(510) 834-1999
rbw@mrwassoc.com

Sara Steck Myers
Attorney At Law
122 28TH AVENUE
SAN FRANCISCO CA 94121
(415) 387-1904
ssmyers@worldnet.att.net
For: CENTER FOR ENERGY EFFICIENCY AND RENEWABLE TECHOLOGIES (CEERT)

Terry E. Singer
NAESCO
1615 M STREET, NORTHWEST
WASHINGTON DC 20036-3203
(202) 822-0950
tes@dwmpdc.com

Richard Roos-Collins
Attorney At Law
NATURAL HERITAGE INSTITUTE
2140 SHATTUCK AVENUE, SUITE 500
BERKELEY CA 94704-1222
(510) 644-2900
rrcollins@n-h-i.org
For: California Hydropower Reform Coalition

Sheryl Carter
NATURAL RESOURCES DEFENSE COUNCIL
71 STEVENSON STREET, SUITE 1825
SAN FRANCISCO CA 94105
(415) 777-0220
scarter@nrdc.org

********** ATTACHMENT C: SERVICE LIST **********
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425 MARKET STREET
SAN FRANCISCO CA 94105
(415) 268-7214
phanschen@mofo.com
For: AGRICULTURAL ENERGY CONSUMERS ASSN.

Steven C. Mcclary
MRW & ASSOCIATES
1999 HARRISON STREET SUITE 1440
OAKLAND CA 94612
(510) 834-1999

Joel A. Linsider
NEW YORK STATE DEPT. OF PUBLIC SERVICE
3 EMPIRE STATE PLAZA, 19TH FLOOR
ALBANY NY 12223

Aaron Thomas
NEWENERGY, INC.
1000 WILSHIRE BOULEVARD, SUITE 1900
LOS ANGELES CA 90017
(213) 996-6136
athomas@newenergy.com
For: New Energy Ventures, Inc.

Cheryl White Mason
Attorney At Law
O'MELVENY & MYERS
275 BATTERY STREET
SAN FRANCISCO CA 94111
(415) 984-8708
cmason@omm.com
For: Pacific Gas and Electric Company

Lindsay Bower
JOHN W. JIMISON
Deputy Attorney General
OFFICE OF THE ATTORNEY GENERAL
455 GOLDEN GATE AVE., STE 1100
SAN FRANCISCO CA 94102-3664
(415) 703-5517
bowerl@hdcdojnet.state.ca.us
For: SELF

Richard Sperberg
President
ONSITE/SYCOM
701 PALOMAR AIRPORT ROAD RM 200
CARLSBAD CA 92009
(760) 931-2400
Rsperberg@onsitesycom.com

Kay Davoodi
NAVY RATE INTERVENTION OFFICE
WASHINGTON NAVY YARD
1314 HARWOOD STREET SE
WASHINGTON DC 20374-5018
(202) 685-0130
DavoodiKR@efaches.navfac.navy.mil

Janie Mollon
NEW WEST ENERGY
PO BOX 61868
PHOENIX AZ 85082-1868
(602) 629-7758
jsmollon@newwestenergy.com
For: NEW WEST ENERGY

Daniel J. Mccarthy
Attorney At Law
PACIFIC BELL
140 NEW MONTGOMERY, 16TH FLOOR
SAN FRANCISCO CA 94105
(415) 542-7547

Brian Cherry
PACIFIC ENTERPRISES
555 WEST 5TH STREET, M.L. 25A1
LOS ANGELES CA 90013-1011

Joyce A. Padleschat
PACIFIC ENTERPRISES
B MINERAL ENERGY SUB MINERAL ENERGY
633 WEST FIFTH STREET, SUITE 5200
LOS ANGELES CA 90071

William H. Edwards
KELLY M. MORTON, JAMES L. LOPES
PACIFIC GAS AND ELECTRIC CO.
77 BEALE STREET
PO BOX 7442, RM 3115-B30A
SAN FRANCISCO CA 94120-7442
(415) 973-2768
whe1@pge.com
For: PG&E

Leslie H. Everett
Director, Regulatory Relations
PACIFIC GAS AND ELECTRIC COMPANY
77 BEALE STREET, ROOM 1087
SAN FRANCISCO CA 94105
(415) 972-6842

Peter Ouborg
Attorney At Law
PACIFIC GAS AND ELECTRIC COMPANY
PO BOX 770000
SAN FRANCISCO CA 94177

********** ATTACHMENT C: SERVICE LIST **********
Last Update on 02-APR-2001 by: CPL
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Joseph M. Malkin
Attorney At Law
ORRICK, HERRINGTON & SUTCLIFFE LLP
400 SANSOME STREET
SAN FRANCISCO CA 94111-3143
(415) 773-5505
jmalkin@orrick.com
For: THE AES CORPORATION

Roy E. Potts
Attorney At Law
OVERTON, LYMAN & PRINCE
777 SOUTH FIGUEROA, 37TH FLOOR
LOS ANGELES CA 90017

Matthew Wright
V. P. Regulation
PACIFICORP
825 NE MULTNOMAH, SUITE 8OO
PORTLAND OR 97232
(503) 813-6015
matthew.wright@Pacificorp.com

John Maher
PAN ALBERTA GAS LTD.
707 8TH AVENUE, S.W. RM 500
CALGARY AB T2P 3V3
CANADA

Jane Pearson
TOM SKUPNJAK
SUITE 150
2500 CITY WEST BOULEVARD
HOUSTON TX 77042
For: CHALK CLIFF, LTD. / MCKITTRICK, LTD.

Leslie H. Everett
PG&E CORPORATION
SUITE 2400
ONE MARKET, SPEAR TOWER
SAN FRANCISCO CA 94105

Douglas Oglesby
Vice President / General Counsel
PG&E ENERGY SERVICES
345 CALIFORNIA STREET, 32ND FLOOR
SAN FRANCISCO CA 94110
(415) 733-4750
For: VANTUS ENERGY CORPORATION

Jeffrey S. Hitchings
Director, Regulatory Affairs & Planning
PG&E GAS TRANSMISSION, NORTHWEST CORP
2100 S.W. RIVER PARKWAY
PORTLAND OR 97201
(503) 833-4252

(415) 973-2286
pxo2@pge.com
For: Pacific Gas and Electric Company

Judy Boyette
Deputy General Counsel
PACIFIC TELESIS LEGAL GROUP
130 KEARNY STREET RM 3659
SAN FRANCISCO CA 94108
(415) 394-3560

Patrick J. Power
Attorney At Law
2101 WEBSTER ST., STE. 1500
OAKLAND CA 94612
(510) 446-7742
pjpowerlaw@aol.com
For: EL PASO NATURAL GAS

Don Schoenbeck
RCS CONSULTING, INC.
900 WASHINGTON STREET, SUITE 1000
VANCOUVER WA 98660
(360) 737-3877
dws@keywaycorp.com
For: Coalinga Cogenerator

James Ross
RCS CONSULTING, INC.
500 CHESTERFIELD CENTER, SUITE 320
CHESTERFIELD MO 63017
(636) 530-9544
rcsstl@cdmnet.com
For: Midway Sunset Cogeneration

Steven Greenberg
REALENERGY
300 CAPITOL MALL, SUITE 300
SACRAMENTO CA 95814
(916) 325-2500
sgreenberg@realenergy.com
For: RealEnergy

Glen Rothner
REICH, ADELL & CROST
501 SHATTO PLACE, STE.100
LOS ANGELES CA 90020

Paul Crost
Attorney At Law
REICH, ADELL & CROST
1918 W. CHAPMAN AVE, STE 205

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Steven Lehtonen
PHCC OF CALIFORNIA
1911 F STREET
SACRAMENTO CA 95814
For: CA Assn of Plumbing / Heating / Cooling Contractors

Patrick J. Power
Attorney At Law
1300 CLAY STREET, SUITE 600
OAKLAND CA 94612
(510) 446-7742
pjpowerlaw@aol.com
For: City of Long Beach; Universal Studios Inc.

Charles Doering
Principal Executive Consultant
RESOURCE MANAGEMENT INTERNATIONAL, INC.
225 W. BROADWAY, SUITE 4004
GLENDALE CA 91204
(818) 244-0117
charles_doering@rmiinc.com
For: Pan Alberta Limited

Randy Britt
ROBINSONS-MAY
6160 LAUREL CANYON BLVD.
NORTH HOLLYWOOD CA 91606
(818) 509-4777
randy_britt@mayco.com
For: Robinsons-May

Arlin Orchard
Attorney At Law
SACRAMENTO MUNICIPAL UTILITY DISTRICT
PO BOX 15830, MAIL STOP-B406
SACRAMENTO CA 95852-1830
(916) 732-5830
aorchar@smud.org
For: Sacramento Municipal Utility District

Dana S. Appling
General Counsel
SACRAMENTO MUNICIPAL UTILITY DISTRICT
LEGAL DEPARTMENT MSB406
PO BOX 15830
SACRAMENTO CA 95852-1830
(916) 732-6126

James D. Bliesner
Reinvestment Director
SAN DIEGO CITY / COUNTY REINVESTMENT TASK
3989 RUFFIN ROAD, MS 0231
SAN DIEGO CA 92123

Steven D. Davis
ORANGE CA 92668

Keith Sappenfield
RELIANT ENERGY RETAIL, INC.
PO BOX 1409
HOUSTON TX 77251-1409
(713) 207-5570
keith-sappenfield@reliantenergy.com
For: Reliant Energy Retail, Inc.

Phillip J. Muller
SCD ENERGY SOLUTIONS
436 NOVA ALBION WAY
SAN RAFAEL CA 94903
(415) 479-1710
pjmuller@ricochet.net
For: Southern Company Energy Marketing

David J. Gilmore
Attorney At Law
SEMPRA ENERGY
555 WEST FIFTH STREET
LOS ANGELES CA 90013-1011
(213) 244-2945
dgilmore@sempra.com
For: Southern California Gas Co. and San Diego Gas & Electric Co.

James R. Dodson
SEMPRA ENERGY
101 ASH STREET
SAN DIEGO CA 92101
(619) 699-5106
jdodson@sempra.com

Jeffrey M. Parrott
LYNN G. VAN WAGENEN
Attorney At Law
SEMPRA ENERGY
101 ASH STREET
SAN DIEGO CA 92101-3017
(619) 699-5063
jparrott@sempra.com
For: San Diego Gas & Electric Company

Judy Young
Attorney At Law
SEMPRA ENERGY
555 W. 5TH STREET, M.L.G.T. 14E7
LOS ANGELES CA 90013
(213) 244-2955

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SAN DIEGO GAS & ELECTRIC COMPANY
101 ASH STREET
SAN DIEGO CA 92101-3017

Patricia Diaz Dennis
Assistant General Counsel
SBC COMMUNICATIONS INC.
175 E. HOUSTON STREET 4-A-70
SAN ANTONIO TX 78205

David M. Norris
Attorney At Law
SIERRA PACIFIC POWER COMPANY
6100 NEIL ROAD
RENO NV 89520-0024
(775) 834-3939
dnorris@sppc.com

Justin D. Bradley
SILICON VALLEY MANUFACTURING GROUP
226 AIRPORT PARKWAY, SUITE 190
SAN JOSE CA 95110
(408) 501-7852
jbradley@svmg.org
For: SILICON VALLEY MANUFACTURERS GROUP

John E. Wood
Mgr., Business Development
SITHE ENERGIES, INC.
707 BROADWAY, SUITE 1500
SAN DIEGO CA 92101-5300

Vicki Kaiser
SOUTHERN CALIFORNIA EDISON
SUITE 369
2244 WALNUT GROVE AVENUE
ROSEMEAD CA 91770
For: EDISON INTERNATIONAL

Vicki Kaiser
SOUTHERN CALIFORNIA EDISON
SUITE 369
2244 WALNUT GROVE AVENUE
ROSEMEAD CA 91770
For: SOUTHERN CALIFORNIA EDISON COMPANY

David B. Follett
Attorney At Law
SOUTHERN CALIFORNIA GAS COMPANY
633 WEST 5TH ST., SUITE 5200

jlyoung@sempra.com
For: Southern California Gas Company

Thomas C. Sanger
SEMPRA ENERGY
101 ASH STREET
SAN DIEGO CA 92101-3017

Andrew Chau
Attorney At Law
SHELL ENERGY SERVICES COMPANY, L.L.C.
1221 LAMAR STREET, SUITE 1000
HOUSTON TX 77010
(713) 241-8939
anchau@shellus.com

Joe F. Young
SOUTHERN CALIFORNIA WATER COMPANY
630 EAST FOOTHILL BLVD.
SAN DIMAS CA 91773
(714) 394-3677

Andrew W. Bettwy
Attorney At Law
SOUTHWEST GAS CORPORATION
5241 SPRING MOUNTAIN ROAD
LAS VEGAS NV 89102
(702) 876-7107
andy.bettwy@swgas.com
For: Southwest Gas Corporation

Jim Solberg
SPURR
1430 WILLOW PASS RD. STE. 240
CONCORD CA 94520-7929

James C. Paine
Attorney At Law
STOEL RIVES LLP
900 S.W. FIFTH AVENUE, STE 2600
PORTLAND OR 97204-1268
(503) 294-9246
jcpaine@stoel.com
For: PacifiCorp

John R. Staffier
Attorney At Law
STUNTZ & DAVIS
SUITE 819
1201 PENNSYLVANIA AVENUE N.W.
WASHINGTON DC 20004
(202) 662-6780
For: PAN-ALBERTA GAS LIMITED

Patrick Mcdonnell
SUNPACIFIC ENERGY MANAGEMENT

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LOS ANGELES CA 90071-2071
(213) 895-5134
dfollett@sempra.com

Beatty Henson
Chairman
SOUTHERN CALIFORNIA GAS WORKERS COUNCIL
7200 GREENLEAF AVENUE, SUITE 380
WHITTIER CA 90601

Keith R. Mccrea
Attorney At Law
SUTHERLAND, ASBILL & BRENNAN LLP
1275 PENNSYLVANIA AVE., N.W., SUITE 800
WASHINGTON DC 20004-2415
(202) 383-0705
kmccrea@sablaw.com

Gene L. Waas
THE CALIFORNIA POWER EXCHANGE
1000 SOUTH FREMONT BUILDING A9 WEST
ALHAMBRA CA 91803
(626) 537-3326
glwaas@calpx.com
For: The California Power Exchange

Peter Bray
THE NEW POWER COMPANY
101 CALIFORNIA STREET, SUITE 1950
SAN FRANCISCO CA 94111
(415) 782-7810
pbray@newpower.com
For: The New Power Company

Michel Peter Florio
Attorney At Law
THE UTILITY REFORM NETWORK
711 VAN NESS AVE., SUITE 350
SAN FRANCISCO CA 94102
(415) 929-8876 (302)
mflorio@turn.org

Robert Finkelstein
Attorney At Law
THE UTILITY REFORM NETWORK
711 VAN NESS AVENUE, SUITE 350
SAN FRANCISCO CA 94102
(415) 929-8876 X-301
bfinkelstein@turn.org
For: The Utility Reform Network (TURN)

Bill L. Kurtz J.
UNION PACIFIC RESOURCES COMPANY
PO BOX 7
900 LARKSPUR LANDING CIRCLE RM 240
LARKSPUR CA 94939
pmcdonne@wenet.net

James Bushee
SUTHERLAND, ASBILL & BRENNAN
1275 PENNSYLVANIA AVENUE
WASHINGTON DC 20004
(202) 383-0100
jbushee@sablaw.com
For: CALIFORNIA MANUFACTURERS ASSOCIATION (CMA)

Bernardo R. Garcia
UTILITY WORKERS UNION OF AMERICA,AFL-CIO
PO BOX 5198
OCEANSIDE CA 92052-5198
(949) 369-9936
uwuaregion5@earthlink.net
For: Utility Workers Union of America, AFL-CIO

Andrew J. Van Horn
VAN HORN CONSULTING
61 MORAGA WAY, SUITE 1
ORINDA CA 94563-3029
(925) 254-3358
vhconsult@earthlink.net

Jerry R. Bloom
JOSEPH KARP / LISA COTTLE
Attorney At Law
WHITE & CASE LLP
TWO EMBARCADERO CENTER, SUITE 650
SAN FRANCISCO CA 94111
(415) 544-1100
bloomje@la.whitecase.com
For: CALIFORNIA COGENERATION COUNCIL

Michael J. Thompson
Attorney At Law
WRIGHT & TALISMAN, PC
1200 G STREET, N.W., STE 600
WASHINGTON DC 20005
(202) 393-1200
thompson@wrightlaw.com
For: KERN RIVER GAS TRANSMISSION COMPANY

Jason J. Zeller
Legal Division
RM. 5002
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-4673
jjz@cpuc.ca.gov
For: Office of Ratepayer Advocates

FORT WORTH TX 76101-0007

Michael Shames
Attorney At Law
UTILITY CONSUMERS' ACTION NETWORK
1717 KETTNER BLVD., SUITE 105
SAN DIEGO CA 92101-2532
(619) 696-6966
mshames@ucan.org
For: Utility Consumers' Action Network (UCAN)

Christopher J. Blunt
Office of Ratepayer Advocates
RM. 4101
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1779
cjb@cpuc.ca.gov

Carol A Brown
Administrative Law Judge Division
RM. 5103
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2971
cab@cpuc.ca.gov

Truman L. Burns
Office of Ratepayer Advocates
RM. 4209
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2932
txb@cpuc.ca.gov

Michael W. Neville
Attorney At Law
CALIFORNIA ATTORNEY GENERAL'S OFFICE
455 GOLDEN GATE AVENUE, SUITE 11000
SAN FRANCISCO CA 94102-7004
(415) 703-5523
nevillm@hdcdojnet.state.ca.us
For: CALIFORNIA RESOURCES AGENCY

Lorenzo Kristov
CALIFORNIA ENERGY COMMISSION
1516 9TH ST., MS-22
SACRAMENTO CA 95814
(916) 654-4773
LKristov@energy.state.ca.us
For: California Energy Commission

Monica Schwebs
Attorney At Law
CALIFORNIA ENERGY COMMISSION
1516 NINTH STREET, MS-14

********** STATE EMPLOYEE **********

Robert A. Barnett
Administrative Law Judge Division
RM. 5008
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1504
rab@cpuc.ca.gov

Robert C. Cagen
Legal Division
RM. 5124
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2197
rcc@cpuc.ca.gov

Sean F. Casey
Office of Ratepayer Advocates
RM. 4205
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1667
sfc@cpuc.ca.gov

John M Chamberlain
Legal Division
RM. 5023
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1960
mcx@cpuc.ca.gov

Richard Clark
Consumer Services Division
RM. 2205
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2349
rwc@cpuc.ca.gov

Jim O'Brien
DEPARTMENT OF WATER RESOURCES
1416 9TH STREET, ROOM 1118
SACRAMENTO CA 94236
(916) 653-8816
dwrlegal1@water.ca.gov
For: Department of Water Resources

Robert Miyashiro
DEPT. OF FINANCE
STATE CAPITOL, RM 1145
SACRAMENTO CA 95814
(916) 445-8610

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SACRAMENTO CA 95814-5512
(916) 654-5207
mschwebs@energy.state.ca.us

Ruben Tavares
Electricity Analysis Office
CALIFORNIA ENERGY COMMISSION
1516 9TH STREET, MS 20
SACRAMENTO CA 95814
(916) 654-5171
rtavares@energy.state.ca.us
For: California Energy Commission

Joseph R. DeUlloa
Administrative Law Judge Division
RM. 5105
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-3124
jrd@cpuc.ca.gov

Janet A. Econome
Administrative Law Judge Division
RM. 5113
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1494
jjj@cpuc.ca.gov

Robert T. Feraru
Public Advisor Office
RM. 5303
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2074
rtf@cpuc.ca.gov

Faline Fua
Energy Division
AREA 4-A
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2481
fua@cpuc.ca.gov

David K. Fukutome
Office of Ratepayer Advocates
RM. 4209
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1136
dkf@cpuc.ca.gov

Jack Fulcher
Energy Division
AREA 4-A

firmiyas@dof.ca.gov
For: DEPT. OF FINANCE (DOF)

Christopher Danforth
Office of Ratepayer Advocates
RM. 4101
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1481
ctd@cpuc.ca.gov

Audra Hartmann
Legal Division
770 L STREET, SUITE 1050
Sacramento CA 95814
(916) 327-1417
ath@cpuc.ca.gov

William Julian Ii
Executive Division
RM. 5139
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2442
bj2@cpuc.ca.gov

Kayode Kajopaiye
Energy Division
AREA 4-A
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2557
kok@cpuc.ca.gov

Robert Kinosian
Office of Ratepayer Advocates
RM. 4209
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1500
gig@cpuc.ca.gov

Laura L. Krannawitter
Executive Division
RM. 5210
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2538
llk@cpuc.ca.gov

Donald J. Lafrenz
Energy Division
AREA 4-A
505 VAN NESS AVE

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505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1711
jef@cpuc.ca.gov

Sean Gallagher
Legal Division
RM. 5035
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2059
shg@cpuc.ca.gov

Jeanette Lo
Energy Division
AREA 4-A
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1825
jlo@cpuc.ca.gov

Scott Logan
Office of Ratepayer Advocates
RM. 4102
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1418
sjl@cpuc.ca.gov

Kim Malcolm
Executive Division
RM. 5115
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1926
kim@cpuc.ca.gov

Maurice Monson
Energy Division
AREA 4-A
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-3072
mdm@cpuc.ca.gov

Anne W. Premo
Energy Division
AREA 4-A
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1247
awp@cpuc.ca.gov

Randy Chinn
SENATE ENERGY COMMITTEE
ROMM 408
San Francisco CA 94102
(415) 703-1063
dlf@cpuc.ca.gov

Steve Linsey
Office of Ratepayer Advocates
RM. 4101
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1341
car@cpuc.ca.gov

Linda Serizawa
Executive Division
RM. 5119
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1383
lss@cpuc.ca.gov

Maria E. Stevens
Executive Division
RM. 5109
320 WEST 4TH STREET SUITE 500
Los Angeles CA 90013
(213) 576-7012
mer@cpuc.ca.gov

Zenaida G. Tapawan-Conway
Energy Division
AREA 4-A
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2624
ztc@cpuc.ca.gov

Ourania M. Vlahos
Legal Division
RM. 5125
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2387
omv@cpuc.ca.gov

Natalie Walsh
Energy Division
AREA 4-A
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1622
nfw@cpuc.ca.gov

Christine M. Walwyn
Administrative Law Judge Division
RM. 5101

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STATE CAPITOL
SACRAMENTO CA 95814
randy.chinn@senate.ca.gov

James E. Scarff
Legal Division
RM. 5121
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1440
jes@cpuc.ca.gov

Sean Wilson
Water Division
AREA 3-C
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-1818
smw@cpuc.ca.gov

Hallie Yacknin
Legal Division
RM. 5032
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2195
hsy@cpuc.ca.gov

Helen W. Yee
Legal Division
RM. 5031
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2474
yee@cpuc.ca.gov

********** INFORMATION ONLY **********

Tom O'Neill
Vice President
ABN AMRO INCORPORATED
EQUITY RESEARCH
ONE CALIFORNIA STREET, SUITE 200
SAN FRANCISCO CA 94111
(415) 983-2901
tom.oneill@abnamro.com

David Marcus
ADAMS BROADWELL & JOSEPH
PO BOX 1287
BERKELEY CA 94701-1287
(510) 528-0728
dmarcus@slip.net
For: Coalition of California Utility Employees

505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2301
cmw@cpuc.ca.gov

Rosalina White
Public Advisor Office
RM. 5303
505 VAN NESS AVE
San Francisco CA 94102
(415) 703-2074
raw@cpuc.ca.gov

Robert E. Anderson
APS ENERGY SERVICES
1500 FIRST AVENUE
ROCHESTER MN 55906
(507) 289-0800
bob_anderson@apses.com
For: APS ENERGY SERVICES

Ed Cazalet
AUTOMATED POWER EXCHANGE, INC.
5201 GREAT AMERICA PARKWAY
SANTA CLARA CA 95054
(408) 517-2900
ed@apx.com
For: Automated Power Exchange, Inc.

Scott Blaising
Attorney At Law
8980 MOONEY ROAD
ELK GROVE CA 95624
(916) 682-9702
blaising@braunlegal.com

Stephen P. Bowen
Attorney At Law
BLUMENFELD & COHEN
4 EMBARCADERO CENTER, SUITE 1170
SAN FRANCISCO CA 94111
(415) 394-7500
stevebowen@earthlink.net

Paul A. Harris
BRIDGE NEWS
44 MONTGOMERY, SUITE 2410
SAN FRANCISCO CA 94104
(415) 835-7641
paul.harris@bridge.com
For: BRIDGE NEWS

Mona Patel
BROWN & WOOD LLP
555 CALIFORNIA STREET, 50TH FLOOR
SAN FRANCISCO CA 94104

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Ira Schoenholtz
President
AMERICAN ASSN OF BUSINESS PERSONS W / DIS
2 WOODHOLLOW
IRVINE CA 92604-3229
(949) 559-1516
For: American Association of Business Persons with Disabilities

Stephen Layman
CALIFORNIA ENERGY COMMISSION, EIAD
1516 9TH STREET, MS-20
SACRAMENTO CA 95814
(916) 654-4845
Slayman@energy.state.ca.us

Derk Pippin
CALIFORNIA ENERGY MARKETS
9 ROSCOE STREET
SAN FRANCISCO CA 94110-5921
(415) 824-3222
derkp@newsdata.com
For: CALIFORNIA ENERGY MARKETS (CEM)

J. A. Savage
CALIFORNIA ENERGY MARKETS
3006 SHEFFIELD AVENUE
OAKLAND CA 94602-1545
(510) 534-9109
honest@compuserve.com
For: California Energy Markets

Jason Mihos
CALIFORNIA ENERGY MARKETS
9 ROSCOE
SAN FRANCISCO CA 94110
(415) 824-3222
jasonm@newsdata.com
For: CALIFORNIA ENERGY MARKETS (NEWSLETTER)

Lulu Weinzimer
CALIFORNIA ENERGY MARKETS
9 ROSCOE STREET
SAN FRANCISCO CA 94110-5921
(415) 824-3222
luluw@newsdata.com

William Dombrowski
CALIFORNIA RETAILERS ASSOCIATION
980 9TH STREET, SUITE 2100
SACRAMENTO CA 95814-2741
(916) 443-1975

Joy Omania
(415) 772-1265
mpatel@brownwoodlaw.com

Glenn Semow
CALIFORNIA CABLE TELEVISION ASSOCIATION
4341 PIEDMONT AVENUE
OAKLAND CA 94611
(510) 428-2225
phil@calcable.org
For: CALIFORNIA CABLE TELEVISION ASSOCIATION

Alexandre B. Makler
CALPINE CORPORATION
6700 KOLL CENTER PARKWAY, SUITE 200
PLEASANTON CA 94566
(925) 600-2081
alexm@calpine.com
For: CALPINE CORPORATION

Susannah Churchill
Energy Advocate
CALPIRG
926 J ST. 523
SACRAMENTO CA 95814
(916) 448-4516
swchurchill@juno.com
For: CALPIRG

Michael S. Hundus
CAMERON MCCKENNA LLP
TWO TRANSAMERICA CENTER
505 SANSOME STREET, 5TH FLOOR
SAN FRANCISCO CA 94111

J. Patrick Tang
JOHN A. RUSSO / BARBARA J. PARKER
Deputy City Attorney
CITY OF OAKLAND
ONE FRANK OGAWA PLAZA 6TH FLOOR
OAKLAND CA 94612
(510) 238-6523
jptang@oaklandcityattorney.org

John A. Barthrop
General Counsel
COMMONWEALTH ENERGY CORP.
15991 RED HILL AVENUE, NO. 201
TUSTIN CA 92780
(714) 258-0470
jbarthrop@powersavers.com
For: Commonwealth Energy Corp.

Angela Oh
Advisor
COMMUNITY TECHNOLOGY POLICY COUNCIL
PMB 7000-639

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Action Association
CALIFORNIA / NEVADA COMMUNITY
225 30TH STREET, SUITE 200
SACRAMENTO CA 95816

Maria Crispi
22 SOUTH PARK, ROOM 320
SAN FRANCISCO CA 94107
(415) 882-1663
musicamaria@yahoo.com

Carl K. Oshiro
Attorney At Law
CSBRT / CSBA
100 FIRST STREET, SUITE 2540
SAN FRANCISCO CA 94105
(415) 927-0158
oshirock@pacbell.net
For: CALIFORNIA SMALL BUSINESS ASSOCIATION AND CALIFORNIA SMALL BUSINESS ROUNDTABLE

Gregory T. Blue
Manager, State Regulatory Affairs
DYNEGY POWER CORP.
5976 W. LAS POSITAS BLVD, SUITE 200
PLEASANTON CA 94588
gtbl@dynegy.com

Joseph A. Young
EAST BAY MUNICIPAL UTILITY DISTRICT
375 ELEVENTH STREET, ROOM MS 205
OAKLAND CA 94607
(510) 287-0147
jyoung@ebmud.com

Jon S. Silva
Government Affairs Associate
EDISON SOURCE
955 OVERLAND COURT
SAN DIMAS CA 91773
(909) 450-6035
jsilva@edisonenterprises.com

Joseph M. Paul
ENERGY LAW GROUP LLP
5976 WEST LAS POSITAS BLVD., STE. 200
PLEASANTON CA 94588
(925) 469-2314
joe.paul@dynegy.com

REDONDO BEACH CA 90277

Jim Conran
President
CONSUMERS FIRST
PO BOX 2346
ORINDA CA 94563
(925) 253-1937
ConsumersFirst@worldnet.att.net
For: CONSUMERS FIRST

Ralph Smith
LARKIN & ASSOCIATES, INC.
15728 FARMINGTON ROAD
LIVONIA MI 48154
(734) 522-3420
ad046@detroit.freenet.org
For: Larkin & Associates, Inc.

Ann M. Pougiales
Attorney At Law
LAW OFFICES OF ANN M. POUGIALES
463 PACIFIC AVENUE
SAN FRANCISCO CA 94133
(415) 397-0407
translaw@pougiales.com

Richard Hamilton
Attorney At Law
LAW OFFICES OF RICHARD L. HAMILTON
100 HOWE AVE. SUITE 230N
SACRAMENTO CA 95825
(916) 484-7646
hylaw@pacbell.net

Karen Lindh
LINDH & ASSOCIATES
7909 WALERGA ROAD, ROOM 112, PMB 119
ANTELOPE CA 95843
(916) 729-1562
karen@klindh.com
For: California Manufacturers Assn.

Fay A. Chu
Deputy City Attorney
LOS ANGELES CITY ATTORNEY'S OFFICE
111 NORTH HOPE JFB 340
LOS ANGELES CA 90012
(213) 367-4580
fchu@legal.ladwp.com

Alvin Chan
LOS ANGELES DEPT. OF WATER & POWER
PO BOX 5 1111, SUITE 340
LOS ANGELES CA 90051-0100
(213) 367-4500

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Joelle Ogg
JOHN & HENGERER
1200 17TH STREET, NW, STE 600
WASHINGTON DC 20036
(202) 429-8812
jogg@jhenergy.com

Candace A. Younger
MANATT, PHELPS & PHILLIPS, LLP
11355 WEST OLYMPIC BOULEVARD
LOS ANGELES CA 90064
(310) 312-4000
cyounger@manatt.com

David L. Huard
MANATT, PHELPS & PHILLIPS, LLP
11355 WEST OLYMPIC BLVD.
LOS ANGELES CA 90064
(310) 312-4000
dhuard@manatt.com

Randall W. Keen
MANATT, PHELPS & PHILLIPS, LLP
11355 WEST OLYMPIC BLVD.
LOS ANGELES CA 90064
(310) 312-4000
rkeen@manatt.com

Linda R. Beck
MCDONOUGH, HOLLAND & ALLEN
1999 HARRISON STREET, STE 1300
OAKLAND CA 94612
(510) 839-9104
For: City of Paso Robles

Christopher J. Mayer
MODESTO IRRIGATION DISTRICT
PO BOX 4060
MODESTO CA 95352-4060
(209) 526-7430
chrism@mid.org
For: MODESTO IRRIGATION DISTRICT (MID)

Gary Herbert
MSDW
ONE TOWER BRIDGE, 11TH FLOOR
WEST CONSHOHOCKEN PA 19428
(610) 940-4524
gerhordt.herbert@msdw.com

Melanie Gillette
NAVIGANT CONSULTING INC
3100 ZINFANDEL DRIVE, SUITE 600
RANCHO CARDOVA CA 95670
(916) 852-1300

Richard J. Mccann
M.CUBED
2655 PORTAGE BAY, SUITE 3
DAVIS CA 95616
(530) 757-6363
rmccann@cal.net

Kay Davoodi
NAVY RATE INTERVENTION OFFICE
WASHINGTON NAVY YARD
1314 HARWOOD STREET SE
WASHINGTON DC 20374-5018
(202) 685-0130
DavoodiKR@efaches.navfac.navy.mil
For: Navy Rate Intervention

Martin Mattes
Attorney At Law
NOSSAMAN GUTHNER KNOX & ELLIOTT, LLP
50 CALIFORNIA STREET, 34TH FLOOR
SAN FRANCISCO CA 94111-4799
(415) 438-7273
mmattes@nossaman.com

Eve Mitchell
OAKLAND TRIBUNE
401 13TH ST.
OAKLAND CA 94612
(510) 208-6474
emitchel@angnewspapers.com

Gabriel Vivas
Special Assistant, Office Of Oversight
OFFICE OF ASSEMBLY SPEAKER HERTZBERG
1020 N STREET, SUITE 367
SACRAMENTO CA 95814
(916) 319-3640
Gabriel.Vivas@asm.ca.gov

Jonathan Jacobs
PA CONSULTING GROUP
75 NOVA DRIVE
PIEDMONT CA 94610-1037
(510) 654-9495
jon.jacobs@paconsulting.com
For: PA CONSULTING GROUP

George A. Perrault
1813 FAYMONT AVENUE
MANHATTAN BEACH CA 90266
(310) 379-0901
georgeperrault@msn.com

Carrie Peyton
SACRAMENTO BEE

melanie_gillette@rmiinc.com

PO BOX 15779
SACRAMENTO CA 95852
(916) 321-1086
cpeyton@sacbee.com

Les Saffil
SSP NORTHRIDGE GAS SHUT-OFF VALVE CO.
5520 SHENANDOAH AVENUE
LOS ANGELES CA 90056
(310) 645-6877
lsaffil@flash.net

Charles C. Read
Attorney At Law
STEPTOE & JOHNSON, LLP
1330 CONNECTICUT AVENUE, N.W.
WASHINGTON DC 20036
(202) 429-6244
cread@steptoe.com

Peter Fox-Penner, Ph.D.
THE BRATTLE GROUP
1133 20TH STREET NW, SUITE 800
WASHINGTON DC 20036
(202) 955-5050
peter_fox-penner@brattle.com

Tony Wetzel
THERMO ECOTEK CORPORATION
1100 MELODY LANE, SUITE 206
ROSEVILLE CA 95678
(916) 773-2940
twetzel@thermoecotek.com
For: THERMO ECOTEK CORPORATION

Fred Wesley Monier
TURLOCK IRRIGATION DISTRICT
PO BOX 949
333 EAST CANAL DRIVE
TURLOCK CA 95381-0949
(209) 883-8321
fwmonier@tid.org

Bill C. Wells
Lt. Col.
TYNDALL AFB
139 BARNES DRIVE, SUITE 1
TYNDALL AFB FL 32403-5319
(850) 283-6347
bill.wells@afcesa.af.mil
For: AIR FORCE LEGAL SERVICES AGENCY

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Tom Dukich
Manager, Rates & Tariffs
WASHINGTON WATER POWER COMPANY
PO BOX 3727
SPOKANE WA 99220
(509) 489-0500

(END OF ATTACHMENT C)

Commissioner Henry M. Duque, concurring:

As I have stated previously, I fully support an investigation into the transfer of funds from the utilities to their holding companies. Yet I am also compelled to raise my concerns here. I have discussed these concerns with Commissioner Bilas. Although he is unable to join my concurrence because he did not vote on the order, I know Commissioner Bilas shares many of my concerns.

To begin with, it is important to note the silence in our order on a few points. It does not say that Public Utilities Code section 456 allows a utility to profit from economies, efficiencies or improvements that it may make and distribute by way of dividends or otherwise dispose of such profits. Footnote 12 does clarify that we do not mean to imply that the dividend transfers to the holding companies were necessarily improper.

Our order also contains a vague reference to Public Utilities Code section 798. The order states that it provides remedies against a utility that makes imprudent payments to its holding company. That is not an accurate characterization of the statute. The order does not say that section 798 contains an element of scienter or knowledge of wrongdoing. The statute requires us to find that the utility "willfully made" an imprudent payment to its holding company. The order also does not say that the statute then requires that the utility have sought to recover the payment in a proceeding before the Commission. This second element is missing in the allegations. For example, there is no Commission proceeding cited in the order. Is the filing of the rate stabilization applications that request for recovery? The order is silent on this point.

Similarly, the order does not say that the penalty set forth by the statute is up to three times the prohibited payment. That makes this a serious enforcement proceeding if you multiply just the 6.7 billion dollars transferred to the holding companies from 1998 to 2000 times 3. That comes to over 20 billion dollars in possible penalties. The order likewise does not say that another part of section 798 declares that the triple penalty is in addition to any criminal penalties that may apply. Is that what this order is meant to accomplish? Again, this is not clear. Any broadening of this OII should be placed before the entire Commission.

The order clearly states that the investigation the Commission has voted out is not exclusive and if evidence comes to light of any additional suspected violations of any law or of any order, rule, regulation, direction, demand or requirement of the Commission or any commissioner, these proceedings may be expanded to include investigation of these potential violations as well. This is an overbroad and vague provision. I particularly wonder what direction, demand or requirement of any commissioner means? What if three other commissioners do not agree with that direction, demand or requirement of one commissioner? Can that become the basis for expanding this investigation? It appears to me it could.

I am also troubled by the assertion that common law provides the Commission with authority to disregard corporate forms in a variety of circumstances in order to carry out its responsibilities. That is a broad statement. The General Telephone case cited for that proposition refers to cases that deal with setting rates of return on rate base or require competitive bidding between affiliates supplying goods to the regulated utility. So is that precedent really germane to this proceeding? In General Telephone, the Supreme Court examined whether the Commission had violated the invasion of management doctrine by engaging in unnecessary intermeddling. In doing so, the Court asked whether disallowing excessive costs for ratemaking purposes could have attained the same result, from the public's point of view.

This Commission is now asserting that the purchases through the PX are subject to reasonableness review and disallowance should we end the rate freeze and pass costs on to ratepayers. Won't this accomplish a better result for ratepayers than penalizing the utilities? Won't any penalties under PU Code section 798 have to go to the state's general fund? And if penalties go to the general fund is this a backdoor way to repay the Department of Water Resources? We need to be clearer on what it is the Commission is trying to accomplish with this investigation.

The order hinges on alleged violations of two conditions on the formation of the holding companies. The first is that the holding company must give first priority to the capital needs of its utility subsidiary to meet its obligation to serve. A review of the holding company decisions shows that this condition was meant to deal with the typical cost of capital equity/debt structure set by the Commission. The holding company decisions say the capital structure must stay on average the same as set in the utility's current GRC or PBR. However, there is nothing in the order that deals with the

impact of the dividends and stock repurchases on the utilities' capital structures. The focus is on dollars, not capital impacts.

The second condition is that the utilities maintain a stand-alone dividend policy. There are no facts in the order that place the utilities' dividends paid before and after electric restructuring in context. For example, the order states SDG&E, Edison and PG&E provided their parents approximately 3.8 billion dollars in dividends on common stock from 1998 through September 2000. The order does not state how this compares to years prior to 1998. This Commission needs this kind of context for all three utilities before we arrive at a final decision on this investigation.

The order also says we will investigate whether the ring fencing of unregulated subsidiaries violated our decisions, rules, orders or statutes. The order is again silent on what these decisions, rules, orders or statutes might be. There is an only an allegation that the ring fencing violated the first priority holding company condition. In any event, FERC approved PG&E and Edison's ring fencings. The Commission did not prevail on rehearing in attempting a reversal of the FERC approvals. Therefore, is this an impermissible collateral attack on FERC orders? The order is silent.

I also ask, how far back in time are we really going? The order now is silent on whether we are going back to the issuance of the holding company decisions, yet the decision refers to the commencement of deregulation, and the request for production of documents in Attachment A asks for information on fund and asset transfers from 1996 onward. Is our focus just 2000 to the present, or does it go farther back?

Finally, what is an accurate construction of our holding company decisions? In reading those decisions it appears the Commission's main concern was that utility funds would be spent on utility owned unregulated affiliates, not movement of money from the utility to the holding company. Those were DRA's concerns and the decisions dealt with them. In the 1988 Edison proceeding, only TURN asserted that the holding company structure would be used to construct and operate new unregulated electric generating plants using surplus cash flow because of the completion of major utility construction programs. The Commission rejected these concerns, as it did TURN's concerns about a holding company structure and a deregulated environment. Similarly, the Commission rejected TURN's assertions that we would lose regulatory control, citing our staff auditing capability.

So what about our auditing capability? The Commission has done several holding company audits in the past and found no serious problems. The Commission has lost a large part of its auditing staff and has not monitored as much as originally intended. I applaud hiring more staff auditors.

In sum, I am all in favor of revisiting our holding company decisions. We must update them to reflect the ratepayer concerns attendant to the changing energy landscape.

/s/ HENRY M. DUQUE
Henry M. Duque
Commissioner

April 3, 2001

San Francisco

Commissioner Bilas, concurring:

Although I believe it is this Commission's duty to ratepayers and taxpayers to begin this investigation, I have many concerns about today's order. Although ultimately I support an investigation, I think it is important to catalog my concerns.

First, let me note a few things the order does not say. It does not say that PU Code Section 456 allows a utility to profit from economies, efficiencies or improvements that it may make and distribute by way of dividends or otherwise dispose of such profits. So I wholeheartedly agree with footnote 12 which states that we do not mean to imply that the dividend transfers to the holding companies were necessarily improper. But the tone of the order as a whole is otherwise.

Today's order refers to, but does not cite, PU Code Section 798. The order merely states that it provides remedies against a utility that makes imprudent payments to its holding company. That is not a correct characterization of the statute. The order does not say that Section 798 contains first an element of scienter or knowledge of wrongdoing. This is because the statute requires us to find that the utility "willfully made" an imprudent payment to its holding company. The order also does not say that the statute then requires that the utility has sought to recover the payment in a proceeding before the Commission. I do not see that second element in the allegations. I do not see any Commission proceeding cited in the order. Is the filing of the rate stabilization applications that request for recovery? The order is silent on this point.

The order also does not say that, if we find that the utilities have violated Section 798, the penalty set forth by the statute is up to three times the prohibited payment. That makes this a serious enforcement proceeding if you multiply just the 6.7 billion dollars transferred to the holding companies from 1998 to 2000 times 3. That comes to over 20 billion dollars in possible penalties. Is that what this order is meant to accomplish? Again, this is not clear.

The order does not say that another part of Section 798 declares that the triple penalty is in addition to any criminal penalties that may apply. This order allows a broadening of the scope of the investigation after we vote it out. So I ask, is there any intent to allege some criminal wrongdoing under the PU Code

once this order is issued? If so, I do not see anywhere that broadening the investigation as to any issue has to come back before the Commission. I urge that any broadening of this OII be placed before the entire Commission.

The order clearly states that the investigation the Commission has voted out is not exclusive and if evidence comes to light of any additional suspected violations of any law or of any order, rule, regulation, direction, demand or requirement of the Commission or any commissioner, these proceedings may be expanded to include investigation of these potential violations as well. This is an overbroad and vague provision. I particularly wonder what direction, demand or requirement of any commissioner means? What if three other commissioners do not agree with that direction, demand, or requirement of one commissioner? Can that become the basis for expanding this investigation? It appears to me it could.

I am also troubled by the assertion that common law provides the Commission with authority to disregard corporate forms in a variety of circumstances in order to carry out its responsibilities. That is also a pretty broad statement. The General Telephone case (34 Cal.3d 817) cited for that proposition refers to cases that deal with setting rates of return on rate base or require competitive bidding between affiliates supplying goods to the regulated utility. So is that precedent really germane to this proceeding? In General Telephone the supreme court examined whether the Commission had violated the invasion of management doctrine by engaging in unnecessary intermeddling. In doing so the court asked whether disallowing excessive costs for ratemaking purposes could have attained the same result, from the public's point of view. This Commission is now asserting that the purchases through the PX are subject to reasonableness review and disallowance should we end the rate freeze and pass costs on to ratepayers. Won't this accomplish a better result for ratepayers than penalizing the utilities? Won't any penalties under PU Code Section 798 have to go to the state's general fund? And if penalties go to the general fund is this a backdoor way to repay the Department of Water Resources? I think we need to be clearer on what it is the Commission is trying to accomplish with this investigation.

The order hinges on alleged violations of two conditions on the formation of the holding companies. The first is that the holding company must give first priority to the capital needs of its utility subsidiary to meet its obligation to serve. A review of the holding company decisions shows that this condition was meant to deal with the typical cost of capital equity / debt structure set by the Commission.

The holding company decisions say the capital structure must stay on average the same as set in the utility's current GRC or PBR. Yet I see nothing in today's order that deals with the impact of the dividends and stock repurchases on the utilities' capital structures. The focus is on dollars, not capital impacts.

The second condition is that the utilities maintain a stand-alone dividend policy. I see no facts in the order that place the utilities' dividends paid before and after electric restructuring in context. For example, the order states SDG&E, Edison and PG&E provided their parents approximately 3.8 billion dollars in dividends on common stock from 1998 through September 2000. The order does not state how this compares to years prior to 1998. This Commission needs this kind of context for all three utilities before we arrive at a final decision on this investigation.

The order also says we will investigate whether the ring fencing of unregulated subsidiaries violated our decisions, rules, orders or statutes. First I do not see any citation to what these decisions, rules, orders or statutes might be. All I see is an allegation that the ring fencing violated the first priority holding company condition. Second, I thought FERC approved PG&E and Edison's ring fencings, and that the Commission did not prevail on rehearing in attempting a reversal of the FERC approvals. Therefore, is this an impermissible collateral attack on FERC orders? The order is silent. I would like this briefed and determined as soon as possible.

I also ask, how far back in time are we really going? The order now is silent on whether we are going back to the issuance of the holding company decisions, yet the decision refers to the commencement of deregulation, and the request for production of documents in Attachment A asks for information on fund and asset transfers from 1996 onward. Is our focus just 2000 to the present, or does it go farther back?

Finally, are we really construing our holding company decisions correctly? In reading those decisions it appears the Commission's concern was that utility funds would be spent on utility owned unregulated affiliates, not movement of money from the utility to the holding company. Those were DRA's concerns and the decisions dealt with them. In the SDG&E holding company case DRA stated it feared cross subsidies from the utility to its unregulated affiliates and management neglect of the utility or favoritism to the affiliates. The Commission in D.95-12-018 declared that "The principal danger from both sources that DRA

identifies is a possible future 'massive increase in the level of SDG&E's utility-affiliate transactions since the utility would be purchasing substantial portions of its power from an unregulated affiliate.' If this becomes a problem, however, it is not because of a holding company transaction now. It will be a problem only if we signally fail in restructuring electric industry regulation." (Mimeo. at 28.) It seems to me that the Commission did fail in its restructuring, and we should not be blaming it on the utilities. Indeed, in the 1988 Edison proceeding (D.88-01-063), only TURN asserted that the holding company structure would be used to construct and operate new unregulated electric generating plants using surplus cash flow because of the completion of major utility construction programs. The Commission rejected these concerns, as it did TURN's concerns about a holding company structure and a deregulated environment. Similarly the Commission rejected TURN's assertions we would lose regulatory control, citing our staff auditing capability.

So what about our auditing capability? The Commission has done several holding company audits in the past and found no serious problems. The Commission has lost a large part of its auditing staff and has not monitored as much as originally intended. Is that the utilities' fault? Is the hyperbole of the investigation bluster to cover our past shortcomings? I am deeply concerned we are dealing in the land of revisionist history here. I am all in favor of revisiting our holding company decisions to update them to reflect the ratepayer concerns attendant to the changing energy landscape. I applaud hiring more staff auditors. But I believe the Commission bears responsibility if it failed to monitor the actions of the holding companies as it said it would.

I urge that better definition of this order be provided in the scoping memo for this proceeding to address all of these shortcomings.

/s/ RICHARD A. BILAS
RICHARD A. BILAS
Commissioner

San Francisco, California
April 3, 2001