UNITED STATES
NUCLEAR REGULATORY COMMISSION
WASHINGTON, D.C. 20555-0001

January 19, 1995

MEMORANDUM TO: Theodore R. Quay, Project Director
Project Directorate IV-2
Division of Reactor Projects III/IV
Office of Nuclear Reactor Regulation

FROM: William M. Lambe, Antitrust Policy Analyst
License Renewal and Environmental Review
Project Directorate
Associate Directorate for Advanced Reactors
and License Renewal
Office of Nuclear Reactor Regulation

SUBJECT: ANTITRUST REVIEW OF PROPOSED RESTRUCTURING OF SAN DIEGO GAS & ELECTRIC COMPANY — SAN ONOFRE NUCLEAR GENERATING STATION, UNITS 2 AND 3 (SONGS); DOCKET NOS. 50-361 AND 362 (UNIT 1 WAS A GRANDFATHERED UNIT FOR PURPOSES OF ANTITRUST REVIEW)

Amendment requests seeking transfer of ownership or control of a licensed facility must conform to the Commission's licensing procedures, including 10 CFR 50.33a, "Information Requested by the Attorney General for Antitrust Review." Publicly available information as well as information collected via 50.33a, enable the staff to make the determination whether a new applicant will use the additional market power associated with a large baseload nuclear facility to adversely enhance its competitive position in the bulk power services market served by the facility in question. The staff makes this determination in all transfers involving new owners or operators.

The corporate restructuring outlined by San Diego Gas & Electric Company (SDG&E) in its amendment request dated November 15, 1994, does not appear to present any opportunity for the new owner of the San Onofre Nuclear Generating Station to exert any undue market power over other power systems in the geographic area served by the SONGS facility. The new owner will be a holding company, with the temporary name, SDO Parent Company (Parent Company) owned and controlled by the existing SDG&E shareholders. The restructuring, as proposed, will not materially affect the operation of the SONGS facility nor the bulk power services market(s) served by the SONGS facility.

CONTACT: W. Lambe:PDLR:NRR
504-1277

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The staff has reviewed several similar restructuring requests by licensees, e.g., Commonwealth Edison Co., Illinois Power Co. and Pennsylvania Power & Light Co., and as in the previous requests to restructure, I think it is important to maintain a competitive review presence in all transfers of ownership of nuclear facilities[1], even in those cases that appear routine.

Such a review is mandated by the Atomic Energy Act and required by our regulations. I would propose handling SDG&E's request in the same manner in which we reviewed previous requests for similar restructurings. In whatever format the staff responds to the SDG&E restructuring proposal, i.e., letter order or an SER amendment format, I would recommend that the staff include language to the effect that the proposal was reviewed for competitive implications -- pursuant to NRC regulations.

Although SDG&E did not address the issue of the competitive implications resulting from the proposed restructuring in its November 15, 1994, letter, I would suggest adding similar language the staff used in its responses to previous restructuring requests in the instant request. In its response to the licensee's request, the staff should indicate that the proposed reorganization will have no adverse affects on the relevant bulk power services market served by the licensed facility. The easiest and most direct way to do this would be to add a phrase to the boilerplate response normally given when there are no problems identified with the amendment request. I suggest adding number 3 below as the most direct way of informing the licensee that the staff has reviewed the request for competitive implications.

> "The staff has reviewed the information contained in your letter to ascertain that the proposed action:
>
> (1) will not reduce funds available to SDG&E to carry out activities under its Operating Licenses;
>
> (2) will not adversely affect the management of SDG&E utility operations;
>
> **(3) will not adversely affect the bulk power services market served by the SONGS facility;** and

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[1]The staff also has specific procedures for reviewing new non-owner operators, i.e., the institution of a license condition prohibiting the new non-owner operator from engaging in marketing or brokering power or energy from the facility in question; however, the licensee has not indicated that the current operator of SONGS will change as a result of the reorganization, consequently, the non-owner operator prohibitions would not apply to Parent Company.

(4) will not result in SDG&E becoming owned, controlled, or dominated by an alien, a foreign corporation, or a foreign government."

By adding number 3 above, the staff indicates that the request has been reviewed for any competitive implications and the proposed restructuring, given the information available to the staff, does not appear to adversely impact the bulk power services market(s) served by the SONGS facility.

Belleville News-Democrat
2/10/94

Stockholders OK Illinova

Associated Press

DECATUR — Illinois Power Co. stockholders Wednesday created Illinova, which will become parent of the gas-and-electricity supplier and all other nonutility subsidiaries.

Illinova will pursue energy-related businesses "not only in Illinois but also anywhere in the world," Chairman Larry Haab said.

Stockholders who have Illinois Power shares will become holders of Illinova stock.

Illinois Power still is seeking approval from the Securities and Exchange Commission and the Federal Energy Regulatory Commission.

The name Illinova is a combination of Illinois and nova, a star that brightens intensely and then gradually dims.

Haab compared the move to internal changes made by the Dallas Cowboys before the NFL team won two consecutive Super Bowls.

"By approving the holding company, I feel as though we have laid the foundation for a competitive team and maybe even a great one," he said.

The Wall Street Journal
2/24/94 Page A1

Retooling Lives

Technological Gains Are Cutting Costs, And Jobs, in Services

Employment Starts to Plunge As Productivity Increases; Good News for Consumers

$10 Box, $2 Million Savings

By Joan E. Rigdon
Staff Reporter of The Wall Street Journal

SANTA CLARITA, Calif. – Like many service companies, Pacific Bell is looking around for big steps toward increased productivity. And it apparently has found one: a $10 circuit box that eventually may save PacBell $2 million a day.

Here's how: Statewide, the regional telephone unit of Pacific Telesis Group dispatches about 20,000 trucks a day to fix customers' lines. When it finds that the line is broken inside a customer's home or office, it's up to the customer to fix it. Customers usually shoo the worker away and do the repair themselves.

But PacBell estimates the cost of sending out a truck at $140 – and wants to pinpoint trouble without dispatching one.

A Quick Diagnosis

In an experiment in this suburb north of Los Angeles, PacBell found that the solution was a circuit box linking two existing technologies. PacBell computers continuously send signals to the device, which bounces them back if the outside line is intact. Whenever a line passes that test, the company knows right away that the problem is on the customer's end. Using that gadget, PacBell has slashed its truck dispatches in Santa Clarita by 30%. Multiplied across the company, the daily savings could exceed $2 million.

Such productivity-enhancing technological gains are accelerating in many service companies. Much of the huge U.S. service sector seems on the verge of an upheaval similar to that which hit farming and manufacturing, where employment plunged for years while production increased steadily. But while the competitiveness of U.S. companies will improve and the cost of services to Americans as consumers will drop, tough times may lie ahead for Americans as employees. PacBell, for instance, won't need anybody to drive the trucks that aren't sent out. Technological advances are now so rapid that companies can shed far more workers than they need to hire to implement the technology or support expanding sales.

"You can very genuinely paint a pretty apocalyptic picture of the state of employment driven by technological changes," says Francis Gouillart, vice president of Gemini Consulting Inc., a management-consulting firm in Morristown, N.J.

A Wave of Layoffs

In fact, three years into the recovery from the 1990-91 recession, service-sector layoffs are being announced with unsettling frequency. American Telephone & Telegraph Co. recently said it plans to reduce its payroll by 15,000 managers and workers in its long-distance division, mainly by deploying "new technology." The announcement came hard on the heels of other decisions to slash jobs: 17,000 at GTE Corp., 16,800 at Nynex Corp. and 10,000 at Pacific Telesis. Aetna Life & Casualty Co. has disclosed a second round of layoffs affecting 4,000 workers. Citicorp took a $604 million charge for unspecified cutbacks. By the time these companies are through, they will have slashed employment by 20% to 40% from their peaks a few years ago.

According to Challenger, Gray & Christmas, a Chicago-based outplacement consulting firm, large employers laid off a total of 108,000 workers in January, a one-month record since the firm began tracking such figures in 1989. Nearly half the cutbacks came in four service industries: communications, insurance, banking and finance. Small businesses and other companies are picking up many of the bodies, but "there's no sign" that major layoffs at big service companies are abating, says Executive Vice President John Challenger.

Not all the job losses are due to new technology, of course. Some companies are consolidating or leaving certain businesses. And most are reluctant to specify the impact of technology on payrolls; they fear a Luddite backlash among employees. But most of the cuts are facilitated, one way or another, by new software programs, better computer networks and more-powerful hardware (such as microchips) that allow companies to "re-engineer" the workplace – that is, get fewer people to do more or better work.

Long-Stagnant Numbers

Doomsayers have been predicting technology-driven layoffs for decades, a chorus that grew as U.S. companies invested more than $1 trillion in information technology during the 1980s. While automation and computerized tools did shrink manufacturing payrolls, measured productivity in the service sector stagnated in the 1980s and began picking up only in 1992.

That isn't as surprising as it may seem; at first, new technologies normally are adopted only slowly. For years, computers weren't used effectively in business offices. Then, employees learned to run the systems but merely adapted them to old work methods, such as replacing a typewriter with a computer – essentially paving the cow paths.

But now, more and more companies are learning to use computer networks to cut out work altogether instead of simply

B/1

Business

IP's restructuring plan focuses on competition

DECATUR — Illinois Power shareholders have approved forming a holding company, Illinova, to help position the utility for competition in an increasingly deregulated industry.

Upon federal regulatory approval and completion of corporate restructuring, Illinova will become the parent corporation of IP and eventually all nonutility subsidiaries.

"By approving the holding company, I feel as though we have laid the foundation for a competitive team, and maybe even a great one," said Larry D. Haab, IP chairman, president and chief executive officer.

IP filed documents with the U.S. Securities and Exchange Commission and other federal agencies in November seeking approval of various aspects of the restructuring. The proposal has been approved by the Illinois Power Board.

The company sought approval of the restructuring from the Securities and Exchange Commission under the Public Utility Holding Company Act, the Federal Energy Regulatory Commission and the Nuclear Regulatory Commission. The nuclear commission gave approval Jan. 31.

An informational filing was provided to the Illinois Commerce Commission, which requested the restructuring.

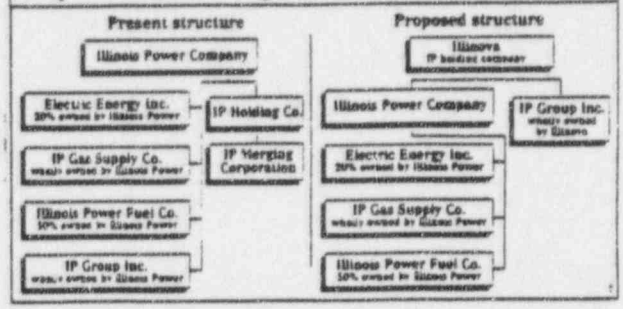
"A holding company will give us greater flexibility to start new ventures and it will satisfy the ICC's desire to have a formal structure separating our regulated from our non-regulated businesses," Haab said.

Illinova will allow the utility to form energy-related businesses "not only in Illinois but also anywhere in the world," he said.

Haab unveiled the Illinova logo and described the name as a combination of "Illinois" and "nova," meaning "new" and "a star that suddenly increases its light output tremendously."

Shareholders will own one share of Illinova stock for each share of Illinois Power stock they own. Existing stock certificates do not have to be exchanged for new ones.

Proposed restructuring of Illinois Power



Company's latest move shows diverse leanings

DECATUR — IP Group Inc. has signed a letter of intent with a Nebraska-based energy firm to participate in independent power generation projects in Texas, Washington and elsewhere in North America.

Under the agreement, IP Group will become a partner in the operation of existing co-generation projects developed by Tenaska Inc. in Paris, Texas, and Ferndale, Wash., and will help develop other independent power projects in the U.S. and Canada.

Co-generation projects typically involve high-efficiency power plants that produce two kinds of energy: electricity from generators and steam that is sold for heating or industrial uses.

IP Group, a Decatur-based subsidiary of Illinois Power, was formed in 1992 to pursue independent power projects worldwide. Tenaska is a privately held company formed in 1987 in Omaha, Neb., to develop co-generation and independent power generation projects and fuel-related services.

Independent power producers are companies that produce electricity using co-generators or other nonutility means and sell to utilities or large power users.

The Tenaska partnership is IP Group's second venture as an independent. The first, the Teesside Power Plant in Northern England, is the largest co-generation plant in the world. IP Group has contractual rights to a part of the plant's capacity to generate electricity for customers in Great Britain.

Tenaska's 220-megawatt co-generation plant at Paris, Texas, which like Teesside uses natural gas as fuel, has operated since 1990. The Ferndale, Wash., plant should enter service in April.

B/2

Date: May 26, 1994

To: Area, district and power plant managers; headquarters and Clinton department heads

cc: Officers

From: Public Affairs

Subject: **Illinova to be created May 27**

IP plans to file merger papers with the Illinois Secretary of State tomorrow, May 27, signaling the official creation of Illinova. Thus, Illinova's "birth date" is May 27, 1994.

Common stock will begin trading as Illinova the next business day, Tuesday May 31. A small group of employees (from locations that won Customer Caring Awards) will accompany Chairman Larry Haab on a visit to the New York Stock Exchange to witness the first day of trading under the new holding company name.

Please feel free to mark this occasion with your employees in some way. A news release will be issued tomorrow (May 27) and a news article appears in today's *Grapevine*. The attached fact sheet also provides information that you can use for discussions with employees.

Attachments (3 pages)

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Fact Sheet
Creation of Illinova Corporation

On Friday, May 27, IP will file with the Illinois Secretary of State documents that consummate the formation of Illinova Corporation. This corporate restructuring will:

- Form a holding company (Illinova).
- Make Illinois Power a subsidiary of Illinova. The electric and gas utility will continue operating as Illinois Power and remains the major business under Illinova.
- Allow IP Group, which will be renamed Illinova Generating, to become a subsidiary under Illinova, independent of the regulated utility.

IP's directors believe the holding company is in the best interest of shareholders. It will:

- Let Illinova Generating and other future subsidiaries operate relatively free from regulation so they can take advantage of competitive opportunities without delay.
- Make subsidiaries accountable as separate business activities.
- Protect the utility and its customers from business risks of the non-regulated companies.
- Give system employees additional expertise in energy-related businesses.

IP shareholders and the necessary regulatory bodies have approved the restructuring.

- *Nov. 9, 1993* — Illinois Commerce Commission approves IP's investment in IP Group and says IP should proceed promptly with forming a holding company and put IP Group under it within two years. (While the ICC endorses the concept of a holding company structure, its approval is not required.)
- *Nov. 15, 1993* — IP files documents with the Securities and Exchange Commission and other federal agencies seeking to establish a holding company structure.
- *Jan. 31, 1994* — Nuclear Regulatory Commission (NRC) approves.
- *Feb. 9, 1994* — Stockholders vote in favor of forming the holding company. Approximately 74 percent of all outstanding shares were voted, of which 94 percent are in favor.
- *May 3, 1994* — Federal Energy Regulatory Commission (FERC) approves.
- *May 18, 1994* — The Securities and Exchange Commission (SEC) approved IP's request to allow the holding company to operate without SEC regulation under the Public Utility Holding Company Act.

- *May 27, 1994* — IP files final documents with the Illinois Secretary of State, effecting the creation of Illinova.

- *May 31, 1994* — Common stock begins trading under the name Illinova.

Communications about the restructuring include:

- May 26 — News article in *Grapevine*. Includes Q&A and sample of newspaper ad.

- May 27 — Issue news release announcing formation of Illinova.

  Mail letter from Haab to IP's largest industrial customers announcing the change.

  Advise government officials (Govt. Affairs).

  Notify ICC of filing w/Secretary of State (Rates).

  Mail flyer to shareholders announcing the restructuring and new stock trading designation.

- May 31 — Small group of IP employees (from locations that won Customer Caring Awards) accompany Chairman Larry Haab on visit to the New York Stock Exchange to witness first day of trading under new holding company name.

  Ads in *Wall Street Journal* and major daily papers in IP territory.

ILNFACTS.SJS

Questions and Answers

Q. Why are we forming a holding company?

A. So we can compete for business on equal footing with other businesses. To do that, we need the flexibility to make decisions without the delays that are a part of operating as a highly regulated company.

Q. Does this mean we work for Illinova now?

A. No. Those of us who do IP business will still be employees of Illinois Power.

Illinova has no employees. Two IP officers handle similar functions for Illinova. Larry D. Haab is the holding company chairman, president and CEO — the same position he serves for Illinois Power. Leah Manning Stetzner, IP vice president, general counsel and corporate secretary, is Illinova's secretary and treasurer.

Basically, the holding company is just a corporate structure. It will not conduct energy service business on its own.

Q. Will Illinova create job opportunities for IP employees?

A. Yes. However, in many cases special skills will be required. The nature of future positions will depend on what types of new businesses are developed. For example, Illinova Generating has created 10 jobs, all of which are specialized positions. Nine of these 10 employees previously worked for Illinois Power.

Q. Will we be changing the logo signs on our trucks and buildings?

A. No. Illinois Power will continue to be an electric and gas utility with the same name and logo it now uses. Sometime in the future we may add the words "An Illinova company" to Illinois Power signs.

Q. What will happen to my IP stock?

A. As of May 31, shares of common stock in Illinois Power will be traded as common shares of Illinova. Nothing changes for Illinois Power preferred stock. It will continue to be preferred shares of the Illinois Power utility.

Q. Do I need to do anything to get my stock changed?

A. No. The change is automatic. If you own IP common stock as most employees do, you will automatically own the same number of shares in Illinova.

Q. If I want to keep up with the stock in the paper, how will it be listed?

A. Illinova common stock will trade on the New York Stock Exchange under the ticker "ILN." Illinois Power preferred will continue to use the symbol "IPC."

Q. Will the company still give us stock under the 401(k) and incentive comp plans?

A. Yes. All the stock plans under which employees buy or are given shares of IP common stock will now provide shares of Illinova. These plans include the employee stock ownership and dividend reinvestment plans, 401(k), and the incentive compensation plan.

Q. Will Illinova pay dividends?

A. Illinova initially expects to pay quarterly dividends at the rate most recently paid on IP stock, and on approximately the same schedule.

DUP

For release: May 27, 1994

For more information: Craig E. Nesbit (217) 424-6400

CORPORATION PAPERS FILED, ILLINOVA HOLDING COMPANY FORMED

DECATUR, Ill. -- Illinois Power today filed documents with the Illinois secretary of state establishing Illinova Corporation as the holding company for Illinois Power.

The filing follows approval of the restructuring by the Federal Energy Regulatory Commission on May 3 and a favorable response from the U.S. Securities and Exchange Commission on May 18 to a filing under the Public Utilities Holding Company Act.

Under the reorganization, Illinova becomes the parent company of Illinois Power and of Illinova Generating Company, formerly IP Group.

"This is a historic day in the evolution of Illinois Power as an energy provider," said Larry D. Haab, chairman and chief executive officer of both Illinois Power and Illinova. "Illinova gives us the flexibility we need to compete in energy markets anywhere in the world."

The two companies initially will share the same board of directors.

Illinois Power common stock will be converted to Illinova stock and, beginning Tuesday, traded as "IlNova" on the New York and Chicago stock exchanges. The three-letter ticker symbol for Illinova common stock is "ILN." Illinois Power preferred stock listings will remain "IllPwr" and "IPC."

Shareholders will own one share of Illinova stock for each share of Illinois Power common stock they own. Existing stock certificates do not have to be exchanged for new ones.

Illinois Power will continue to be regulated by the Illinois Commerce Commission. The utility serves 560,000 natural gas and

electric customers in a 15,000-square-mile service territory.

Illinova Generating, formed in 1992 as a subsidiary of Illinois Power, will become a wholly owned and unregulated subsidiary of Illinova under the restructuring. Illinova Generating is a developer of and investor in independent power projects worldwide.

Because of its unregulated status, Illinova will be able to spawn new subsidiaries to develop markets for new energy-related products and services.

On Tuesday, Haab will lead a small delegation of Illinois Power employees to the floor of the New York Stock Exchange to witness the first day of trading of Illinova stock.

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FACTS ABOUT ILLINOIS POWER, ILLINOVA AND ILLINOVA GENERATION

* Illinova is headquartered in Decatur, Ill. Its "birthday" is May 27, 1994.

* Illinova is the holding company for Illinois Power and Illinova Generating Company, formerly IP Group. As a subsidiary, Illinois Power remains a regulated utility. Illinova Generating will become a subsidiary of Illinova and is an unregulated independent power producer.

* The holding company structure was approved by Illinois Power shareholders on Feb. 9 and by the Federal Energy Regulatory Commission on May 3. The U.S. Securities and Exchange Commission issued a favorable response on May 18 to a related filing under the Public Utilities Holding Company Act.

* IP Group changed its name to Illinova Generating to conform with the holding company name. Illinova Generating is headquartered in Beresford Plaza in Decatur.

* Illinois Power has three existing subsidiaries that will remain IP

subsidiaries: **Electric Energy, Inc.** (20-percent owned by IP); **IP Gas Supply Co.** (wholly owned); and **Illinois Power Fuel** (50-percent owned by IP).

* **Larry D. Haab** is chairman and CEO of Illinova and Illinois Power. **David W. Butts** is president of Illinova Generating.

* Initially, Illinois Power and Illinova will share the same board of directors. The first board meeting of both companies is scheduled for June 8.

* Illinova will be the only common stock shareholder of Illinois Power. Preferred stock is not affected by the restructuring.

* Illinova stock begins trading May 31, 1994, under the stock-tables designation IlNova and ticker symbol ILN. The old IllPwr and IPC Illinois Power common stock symbols will disappear that day, although preferred stock listings will remain under IllPwr.

* Preferred stock dividends remain protected. All Illinois Power preferred stock obligations must be met before Illinova can pay a common share dividend.

May 27, 1994

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas & Electric Company (U 902-M) for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure.	)	Application 94-11-____

APPLICATION

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November 7, 1994

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November 7, 1994

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APPENDIX C	SDG&E Financial Information
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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas & Electric Company (U 902-M) for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure.	Application 94-11-____

APPLICATION

Pursuant to the applicable Rules of Practice and Procedure of the California Public Utilities Commission ("Commission"), Applicant San Diego Gas & Electric Company ("SDG&E") respectfully requests authorization from the Commission, under Sections 701 and 818 of the California Public Utilities Code ("Code"), to implement a plan of reorganization ("Plan") which will result in a holding company structure. A complete statement of the authorization sought is set forth herein.

I.

INTRODUCTION

Under the Plan which SDG&E requests authority to implement, SDG&E's utility operations, and SDG&E's existing unregulated subsidiaries, will all become independent subsidiaries of a holding company, SDO Parent Co., Inc. ("Parent Company"). The present shareholders of SDG&E's common stock will become the shareholders of the common stock of Parent Company.

The Commission's jurisdiction to review this Plan is set forth in Sections 701 and 818 of the Code. These sections state, in

pertinent part:

> §701: The Commission may supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction.
>
> §818: No public utility may issue stocks and stock certificates, or other evidence of interest or ownership . . . unless, in addition to the other requirements of law it shall first have secured from the Commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied, and that, in the opinion of the Commission, the money, property, or labor to be procured or paid for by the issue is reasonably required for the purposes specified in the order . . . .

Applicant, therefore, requests authorization to implement the Plan which involves converting 100 percent of SDG&E's issued and outstanding common stock into the common stock of a newly-formed corporation, Parent Company, through a separate, newly-formed corporation, San Diego Merger Company ("Merger Company"), as specifically set forth herein.

II.

DESCRIPTION OF THE RELIEF REQUESTED

A. REORGANIZATION PLAN

The Plan is consistent with the corporate structure used by many utilities throughout the United States, and is very similar in procedure and structure to the reorganization approved by this Commission for Southern California Edison Company (D.88-01-063, 27 CPUC 2nd 347). The Plan establishes a holding company structure for SDG&E's utility and its various non-utility businesses, without diminishing the Commission's ability to regulate effectively SDG&E's

utility operations and without adversely impacting SDG&E's customers.

To carry out the Plan, SDG&E will incorporate two new California corporations, Parent Company and Merger Company. At present, neither company is in existence; however, each will be incorporated during this Application proceeding. Upon approval of this Application by the Commission, both companies will issue a nominal amount of stock with SDG&E owning all the outstanding stock of Parent Company and Parent Company, in turn, owning all the outstanding stock of Merger Company.

SDG&E, Parent Company and Merger Company intend to execute an Agreement of Merger[1] whereby, subject to various conditions including legally required shareholder approvals, SDG&E will become a subsidiary of Parent Company through the merger of Merger Company with and into SDG&E. In the merger, the common stock of SDG&E will be converted share-for-share into common stock of Parent Company. As a result, Parent Company will become the sole owner of all SDG&E common stock and former SDG&E common shareholders will become the common shareholders of Parent Company. All of SDG&E's debt securities, as well as all outstanding shares of SDG&E preferred and preference stock, will remain with SDG&E and will be unaffected by the Plan.

At present, all the common stock of SDG&E's subsidiaries is wholly-owned by SDG&E,[2] and those subsidiaries are unregulated by the Commission. As part of the Plan, SDG&E will transfer to Parent

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[1] A copy of the proposed Agreement of Merger in substantially the form contemplated to be executed is attached to Exhibit SDG&E-1, as Attachment A.

[2] Twenty percent of Wahlco Environmental Systems, Inc. is owned by members of the public. The remaining eighty percent is owned by Pacific Diversified Capital Company, a wholly-owned subsidiary of SDG&E.

Company all of the common stock which SDG&E owns in its subsidiaries. The merger transaction will not result in SDG&E transferring any of its utility assets or property to any subsidiary or to Parent Company. A complete description of the steps which will be utilized to implement SDG&E's Plan is set forth in Exhibit SDG&E-1, Chapter II, and depicted graphically on the six charts attached to Exhibit SDG&E-1, as Attachment B.

Implementing the Plan requires a number of other actions by SDG&E, also discussed in Exhibit SDG&E-1, Chapter II. In addition to obtaining the approval of the Commission, SDG&E will file with the Securities and Exchange Commission ("SEC") a claim of exemption from the provisions of the Public Utility Holding Company Act as an intrastate holding company under Section 3(a)(1) of the Act.[3] A copy of this claim of exemption will be sent to the Commission when submitted to the SEC. SDG&E will seek an opinion of counsel to the effect that the contemplated reorganization is a tax-free event for SDG&E and its shareholders. SDG&E will seek approval from the Federal Energy Regulatory Commission for the transfer of its stock to Parent Company pursuant to Section 203 of the Federal Power Act, and will also request authorization from the Nuclear Regulatory Commission to form a holding company under specific provisions of the Atomic Energy Act. Under the terms of certain agreements to which SDG&E is a party, SDG&E will obtain approval for the Plan from certain creditors, or will provide notification as is required by the terms of the applicable agreements. Finally, SDG&E will seek the necessary shareholder approvals of the Plan at the appropriate time.

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[3] 15 U.S.C. 79c(a)(1)

Parent Company securities will be registered with the SEC and SDG&E will submit to the SEC for review the proxy materials by which SDG&E will solicit the legally required shareholder approvals for the Plan. A copy of the proxy and registration materials will be sent to the Commission prior to soliciting the necessary shareholder approvals.

B. RATIONALE FOR REORGANIZATION PLAN

The proposed reorganization of SDG&E is a reasonable and necessary response to the continually changing business environment in the electric and gas utility industries. For over a century SDG&E has operated as a vertically integrated electric utility that, subject to this Commission's regulation, has been responsible for constructing and operating the generation, transmission and distribution facilities needed to serve its customers. However, both regulation, and the markets for SDG&E's services, are changing in the electric utility business in a manner similar to the way the natural gas and electric generation businesses have changed over the last decade.

The passage of the Public Utility Regulatory Policies Act of 1978 ("PURPA") initiated the beginning of a significant change in the character of the electric business. Where once the only owners of electric generating facilities were utilities, due in great measure to PURPA there are now thousands of power plants of different sizes owned by either Qualifying Facilities ("QFs") or Independent Power Producers ("IPPs"), not electric utilities. The Commission has, through its policies to implement PURPA, facilitated the development of this new class of non-utility generators of electricity. The success of these policies over the past decade has

introduced competition into the generation segment of the electric business where there had been none before. With the number of non-utility players involved, this competition will only increase.

The "Blue Book" (OIR 94-04-031, April 20, 1994) issued by the Commission clearly contemplates the evolution of the electric utility business to a form where generation and other traditionally regulated utility activities become unregulated, competitive businesses, resulting in the "de-integration" of California utilities.

SDG&E's Plan for reorganization will allow it to operate its regulated utility business efficiently and effectively, while providing the "platform" for separating, initially, the competitive generating business from the regulated business whenever that separation becomes appropriate. As the utility industry continues to transform, current "monopoly" segments other than generation may also evolve into competitive businesses, or will otherwise need to be separated from the core utility business for structural reasons. Three potential candidates for this continued de-integration are the generation dispatch function, transmission facilities, and demand-side management activities. SDG&E believes that, at present, the opportunity exists to establish the holding company structure as the appropriate "platform" from which to address these future developments, while the Commission considers further evolution of the utility industry in the Blue Book proceedings.[4]

In light of the potential for the development of these

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[4] In its initial comments on the Blue Book proposal, SDG&E stated its intent to form a holding company to facilitate the separation of generation and other competitive activities from monopoly activities. (SDG&E Comments, p. 18, June 8, 1994.)

competitive businesses, it is important that SDG&E implement a holding company structure to protect its utility customers. It is well known that competitive businesses by their nature are unpredictable, as that is the way of competition. That unpredictability can lead potentially to volatile, fluctuating earnings. If the volatile earnings stream becomes a part of the core regulated utility, it could create a volatility and riskiness to the earnings of the utility that would have an undesired impact on the assessment of the utility by the financial community, including bond rating agencies. This volatility and risk could result in increased capital costs for the utility, causing a higher cost of service and higher rates than would otherwise be necessary. With the type of separation a holding company structure will provide between the regulated utility and competitive business segments, the financial community will view SDG&E as more stable, and not influenced by the volatility of the earnings of the unregulated enterprises.

In addition, SDG&E's proposed reorganization increases the degree of separation between the existing diversified activities that SDG&E has undertaken over the past decade, and the existing utility business. The separation will be enhanced because SDG&E will no longer own the diversified entities and the utility. Rather the only relationship will be common ownership by Parent Company. This structure will create a more defined separation that will better protect the utility's customers from the creditors of the unregulated businesses. SDG&E's shareholders are benefited as well because not only will the holding company structure provide them the opportunity to maintain an ownership interest in utility

and unregulated businesses as de-integration of the electric utility industry proceeds, but also the new corporate structure provides the greater financing flexibility necessary to nurture existing and future unregulated business enterprises.

In summary, SDG&E's Plan provides a corporate structure "platform" that allows SDG&E to prepare for the continued development of competitive, unregulated businesses within the de-regulated utility industry. The holding company will allow, at the appropriate time, the separation of SDG&E's generating business to isolate it from the regulated utility, and thereby protect the customers of the regulated utility from the potential financial impacts of this evolving, and likely volatile, competitive business. It will facilitate the separation of other portions of the core utility business as further de-integration occurs. And, finally, the holding company structure will enhance the separation between the utility and its current and future diversified activities to the benefit of both utility customers and SDG&E shareholders.

A further discussion of the reasons supporting the Plan is set forth in Exhibit SDG&E-1, Chapter I, which is incorporated by reference.

C. STANDARD OF REVIEW

Section 701 of the Code gives the Commission authority to supervise and regulate all activities of SDG&E and clearly provides the Commission with regulatory oversight of SDG&E's Plan. Section 818 of the Code states that no public utility may issue stock or other evidence of ownership without securing from the Commission an order authorizing the issuance. While SDG&E itself is not issuing any stock as part of its Plan, both Parent Company and Merger

Company will issue stock. This transaction is substantially similar to that addressed in Re Sierra Pacific Power Company (D.84-03-020, 14 CPUC 2d 419, slip op. at 1, 5) in which the utility, Sierra Pacific Power Company, formed two corporations, Merger Company and Resources Company, both of which planned to issue stock in a series of transactions under which the utility would become a subsidiary of Resources Company, and Merger Company would ultimately disappear. In that case, the Commission applied Section 818 to the issuance of stock by both Resources Company and Merger Company. The Commission's rationale for applying Section 818 to the reorganization of Sierra Pacific Power Company was reaffirmed recently in Re Pacific Telesis Groups "Spinoff" Proposal (D.93-11-011, 1993 WL 561951, pp. *1, *10-*11). Consequently, in this Application the issuance of stock by Merger Company and Parent Company falls within the Commission's jurisdiction and an order authorizing the issuance of those securities is requested.

Approval of SDG&E's Plan is not required under either Code Sections 851, 853 or 854. California Public Utilities Code Section 851 provides in pertinent part:

> No public utility . . . shall sell, lease, assign, mortgage or otherwise dispose of or encumber the whole or any part of its . . . line, plant, system, or other property necessary or useful in the performance of its duties to the public . . . without first having secured from the Commission an order authorizing it to do so.

As demonstrated by the Exhibits attached to this Application, which set forth the testimony of SDG&E supporting this Application, the Plan does not contemplate the sale, lease, assignment, mortgage or disposal of any utility line, plant, system, or other property. The

reorganization does not include the shifting of utility assets from SDG&E to either Parent Company or any future SDG&E affiliate. As a result, Code Section 851 is not relevant to this Application.

Consistent with the precedent set by the Commission in Re Pacific Telesis Group's "Spinoff" Proposal (Id., pp. *14, *15), SDG&E's Plan does not involve the acquisition or control of SDG&E by another party. Public Utility Code Section 854(a) states in pertinent part:

> No person or corporation . . . shall acquire or control either directly or indirectly any public utility organized and doing business in this state without first securing authorization to do so from the Commission. The Commission may establish by order or rule the definitions of what constitute acquisition or control activities which are subject to this section . . .

In its Pacific Telesis "Spinoff" decision, the Commission further defined what it considers "acquisition or control activities" requiring Commission approval. In that case, Pacific Telesis Group ("PTG") argued that Section 854 did not apply to the "spin off" of its wholly-owned subsidiary, PacTel, because, except for a new group of shareholders established through an initial public offering ("IPO") of 20% ownership in PacTel, PacTel would be owned by the current shareholders of PTG. (Id., p. *14.) Given these facts, the Commission concluded that if the IPO was structured appropriately, ". . . there is no reason to require a Section 854 application for the proposed transaction, as no approval under Section 854 will be required." (Id., p. *14.) In reaching that conclusion, the Commission implicitly determined that transferring ownership of PacTel from PacTel's parent (PTG) to the shareholders of PacTel's parent (setting aside the concern over the IPO) did not

involve the acquisition or control, either directly or indirectly, of PacTel as those terms are used in Section 854.

SDG&E's plan of reorganization is essentially the reverse of the PacTel spinoff without the complication of the IPO. The present owners of SDG&E will, after the reorganization, be the sole owners of all the stock in Parent Company, which will, in turn, be the sole owner of all the common stock of SDG&E. Consequently, the ultimate ownership and control of SDG&E will be retained in the same public shareholders both before and after the reorganization. Following the guidance of the Commission in the Pacific Telesis "Spinoff" case for determining what constitutes the acquisition or control of a public utility, SDG&E's Plan does not require prior authorization under Section 854 and the Commission should so determine.[5]

The Plan is a straightforward methodology for creating a more suitable structure from which to address the electric industry restructuring. Additionally, the Plan establishes a greater separation between SDG&E's regulated and unregulated businesses. No transfer of utility property is proposed. No new control group will, under the Plan, acquire ultimate ownership or control of SDG&E. As a result, no reason exists for the Commission to review this Plan under either Code Sections 851 or 854.

D. ENVIRONMENTAL REVIEW

SDG&E's Plan is essentially a "paper" transaction in that Parent Company will now be the parent of both SDG&E and the unregulated subsidiaries of SDG&E. No new construction is requested

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[5] Likewise, Code Section 853(a) does not apply to SDG&E's plan. Under Section 853(a), the Commission can apply Sections 851 and 854 to a transaction where it is "required by the public interest." In this case the public interest will be fully protected by the Commission's review of SDG&E's Plan pursuant to Code Sections 701 and 818.

by this Application and no utility assets are being shifted from SDG&E to its affiliates or Parent Company. Pursuant to 14 California Code of Regulation Section 15061(b)(3), it can be seen with certainty that there is no possibility that the Plan for which SDG&E seeks approval from the Commission may have a significant effect on the environment. Therefore this Application is not subject to the California Environmental Quality Act. This perspective is consistent with that previously taken by the Commission in Re American Telephone and Telegraph Company (D.94-04-042, 1994 WL 209815, slip op. 1,23) in which the Commission determined there was no possibility that the proposed merger between AT&T and McCaw Cellular Communications, Inc. would have a significant adverse affect on the environment. This statement is also generally consistent with Rule 17.1(d)(1) of the Public Utilities Commission's Rules of Practice and Procedure.

III.

STATUTORY AND PROCEDURAL REQUIREMENTS

A. STATUTORY AUTHORITY

This application is made pursuant to Sections 701 and 818 of the Public Utilities Code of the State of California, the Commission's Rules of Practice and Procedure, and prior decisions, orders and resolutions of this Commission.

B. CHARACTER OF BUSINESS PERFORMED AND TERRITORY SERVED

Applicant San Diego Gas & Electric Company is a public utility organized and existing under the laws of the State of California. SDG&E is engaged in the business of providing electric service in a portion of Orange County and electric and gas service in San Diego County. SDG&E's principal place of business is 101 Ash Street, San

Diego, California. Its mailing address is Post Office Box 1831, San Diego, California 92112. SDG&E's attorney in this matter is Jeffrey M. Parrott. Correspondence or communications regarding this Application should be addressed to:

Lynn G. VanWagenen
Regulatory Affairs Department
San Diego Gas & Electric Company
Post Office Box 1831
San Diego, California 92112-4150
(619) 696-4055

with a copy to:

Jeffrey M. Parrott
Law Department
San Diego Gas & Electric Company
Post Office Box 1831
San Diego, California 92112-4150
(619) 699-5015

C. ARTICLES OF INCORPORATION

Pursuant to Rules 16 and 34 of the Commission's Rules of Practice and Procedure, a copy of SDG&E's Restated Articles of Incorporation, as amended through April 26, 1994, presently in effect and certified by the California Secretary of State, was mailed to the Commission on May 23, 1994, and is incorporated herein by reference.

A copy of the draft Articles of Incorporation of Parent Company, in a form and having the content substantially similar to that which will be filed with and certified by the California Secretary of State, is attached hereto as Appendix A, and a copy of the draft Articles of Incorporation of Merger Company, in a form and having the content substantially similar to that which will be filed with and certified by the California Secretary of State, is attached hereto as Appendix B.

D. FINANCIAL INFORMATION

Pursuant to Rules 17 and 34 of the Commission's Rules of Practice and Procedure, attached hereto as Appendix C is a copy of SDG&E's Statement of Income and Retained Earnings, SDG&E's Balance Sheet as of September 30, 1994, and the following additional financial statement information current as of September 30, 1994:

(a) Amount and kinds of stock authorized by SDG&E's Articles of Incorporation and amount outstanding.

(b) Terms of preference stock, whether cumulative or participating, or on dividends or assets, or otherwise.

(c) Brief description of each security agreement, mortgage and deed of trust upon SDG&E's property, showing date of execution, debtor and secured party, mortgagor and mortgagee and trustor and beneficiary, amount of indebtedness authorized to be secured thereby, and amount of indebtedness actually secured, together with any sinking fund provisions.

(d) Amount of bonds authorized and issued, giving name of the public utility which issued same, describing each class separately, and giving date of issue, par value, rate of interest, date of maturity and how secured, together with amount of interest paid thereon during the last fiscal year. There are no other notes outstanding.

(e) Other indebtedness, giving same by classes and describing security, if any, with a brief statement of the devolution or assumption of any portion of such indebtedness upon or by any person or corporation if the original liability has been transferred, together with amount of interest paid thereon during the last fiscal year.

(f) Rate and amount of dividends paid during the five previous fiscal years, and the amount of capital stock on which dividends were paid each year.

A pro forma balance sheet and income statement for Parent Company and SDG&E is attached hereto as Appendix D.

E. DESCRIPTION OF APPLICANT'S BUSINESS AND PROPERTY

Attached hereto as Appendix E is a general description of SDG&E's property, the original cost of its property and equipment by class, and the depreciation and amortization reserves applicable to such property and equipment.

F. DESCRIPTION OF SECURITIES TO BE ISSUED

The draft Articles of Incorporation of Parent Company provide for the issuance of up to 300,000,000 shares of common stock and 30,000,000 shares of preferred stock. For purposes of this Application, specific authority is sought, in the first instance, to issue 100 shares of common stock, all of which shares will be issued to SDG&E, and in the second instance, to (i) issue a number of shares of Parent Company stock equal to the number of shares of SDG&E common stock outstanding immediately prior to effectiveness of the reverse triangular merger ("RTM") and (ii) reserve for issuance a number of shares of Parent Company common stock equal to the number of shares of SDG&E common stock reserved for issuance by SDG&E's Board of Directors under employee benefit plans and the like immediately prior to the effectiveness of the RTM. Upon the RTM, the initial 100 shares of Parent Company common stock issued to SDG&E will be canceled.

The draft Articles of Incorporation of Merger Company provide for the issuance of 1,000 shares of common stock. Specific authority is sought to issue 100 shares of common stock, all of which shares will be issued to Parent Company. The 100 outstanding shares of common stock of Merger Company will be converted, pursuant to the RTM, into the number of shares of common stock of SDG&E equal to the number of outstanding shares of common stock of SDG&E

immediately prior to effectiveness of the RTM.

G. SDG&E'S LATEST PROXY STATEMENT

Certain classes and series of SDG&E's capital stock are listed on a "National Securities Exchange," as defined in the Securities Exchange Act of 1934. A copy of SDG&E's latest proxy statement sent to its stockholders was filed with the Commission on April 25, 1994, as an attachment to SDG&E's Application No. 94-04-038.

H. APPLICANT'S SHOWING

Applicant's showing in support of this Application includes the following appendices and exhibits, all of which are attached hereto and incorporated herein by reference:

Appendices:

Appendix A	Copy of draft Articles of Incorporation of SDO Parent Co., Inc.
Appendix B	Copy of draft Articles of Incorporation of San Diego Merger Company
Appendix C	SDG&E Financial Information
Appendix D	Parent Company and SDG&E Pro Forma Balance Sheets and Income Statements
Appendix E	Cost of Property and Depreciation Reserve

Exhibits:

SDG&E-1	Policy Testimony Regarding Proposed Corporate Reorganization of SDG&E
SDG&E-2	Testimony Regarding Affiliate Relations

I. SERVICE OF APPLICATION

In order to provide distribution of this Application to potentially interested parties, this Application is being served on all appearances in SDG&E's 1995 Cost of Capital Proceeding (A.94-05-

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IV.

CONCLUSION

SDG&E is ready to proceed with hearings on the matters set forth herein, and requests that the Commission act expeditiously in reviewing and authorizing the proposed Plan.

WHEREFORE, SDG&E respectfully requests that: (1) the Commission find that this Application is not subject to the California Environmental Quality Act, (2) the Commission grant this Application and authorize all the stock issuances and other transactions necessary to implement the Plan as described herein, and (3) the Commission grant such other and further relief as may be necessary to enable SDG&E to go forward with the Plan.

DATED at San Diego, California, this 7th day of November, 1994.

SAN DIEGO GAS & ELECTRIC COMPANY,
a California Corporation

By: _____
R. K. Fuller
Vice President -
Governmental and Regulatory Services

_____
Jeffrey M. Parrott

N. A. PETERSON
Senior Vice President
and General Counsel
DAVID R. CLARK
JEFFREY M. PARROTT
Attorneys for
San Diego Gas & Electric Company
101 Ash Street
Post Office Box 1831
San Diego, California 92112-4150
(619) 699-5015

VERIFICATION

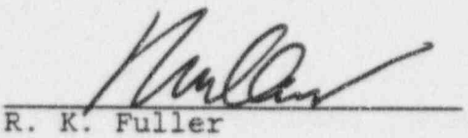
STATE OF CALIFORNIA)
) ss:
COUNTY OF SAN DIEGO)

I, R. K. Fuller, declare:

That I am an officer, to wit, Vice President - Governmental and Regulatory Services of San Diego Gas & Electric Company. I am authorized to make this verification on its behalf. I am informed and believe, and on that basis state, that the facts set forth in the foregoing APPLICATION are true.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on November 7, 1994, at San Diego, California.



R. K. Fuller
Vice President -
Governmental and Regulatory Services

APPENDIX A

DRAFT ARTICLES OF INCORPORATION OF SDO PARENT CO., INC.

ARTICLES OF INCORPORATION
OF
SDO PARENT CO., INC.

FIRST: The name of the Corporation is SDO Parent Co., Inc.

SECOND: The purpose of the Corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business or the practice of a profession permitted to be incorporated by the California Corporations Code.

THIRD: The name and address in the State of California of this Corporation's initial agent for service of process is:

Nad A. Peterson, Esq.
Senior Vice President, General Counsel and Secretary
San Diego Gas & Electric Company
101 Ash Street, 18th Floor
San Diego, California 92101

FOURTH: Stock.

A. The Corporation is authorized to issue two classes of shares, to be designated respectively Preferred Stock ("Preferred Stock") and Common Stock ("Common Stock"). The total number of shares of capital stock that the Corporation is authorized to issue is 330,000,000, of which 30,000,000 shall be Preferred Stock and 300,000,000 shall be Common Stock.

B. The Preferred Stock may be issued from time to time in one or more series. The Board of Directors of the Corporation (the "Board of Directors") is expressly authorized to provide for the issue of all or any of the shares of the Preferred Stock in one or more series, and to fix the designation and number of shares and to determine or alter for each such series, such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other rights and such qualifications, limitations or restrictions thereof, as shall be stated and expressed in the resolution or resolutions adopted by the Board of Directors providing for the issue of such shares and as may be permitted by the General Corporation Law of California. The Board of Directors is also expressly authorized to increase or decrease (but not below the number of shares of such series then outstanding) the number of shares of any series subsequent to the issue of shares of that series. If the number of shares of any such series shall be so decreased, the shares constituting such decrease shall resume the status that they had prior to the adoption of the resolution originally fixing the number of shares of such series.

FIFTH: Directors.

A. The authorized number of directors of the Corporation shall not be fewer than nine (9) nor more than thirteen (13). The exact authorized number of directors shall be fixed from time to time, within the limits specified in this Article FIFTH, by resolution of the Board of Directors, or by a bylaw or amendment thereof duly adopted by the Board of Directors or the affirmative vote of the holders of shares representing at least 66-2/3% of the outstanding shares of the Corporation entitled to vote.

B. The Board of Directors shall be divided into three classes, designated Class I, Class II and Class III, as nearly equal in number as possible, and the term of office of directors of one class shall expire at each annual meeting of shareholders, but in all cases continue as to each director until his or her successor shall be elected and shall qualify or until his or her earlier resignation, removal from office, death or incapacity. Additional directorships resulting from an increase in number of directors shall be apportioned among the classes as equally as possible. The initial terms of office shall be determined by resolution duly adopted by the Board of Directors. At each annual meeting of shareholders the number of directors equal to the number of directors of the class whose term expires at the time of such meeting (or, if fewer, the number of directors properly nominated and qualified for election) shall be elected to hold office until the third succeeding annual meeting of shareholders after their election. This Paragraph B of this Article FIFTH shall become effective only when the Corporation shall have become a "listed corporation" within the meaning of section 301.5 of the California Corporations Code.

C. Vacancies in the Board of Directors, including, without limitation, vacancies created by the removal of any director, may be filled by a majority of the directors then in office, whether or not less than a quorum, or by a sole remaining director.

SIXTH: No shareholder may cumulate votes in the election of directors. This Article SIXTH shall become effective only when the Corporation shall have become a "listed corporation" within the meaning of section 301.5 of the California Corporations Code.

SEVENTH: Unless the Board of Directors, by a resolution adopted by 66-2/3% of the authorized number of directors, waives the provisions of this Article SEVENTH in any particular circumstance, any action required or permitted to be taken by shareholders of the Corporation must be taken either (i) at a duly called annual or special meeting of shareholders of the Corporation or (ii) by the unanimous written consent of all of the shareholders.

EIGHTH: Fair Price.

A. REQUIRED SHAREHOLDER VOTE FOR CERTAIN TRANSACTIONS.

Unless all of the conditions set forth in either Subsection 1 or 2 of Section B of this Article EIGHTH have been fulfilled, any agreement, contract, transaction or other arrangement providing for or resulting in a Business Combination must be approved by the affirmative vote of 66-2/3% of the number of shares of Common Stock outstanding at the time voting as a separate class. Such affirmative vote shall be required notwithstanding the fact that no vote may be required by law or these Articles or that a lesser percentage, different or additional vote may be specified by law, these Articles, or in any agreement with any national securities exchange or otherwise, in which case each vote requirement shall be satisfied individually.

B. EXCEPTIONS.

Section A of this Article EIGHTH shall not apply to any Business Combination if the conditions specified in either Subsection 1 or 2 below are met.

1. The Business Combination shall have been approved by a resolution adopted by 66-2/3% of the authorized number of directors of the Corporation, or

2. All of the following conditions have been met:

a. Any consideration to be received for any stock as a result of the Business Combination shall be in cash or in the same form as a Dominant Shareholder has previously paid for shares of that class. If varying forms of consideration have been

used, the form of consideration shall be the form used to acquire the largest number of shares of the class receiving consideration.

b. The aggregate amount of cash and the fair market value of any other form of consideration shall, on a per share basis, be at least equal to the Highest Purchase Price paid by a Dominant Shareholder for shares of the same class.

c. After such Dominant Shareholder has become a Dominant Shareholder and prior to the consummation of such Business Combination:

(1) There shall have been no failure to declare and pay in full at the regular rate any periodic dividends on any outstanding preferred stock unless such failure is approved by 66-2/3% of the authorized number of directors of the Corporation;

(2) There shall have been no reduction in the quarterly rate of dividends, if any, paid on common shares (such rate to be appropriately adjusted to reflect the occurrence of any reclassification, reverse stock split, recapitalization, reorganization or other similar transaction having the effect of changing the number of outstanding common shares) unless such reduction is approved by 66-2/3% of the authorized number of directors of the Corporation; and

(3) Neither a Dominant Shareholder nor an Affiliate thereof shall have acquired Beneficial Ownership of any additional shares of voting stock of the Corporation except as part of a transaction which has been approved by a resolution adopted by 66-2/3% of the authorized number of directors.

3. Definitions.

a. "Affiliate" means: a Person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, a specified Person.

b. "Beneficial Ownership" means: ownership; holding the right to vote pursuant to any agreement, arrangement or understanding; having the right to acquire pursuant to any agreement, arrangement, understanding, option, right, warrant or right of conversion; having the right to dispose of pursuant to any agreement, arrangement or understanding; having the right to receive money (e.g., dividends, redemption proceeds or proceeds from any sale) with respect to pursuant to any agreement, arrangement or understanding; and Beneficial Ownership (pursuant to the foregoing provisions of this definition) by an Affiliate or by an officer, director or employee of a Dominant Shareholder or any Affiliate of such an officer, director or employee.

c. "Business Combination" means: (1) a merger or consolidation of the Corporation or any Subsidiary with a Dominant Shareholder or with any other corporation or entity which is, or after such merger or consolidation would be, an Affiliate of a Dominant Shareholder; (2) the sale, lease, exchange, pledge, transfer or other disposition by the Corporation, or a Subsidiary, of assets exceeding ten percent (10%) of the total assets of the Corporation in a transaction or series of transactions in which a Dominant Shareholder is either a party or has an interest; (3) the issuance, sale, exchange, disposition or other transfer by the Corporation or any Subsidiary, in one transaction or a series of transactions, of any securities of the Corporation, or any Subsidiary, to any Dominant Shareholder or any Affiliate of any Dominant Shareholder in exchange for cash, securities or other property having an aggregate fair market value

in excess of ten percent (10%) of the fair market value of the issued and outstanding capital stock of the Corporation prior to such transaction; (4) any reclassification of securities, any reverse stock split, or any recapitalization of the Corporation or any other transaction which has the effect, directly or indirectly, of increasing the Beneficial Ownership of the Corporation or any Subsidiary by the Dominant Shareholder or any Affiliate thereof.

d. "Dominant Shareholder" means: any Person (except this Corporation, any Subsidiary of this Corporation, and any Savings, Pension, TRESOP or other benefit plan of this Corporation or any fiduciary, trustee or custodian thereof acting in such a capacity) who is the Beneficial Owner, directly or indirectly, of more than ten percent (10%) but less than ~~99~~ percent (99%) of the shares of the Corporation having the power to vote for the Board of Directors. The relevant time for calculating this percentage shall be each date on which any approval (board, shareholder, governmental or any other) necessary to complete any agreement, contract, transaction or other arrangement providing for or resulting in a Business Combination is obtained.

e. "Highest Purchase Price" shall mean the highest amount of consideration paid by a Dominant Shareholder at any time within two years prior to the date of becoming a Dominant Shareholder and during any time while having the status of Dominant Shareholder; provided, however, that the Highest Purchase Price shall be appropriately adjusted to reflect the occurrence of any reclassification, recapitalization, stock split, reverse stock split or other readjustment to the number of outstanding shares of stock in a class, or the payment of a stock dividend thereon occurring between the last date upon which such Dominant Shareholder paid the Highest Purchase Price and the effective date of the Business Combination.

f. "Person" means: any individual, group, partnership, association, firm, corporation or other entity.

g. "Subsidiary" means: any corporation in which this Corporation has Beneficial Ownership of at least a majority of any class of stock having the right to vote for directors.

4. The Board of Directors by a vote of 66-2/3% of the authorized number of directors shall have the right to make any determinations required under this Article EIGHTH.

NINTH: Indemnity.

A. LIMITATION OF DIRECTORS' LIABILITY.

The liability of the directors of the Corporation for monetary damages shall be eliminated to the fullest extent permissible under California law.

B. INDEMNIFICATION OF CORPORATE AGENTS.

The Corporation is authorized to provide indemnification of agents (as defined in Section 317 of the California Corporations Code) through bylaw provisions, agreements with agents, vote of shareholders or disinterested directors, or otherwise, in excess of the indemnification otherwise permitted by Section 317 of the California Corporations Code, subject only to the applicable limits set forth in Section 204 of the California Corporations Code.

TENTH: The Board of Directors is expressly authorized to make, amend or repeal the bylaws of the Corporation, without any action on the part of the shareholders, solely by the affirmative vote of at least 66-2/3% of the authorized number of directors. The bylaws may also be amended or repealed by the shareholders, but only by the affirmative vote of the holders of shares representing at least 66-2/3% of the outstanding shares of the Corporation entitled to vote.

ELEVENTH: The amendment or repeal of Articles FIFTH, SIXTH, SEVENTH, EIGHTH, NINTH, TENTH and ELEVENTH shall require the approval of the holders of shares representing at least 66-2/3% of the outstanding shares of the Corporation entitled to vote.

For the purpose of forming the Corporation under the laws of the State of California, the undersigned sole incorporator has executed these Articles of Incorporation.

Dated: _____ __, 1994

_____
Kevin C. Sagara, Sole Incorporator

APPENDIX B

DRAFT ARTICLES OF INCORPORATION OF SAN DIEGO MERGER COMPANY

ARTICLES OF INCORPORATION
OF
SAN DIEGO MERGER COMPANY

FIRST: The name of this corporation is San Diego Merger Company.

SECOND: The purpose of this corporation is to engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business or the practice of a profession permitted to be incorporated by the California Corporations Code.

THIRD: The name and address in the State of California of this corporation's initial agent for service of process is:

Nad A. Peterson, Esq.
Senior Vice President, General Counsel and Secretary
San Diego Gas & Electric Company
101 Ash Street, 18th Floor
San Diego, California 92101

FOURTH: This corporation is authorized to issue only one class of shares of stock, and the total number of shares which this corporation is authorized to issue is one thousand (1,000).

FIFTH: The liability of the directors of this corporation for monetary damages shall be eliminated to the fullest extent permissible under California law. This corporation is authorized to provide indemnification of agents (as defined in Section 317 of the California Corporations Code) to the fullest extent permissible under California law for breach of duty to this corporation and its shareholders through bylaw provisions or through agreements with the agents, or both, through vote of the shareholders or disinterested directors, or otherwise in excess of the indemnification otherwise permitted by Section 317 of the California Corporations Code, subject to the limits on such excess indemnification set forth in Section 204 of the California Corporations Code.

For the purpose of forming the corporation under the laws of the State of California, the undersigned sole incorporator has executed these Articles of Incorporation.

Dated: _____ __, 1994

_____
Kevin C. Sagara, Sole Incorporator

20647263

APPENDIX C

SDG&E FINANCIAL INFORMATION

SAN DIEGO GAS & ELECTRIC COMPANY
STATEMENT OF INCOME AND RETAINED EARNINGS
NINE MONTHS ENDED SEPTEMBER 30, 1994

1. UTILITY OPERATING INCOME

400	OPERATING REVENUE		$1,367,432,104
401	OPERATING EXPENSE	$744,979,773	
402	MAINTENANCE EXPENSE	47,969,794	
403–7	DEPRECIATION AND AMORTIZATION EXPENSE	187,836,854	
408.1	TAXES OTHER THAN INCOME TAXES	33,717,158	
409.1	INCOME TAXES	127,082,000	
410.1	PROVISION FOR DEFERRED INCOME TAX	52,017,000	
411.1	PROVISION FOR DEFERRED INCOME TAX – CREDIT	(34,735,000)	
411.4	INVESTMENT TAX CREDIT ADJUSTMENTS	(3,819,000)	
	TOTAL OPERATING REVENUE DEDUCTIONS		1,155,048,579
	NET OPERATING INCOME		212,383,525

2. OTHER INCOME AND DEDUCTIONS

415	REVENUE FROM MERCH, JOBBING & CONTRACT	–	
417.1	NON–UTILITY OPERATIONS	(62,516)	
418	NON–OPERATING RENTAL INCOME	701,412	
418.1	EQUITY IN EARNINGS/(LOSSES) OF SUBSIDIARIES	(62,325,752)	
419	INTEREST AND DIVIDEND INCOME	1,903,579	
419.1	ALLOWANCE FOR OTHER FUNDS USED DURING CONSTRUCTION	6,035,511	
421	MISCELLANEOUS NON–OPERATING INCOME	5,108,299	
	TOTAL OTHER INCOME AND DEDUCTIONS	(48,639,467)	
426	MISCELLANEOUS OTHER INCOME DEDUCTIONS	8,918,961	
408.2	TAXES OTHER THAN INCOME TAXES	231,311	
409.2	INCOME TAXES	(676,000)	
410.2	DEFERRED INCOME TAXES	1,396,000	
411.2	DEFERRED INCOME TAX CREDIT	(73,000)	
	TOTAL TAXES ON OTHER INCOME AND DEDUCTIONS	878,311	
	TOTAL OTHER INCOME AND DEDUCTIONS		(58,436,739)
	INCOME BEFORE INTEREST CHARGES		153,946,786
	NET INTEREST CHARGES*		67,580,057
	NET INCOME		$86,366,729

**NET OF ALLOWANCE FOR BORROWED FUNDS USED DURING CONSTRUCTION. ($2,579,694)*

SAN DIEGO GAS & ELECTRIC COMPANY
STATEMENT OF INCOME AND RETAINED EARNINGS
NINE MONTHS ENDED SEPTEMBER 30, 1994

3. RETAINED EARNINGS

RETAINED EARNINGS AT BEGINNING OF PERIOD, AS PREVIOUSLY REPORTED	$659,833,207
NET INCOME (FROM PRECEDING PAGE)	86,366,729
DIVIDENDS DECLARED:	
PREFERRED STOCK	5,747,235
COMMON STOCK	132,782,696
TOTAL DIVIDENDS DECLARED	138,529,931
RETAINED EARNINGS AT END OF PERIOD	$607,670,005

SAN DIEGO GAS & ELECTRIC COMPANY
BALANCE SHEET
ASSETS AND OTHER DEBITS
SEPTEMBER 30, 1994

1. UTILITY PLANT

101	UTILITY PLANT	$4,753,439,54
102	UTILITY PLANT PURCHASED OR SOLD	3,787
105	PLANT HELD FOR FUTURE USE	255,16
106	COMPLETED CONSTRUCTION NOT CLASSIFIED	168,249,90
107	CONSTRUCTION WORK IN PROGRESS	106,056,32
108	ACCUMULATED PROVISION FOR DEPRECIATION – UTILITY PLANT	(2,015,726,08
111	ACCUMULATED PROVISION FOR AMORTIZATION – UTILITY PLANT	(94,757,95
118	OTHER UTILITY PLANT	226,388,59
119	ACCUMULATED PROVISION FOR DEPRECIATION – OTHER PLANT	(28,929,24
120	NUCLEAR FUEL UNDER CAPITAL LEASES – NET	19,830,57
	TOTAL NET UTILITY PLANT	3,134,810,59

2. OTHER PROPERTY & INVESTMENTS

121	NON–UTILITY PROPERTY	17,233,41
122	ACCUMULATED DEPRECIATION OF NON–UTILITY PROPERTY	(567,83
123	INVESTMENTS IN SUBSIDIARY COMPANIES	105,975,74
124	OTHER INVESTMENTS	10,043,59
125	SINKING FUNDS	–
128	OTHER SPECIAL FUNDS	206,566,53
	TOTAL OTHER PROPERTY & INVESTMENTS	339,251,451

SAN DIEGO GAS & ELECTRIC COMPANY
BALANCE SHEET
ASSETS AND OTHER DEBITS
SEPTEMBER 30, 1994

3. CURRENT AND ACCRUED ASSETS

131	CASH	986,887
132	INTEREST DEPOSIT	–
134	OTHER SPECIAL DEPOSITS	38,877
135	WORKING FUNDS	147,942
136	TEMPORARY CASH INVESTMENTS	–
142	CUSTOMER ACCOUNTS RECEIVABLE	132,991,129
143	OTHER ACCOUNTS RECEIVABLE	7,036,102
144	ACCUMULATED PROVISION FOR UNCOLLECTIBLE ACCOUNTS	(2,410,409)
145	NOTES RECEIVABLE FROM ASSOCIATED COMPANIES	2,933,175
146	ACCOUNTS RECEIVABLE FROM ASSOCIATED COMPANIES	8,110,372
151	FUEL STOCK	13,527,721
152	FUEL STOCK EXPENSE UNDISTRIBUTED	–
154	PLANT MATERIALS AND OPERATING SUPPLIES	46,296,666
156	OTHER MATERIALS AND SUPPLIES	287,073
163	STORES EXPENSE UNDISTRIBUTED	(280,642)
164	GAS STORED	27,758,633
165	PREPAYMENTS	3,037,428
171	INTEREST RECEIVABLE	–
173	ACCRUED UTILITY REVENUES	49,808,650
174	REGULATORY BALANCING ACCOUNTS – UNDERCOLLECTED	30,360,818
	TOTAL CURRENT AND ACCRUED ASSETS	320,630,422

4. DEFERRED DEBITS

181	UNAMORTIZED DEBT EXPENSE	15,903,745
182	UNRECOVERED PLANT AND OTHER REGULATORY ASSETS	534,427,997
183	PRELIMINARY SURVEY & INVESTIGATION CHARGES	2,091,153
184	CLEARING ACCOUNTS	2,495,774
185	TEMPORARY FACILITIES	(214,099)
186	MISCELLANEOUS DEFERRED DEBITS	44,434,713
189	UNAMORTIZED LOSS ON REACQUIRED DEBT	60,556,357
190	ACCUMULATED DEFERRED INCOME TAXES	244,803,517
	TOTAL DEFERRED DEBITS	905,499,157
	TOTAL ASSETS AND OTHER DEBITS	$4,700,191,629

SAN DIEGO GAS & ELECTRIC COMPANY
BALANCE SHEET
LIABILITIES AND OTHER CREDITS
SEPTEMBER 30, 1994

5. PROPRIETARY CAPITAL

201	COMMON STOCK ISSUED	$291,189,888
204	PREFERRED STOCK ISSUED	118,493,000
207	PREMIUM ON CAPITAL STOCK	590,477,120
214	LESS: CAPITAL STOCK EXPENSE	(26,212,648
216	UNAPPROPRIATED RETAINED EARNINGS	607,670,005
	TOTAL PROPRIETARY CAPITAL	1,581,617,365

6. LONG-TERM DEBT

221	FIRST MORTGAGE BONDS	1,226,620,000
224	OTHER LONG-TERM DEBT	75,591,541
225	UNAMORTIZED DEBT PREMIUM	653,005
226	UNAMORTIZED DEBT DISCOUNT	(8,666,025
	TOTAL LONG-TERM DEBT	1,294,198,521

7. OTHER NON-CURRENT LIABILITIES

227	CAPITAL LEASES - NON-CURRENT	89,480,921
228	ACCUMULATED PROVISION FOR INJURIES AND DAMAGES	28,218,983
	TOTAL OTHER NON-CURRENT LIABILITIES	117,699,904

SAN DIEGO GAS & ELECTRIC COMPANY
BALANCE SHEET
LIABILITIES AND OTHER CREDITS
SEPTEMBER 30, 1994

8. CURRENT AND ACCRUED LIABILITES

231	NOTES PAYABLE	9,000,000
232	ACCOUNTS PAYABLE	101,471,258
233	NOTES PAYABLE ASSOCIATED COMPANIES	–
234	ACCOUNTS PAYABLE ASSOCIATED COMPANIES	12,215,710
235	CUSTOMER DEPOSITS	19,621,108
236	TAXES ACCRUED	102,830,207
237	INTEREST ACCRUED	20,176,450
238	DIVIDENDS DECLARED	46,176,608
241	TAX COLLECTIONS PAYABLE	1,723,516
242	MISC. CURRENT AND ACCRUED LIABILITIES	47,431,880
242	REGULATORY BALANCING ACCOUNTS – OVERCOLLECTED	148,668,849
243	CAPITAL LEASES – CURRENT	22,776,192
	TOTAL CURRENT AND ACCRUED LIABILITIES	532,091,778

9. DEFERRED CREDITS

252	CUSTOMER ADVANCES FOR CONSTRUCTION	29,274,058
253	OTHER DEFERRED CREDITS	84,678,837
254	OTHER REGULATORY LIABILITIES	181,102,000
255	ACCUMULATED DEFERRED INVESTMENT TAX CREDITS	110,339,509
257	GAIN ON SINKING FUND DEBENTURES	–
281	ACCUMULATED DEFERRED INCOME TAXES – ACCELERATED	1,101,000
282	ACCUMULATED DEFERRED INCOME TAXES – PROPERTY	545,425,194
283	ACCUMULATED DEFERRED INCOME TAXES – OTHER	222,663,463
	TOTAL DEFERRED CREDITS	1,174,584,061
	TOTAL LIABILITES AND OTHER CREDITS	$4,700,191,629

SAN DIEGO GAS & ELECTRIC COMPANY
FINANCIAL STATEMENT
SEPTEMBER 30, 1994

(a) Amounts and Kinds of Stock Authorized:

Preferred Stock	1,375,000 shares	Par Value $27,500,000
Preferred Stock	10,000,000 shares	Without Par Value
Common Stock	255,000,000 shares	Without Par Value

Amounts and Kinds of Stock Outstanding:

PREFERRED STOCK		
5.0%	375,000 shares	$7,500,000
4-1/2%	300,000 shares	6,000,000
4.4%	325,000 shares	6,500,000
4.6%	374,650 shares	7,493,000
$7.20	150,000 shares	15,000,000
$1.7825	1,000,000 shares	25,000,000
$1.70	1,400,000 shares	35,000,000
$1.82	640,000 shares	16,000,000
COMMON STOCK	116,475,955 shares	291,189,888

(b) Terms of Preferred Stock:
Full information as to this item is given in connection with Application No. 53104, to which reference is hereby made.

(c) Brief Description of Mortgage:
Full information as to this item is given in Application No. 23638, to which reference is hereby made.

(d) Number and Amount of Bonds Authorized and Issued:

First Mortgage Bonds:	Nominal Date of Issue	Par Value Authorized and Issued	Par Value Outstanding	Interest Paid in 1993
5-1/2% Series I, due 1997	03-01-67	$25,000,000	$25,000,000	$1,375,000
7% Series J, due 1998	12-01-68	35,000,000	-	1,225,000
8% Series L, due 2001	09-01-71	45,000,000	-	2,400,000
8-3/8% Series M, due 2004	01-15-74	75,000,000	-	4,449,219
8-3/4% Series Q, due 2007	03-15-77	50,000,000	-	2,734,375
5-1/2% Series U-2, due 1994	01-15-82	13,268,000	-	487,740
10% Series AA, due 2018	06-01-83	150,000,000	-	4,285,500
10% Series BB, due 2018	09-01-83	150,000,000	-	12,132,500
4.25% Series CC, due 2008	05-01-84	53,000,000	53,000,000	1,563,500
4.25% Series DD, due 2008	12-01-84	27,000,000	27,000,000	1,147,500
9-1/4% Series EE, due 2020	09-01-85	100,000,000	74,350,000	6,877,375
4.25% Series FF, due 2007	12-01-85	35,000,000	35,000,000	1,102,500
7-5/8% Series GG, due 2021	07-01-86	44,250,000	44,250,000	3,374,062
7-3/8% Series HH, due 2021	12-01-86	81,350,000	81,350,000	5,999,563
8-3/4% Series II, due 2023	09-01-87	25,000,000	25,000,000	2,187,500
9-5/8% Series JJ, due 2020	04-15-90	100,000,000	100,000,000	9,625,000
6.8% Series KK, due 2015	12-01-91	14,400,000	14,400,000	979,200
8.5% Series LL, due 2022	04-01-92	60,000,000	60,000,000	5,100,000
7-5/8% Series MM, due 2002	06-15-92	80,000,000	80,000,000	6,100,000
6.1% & 6.4% Series NN, due 2018 & 2019	09-01-92	118,615,000	118,615,000	6,812,182
Var% Series OO, due 2027	12-01-92	250,000,000	250,000,000	10,272,360
5.9% Series PP, due 2018	04-29-93	70,795,000	70,795,000	2,245,775
Var% Series QQ, due 2018	04-29-93	14,915,000	14,915,000	309,683
5.85% Series RR, due 2021	06-29-93	60,000,000	60,000,000	1,482,000
5.9% Series SS, due 2018	07-29-93	92,945,000	92,945,000	223,068
Pollution Control Revenue Bonds:				
6-3/8%, Due 2007	04-01-77	$9,575,000	$9,215,000	$604,669
7.2%, Due 2009	04-01-79	5,700,000	5,700,000	410,400

SAN DIEGO GAS & ELECTRIC COMPANY
FINANCIAL STATEMENT
SEPTEMBER 30, 1994

(e) Other Indebtedness:	Date of Issue	Date of Maturity	Interest Rate	Outstanding	Interest Paid in 1993
Commercial Paper & ST Bank Loans	Various	Various	Various	$9,000,000	$1,230,623
Long-term Bank Loans					
Mellon Bank	04-15-93	12-31-94	Various	35,000,000	453,691
First Interstate Bank	04-15-93	04-15-95	Various	25,000,000	1,157,322
Sinking Fund Debentures	09-01-64	09-01-94	4.5%	–	55,080
Sundesert Properties:					
FLBA of Riverside	1976[1]	12-01-03	Variable	24,431	2,289
FLBA of Blythe	1976[1]	12-01-03	Variable	652,110	59,378
Capitalized Leases	–	–	–	109,748,093	–

(f) Amounts and Rates of Dividends Declared:

The amounts and rates of dividends during the past five fiscal years are as follows:

Preferred Stock	Shares Outstanding @9/30/94	Dividends Declared 1989	1990	1991	1992	1993
5.0%	375,000	$375,000	$375,000	$375,000	$375,000	$375,000
4-1/2%	300,000	270,000	270,000	270,000	270,000	270,000
4.40%	325,000	286,000	286,000	286,000	286,000	286,000
4.60%	374,650	344,678	344,678	344,678	344,678	344,678
$ 7.80 [2]	–	1,560,000	1,560,000	1,560,000	1,560,000	1,005,340
$ 7.20	150,000	1,080,000	1,080,000	1,080,000	1,080,000	1,080,000
$ 2.475 [3]	–	2,475,000	2,475,000	2,475,000	1,794,379	–
$ 8.25 [4]	–	639,375	556,875	474,375	289,781	–
$ 9.125 [5]	–	988,542	726,198	486,667	241,432	–
$ 7.05 [6]	–	3,172,500	3,172,500	3,172,500	3,115,043	2,335,493
$1.7625 [7]	1,000,000	–	–	–	176,250	1,762,500
$ 1.70 [8]	1,400,000	–	–	–	–	892,500
$ 1.82 [9]	640,000	–	–	–	–	171,456
	4,564,650	$11,191,095	$10,846,251	$10,524,220	$9,532,563	$8,522,967
Common Stock						
Amount		$150,944,895	$150,999,165	$155,435,381	$164,042,932	$171,845,666
Rate per share		$1.35	$1.35	$1.3875	$1.44	$1.48

A balance sheet and a statement of income and retained earnings of Applicant for the nine months ended September 30, 1994, are attached hereto.

[1] Year assumed from subsidiary.
[2] 200,000 shares were retired in 1993.
[3] 1,000,000 shares were retired in 1992.
[4] 10,000 shares were retired each year in 1989, 1990, and 1991, and 55,000 shares in 1992.
[5] 20,000 shares in 1989, 35,000 shares in 1990, 20,000 shares in 1991, and 45,000 shares in 1992.
[6] 16,300 shares were retired in 1992 and 433,700 shares in 1993.
[7] 1,000,000 shares were issued in December 1992.
[8] 1,400,000 shares were issued in August 1993.
[9] 640,000 shares were issued in November 1993.

APPENDIX D

PARENT COMPANY AND SDG&E PRO FORMA BALANCE SHEETS AND INCOME STATEMENTS

PROPOSED HOLDING COMPANY
PRO FORMA STATEMENT OF INCOME AND RETAINED EARNINGS
NINE MONTHS ENDED SEPTEMBER 30, 1994

1. UTILITY OPERATING INCOME

400	OPERATING REVENUE		$1,367,432,104
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411.1	PROVISION FOR DEFERRED INCOME TAX – CREDIT	(34,735,000)	
411.4	INVESTMENT TAX CREDIT ADJUSTMENTS	(3,819,000)	
	TOTAL OPERATING REVENUE DEDUCTIONS		1,155,048,579
	NET OPERATING INCOME		212,383,525

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411.2	DEFERRED INCOME TAX CREDIT	(73,000)	
	TOTAL TAXES ON OTHER INCOME AND DEDUCTIONS	878,311	
	TOTAL OTHER INCOME AND DEDUCTIONS		(58,436,739
	INCOME BEFORE INTEREST CHARGES		153,946,786
	NET INTEREST CHARGES AND PREFERRED DIVIDEND REQUIREMENTS OF SAN DIEGO GAS & ELECTRIC COMPANY*		73,327,292
	NET INCOME		$80,619,494

**NET OF ALLOWANCE FOR BORROWED FUNDS USED DURING CONSTRUCTION. ($2,579,694)*

PROPOSED HOLDING COMPANY
PRO FORMA STATEMENT OF INCOME AND RETAINED EARNINGS
NINE MONTHS ENDED SEPTEMBER 30, 1994

3. RETAINED EARNINGS

RETAINED EARNINGS AT BEGINNING OF PERIOD, AS PREVIOUSLY REPORTED	$659,833,207
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DIVIDENDS DECLARED:	
COMMON STOCK	132,782,696
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PROPOSED HOLDING COMPANY
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ASSETS AND OTHER DEBITS
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PROPOSED HOLDING COMPANY
PRO FORMA BALANCE SHEET
LIABILITIES AND OTHER CREDITS
SEPTEMBER 30, 1994

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LIABILITIES AND OTHER CREDITS
SEPTEMBER 30, 1994

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233	NOTES PAYABLE ASSOCIATED COMPANIES	–
234	ACCOUNTS PAYABLE ASSOCIATED COMPANIES	12,215,710
235	CUSTOMER DEPOSITS	19,621,108
236	TAXES ACCRUED	102,830,207
237	INTEREST ACCRUED	20,176,450
238	DIVIDENDS DECLARED	46,176,608
241	TAX COLLECTIONS PAYABLE	1,723,516
242	MISC. CURRENT AND ACCRUED LIABILITIES	47,431,880
242	REGULATORY BALANCING ACCOUNTS – OVERCOLLECTED	148,668,849
243	CAPITAL LEASES – CURRENT	22,776,192
	TOTAL CURRENT AND ACCRUED LIABILITIES	532,091,778

9. DEFERRED CREDITS

252	CUSTOMER ADVANCES FOR CONSTRUCTION	29,274,058
253	OTHER DEFERRED CREDITS	84,678,837
254	OTHER REGULATORY LIABILITIES	181,102,000
255	ACCUMULATED DEFERRED INVESTMENT TAX CREDITS	110,339,509
257	GAIN ON SINKING FUND DEBENTURES	–
281	ACCUMULATED DEFERRED INCOME TAXES – ACCELERATED	1,101,000
282	ACCUMULATED DEFERRED INCOME TAXES – PROPERTY	545,425,194
283	ACCUMULATED DEFERRED INCOME TAXES – OTHER	222,663,463
	TOTAL DEFERRED CREDITS	1,174,584,061
	TOTAL LIABILITES AND OTHER CREDITS	$4,700,191,629

SAN DIEGO GAS & ELECTRIC COMPANY
PRO FORMA STATEMENT OF INCOME AND RETAINED EARNINGS
NINE MONTHS ENDED SEPTEMBER 30, 1994

1. UTILITY OPERATING INCOME

400	OPERATING REVENUE		$1,367,432,104
401	OPERATING EXPENSE	$744,979,773	
402	MAINTENANCE EXPENSE	47,969,794	
403-7	DEPRECIATION AND AMORTIZATION EXPENSE	187,836,854	
408.1	TAXES OTHER THAN INCOME TAXES	33,717,158	
409.1	INCOME TAXES	127,082,000	
410.1	PROVISION FOR DEFERRED INCOME TAX	52,017,000	
411.1	PROVISION FOR DEFERRED INCOME TAX - CREDIT	(34,735,000)	
411.4	INVESTMENT TAX CREDIT ADJUSTMENTS	(3,819,000)	
	TOTAL OPERATING REVENUE DEDUCTIONS		1,155,048,579
	NET OPERATING INCOME		212,383,525

2. OTHER INCOME AND DEDUCTIONS

415	REVENUE FROM MERCH, JOBBING & CONTRACT	-	
417.1	NON-UTILITY OPERATIONS	(62,516)	
418	NON-OPERATING RENTAL INCOME	701,412	
419	INTEREST AND DIVIDEND INCOME	1,303,579	
419.1	ALLOWANCE FOR OTHER FUNDS USED DURING CONSTRUCTION	6,035,511	
421	MISCELLANEOUS NON-OPERATING INCOME	5,108,299	
	TOTAL OTHER INCOME AND DEDUCTIONS	13,686,285	
426	MISCELLANEOUS OTHER INCOME DEDUCTIONS	8,918,961	
408.2	TAXES OTHER THAN INCOME TAXES	231,311	
409.2	INCOME TAXES	(676,000)	
410.2	DEFERRED INCOME TAXES	1,396,000	
411.2	DEFERRED INCOME TAX CREDIT	(73,000)	
	TOTAL TAXES ON OTHER INCOME AND DEDUCTIONS	878,311	
	TOTAL OTHER INCOME AND DEDUCTIONS		3,889,013
	INCOME BEFORE INTEREST CHARGES		216,272,538
	NET INTEREST CHARGES*		67,580,057
	NET INCOME		$148,692,481

**NET OF ALLOWANCE FOR BORROWED FUNDS USED DURING CONSTRUCTION. ($2,579,694)*

SAN DIEGO GAS & ELECTRIC COMPANY
PRO FORMA STATEMENT OF INCOME AND RETAINED EARNINGS
NINE MONTHS ENDED SEPTEMBER 30, 1994

3. RETAINED EARNINGS

RETAINED EARNINGS AT BEGINNING OF PERIOD, AS PREVIOUSLY REPORTED	$358,749,014
NET INCOME (FROM PRECEDING PAGE)	148,692,481
DIVIDENDS DECLARED:	
PREFERRED STOCK	5,747,235
RETAINED EARNINGS AT END OF PERIOD	$501,694,260

SAN DIEGO GAS & ELECTRIC COMPANY
PRO FORMA BALANCE SHEET
ASSETS AND OTHER DEBITS
SEPTEMBER 30, 1994

1. UTILITY PLANT

101	UTILITY PLANT	$4,753,439,543
102	UTILITY PLANT PURCHASED OR SOLD	3,787
105	PLANT HELD FOR FUTURE USE	255,160
106	COMPLETED CONSTRUCTION NOT CLASSIFIED	168,249,900
107	CONSTRUCTION WORK IN PROGRESS	106,056,329
108	ACCUMULATED PROVISION FOR DEPRECIATION - UTILITY PLANT	(2,015,726,089)
111	ACCUMULATED PROVISION FOR AMORTIZATION - UTILITY PLANT	(94,757,959)
118	OTHER UTILITY PLANT	226,388,596
119	ACCUMULATED PROVISION FOR DEPRECIATION - OTHER PLANT	(28,929,243)
120	NUCLEAR FUEL UNDER CAPITAL LEASES - NET	19,830,575
	TOTAL NET UTILITY PLANT	3,134,810,599

2. OTHER PROPERTY & INVESTMENTS

121	NON-UTILITY PROPERTY	17,233,419
122	ACCUMULATED DEPRECIATION OF NON-UTILITY PROPERTY	(567,835)
124	OTHER INVESTMENTS	10,043,590
125	SINKING FUNDS	-
128	OTHER SPECIAL FUNDS	206,566,532
	TOTAL OTHER PROPERTY & INVESTMENTS	233,275,706

SAN DIEGO GAS & ELECTRIC COMPANY
PRO FORMA BALANCE SHEET
ASSETS AND OTHER DEBITS
SEPTEMBER 30, 1994

3. CURRENT AND ACCRUED ASSETS

131	CASH	986,887
132	INTEREST DEPOSIT	-
134	OTHER SPECIAL DEPOSITS	38,877
135	WORKING FUNDS	147,942
136	TEMPORARY CASH INVESTMENTS	-
142	CUSTOMER ACCOUNTS RECEIVABLE	132,991,129
143	OTHER ACCOUNTS RECEIVABLE	7,036,102
144	ACCUMULATED PROVISION FOR UNCOLLECTIBLE ACCOUNTS	(2,410,409)
145	NOTES RECEIVABLE FROM ASSOCIATED COMPANIES	2,933,175
146	ACCOUNTS RECEIVABLE FROM ASSOCIATED COMPANIES	8,110,372
151	FUEL STOCK	13,527,721
152	FUEL STOCK EXPENSE UNDISTRIBUTED	-
154	PLANT MATERIALS AND OPERATING SUPPLIES	46,296,666
156	OTHER MATERIALS AND SUPPLIES	287,073
163	STORES EXPENSE UNDISTRIBUTED	(280,642)
164	GAS STORED	27,758,633
165	PREPAYMENTS	3,037,428
171	INTEREST RECEIVABLE	-
173	ACCRUED UTILITY REVENUES	49,808,650
174	REGULATORY BALANCING ACCOUNTS - UNDERCOLLECTED	30,360,818
	TOTAL CURRENT AND ACCRUED ASSETS	320,630,422

4. DEFERRED DEBITS

181	UNAMORTIZED DEBT EXPENSE	15,903,745
182	UNRECOVERED PLANT AND OTHER REGULATORY ASSETS	534,427,997
183	PRELIMINARY SURVEY & INVESTIGATION CHARGES	2,091,153
184	CLEARING ACCOUNTS	3,495,774
185	TEMPORARY FACILITIES	(214,099)
186	MISCELLANEOUS DEFERRED DEBITS	44,434,713
189	UNAMORTIZED LOSS ON REACQUIRED DEBT	60,556,357
190	ACCUMULATED DEFERRED INCOME TAXES	244,803,517
	TOTAL DEFERRED DEBITS	905,499,157
	TOTAL ASSETS AND OTHER DEBITS	$4,594,215,884

SAN DIEGO GAS & ELECTRIC COMPANY
PRO FORMA BALANCE SHEET
LIABILITIES AND OTHER CREDITS
SEPTEMBER 30, 1994

5. PROPRIETARY CAPITAL

201	COMMON STOCK ISSUED	$291,189,888
204	PREFERRED STOCK ISSUED BY SAN DIEGO GAS & ELECTRIC CO.	118,493,000
207	PREMIUM ON CAPITAL STOCK	590,477,120
214	LESS: CAPITAL STOCK EXPENSE	(26,212,648)
216	UNAPPROPRIATED RETAINED EARNINGS	501,694,260
	TOTAL PROPRIETARY CAPITAL	1,475,641,620

6. LONG-TERM DEBT

221	FIRST MORTGAGE BONDS	1,226,620,000
224	OTHER LONG-TERM DEBT	75,591,541
225	UNAMORTIZED DEBT PREMIUM	653,005
226	UNAMORTIZED DEBT DISCOUNT	(8,666,025)
	TOTAL LONG-TERM DEBT	1,294,198,521

7. OTHER NON-CURRENT LIABILITIES

227	CAPITAL LEASES - NON-CURRENT	89,480,921
228	ACCUMULATED PROVISION FOR INJURIES AND DAMAGES	28,218,983
	TOTAL OTHER NON-CURRENT LIABILITIES	117,699,904

SAN DIEGO GAS & ELECTRIC COMPANY
PRO FORMA BALANCE SHEET
LIABILITIES AND OTHER CREDITS
SEPTEMBER 30, 1994

8. CURRENT AND ACCRUED LIABILITES

231	NOTES PAYABLE	9,000,000
232	ACCOUNTS PAYABLE	101,471,258
233	NOTES PAYABLE ASSOCIATED COMPANIES	-
234	ACCOUNTS PAYABLE ASSOCIATED COMPANIES	12,215,710
235	CUSTOMER DEPOSITS	19,621,108
236	TAXES ACCRUED	102,830,207
237	INTEREST ACCRUED	20,176,450
238	DIVIDENDS DECLARED	46,176,608
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242	REGULATORY BALANCING ACCOUNTS - OVERCOLLECTED	148,668,849
243	CAPITAL LEASES - CURRENT	22,776,192
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254	OTHER REGULATORY LIABILITIES	181,102,000
255	ACCUMULATED DEFERRED INVESTMENT TAX CREDITS	110,339,509
257	GAIN ON SINKING FUND DEBENTURES	-
281	ACCUMULATED DEFERRED INCOME TAXES - ACCELERATED	1,101,000
282	ACCUMULATED DEFERRED INCOME TAXES - PROPERTY	545,425,194
283	ACCUMULATED DEFERRED INCOME TAXES - OTHER	222,663,463
	TOTAL DEFERRED CREDITS	1,174,584,061
	TOTAL LIABILITES AND OTHER CREDITS	$4,594,215,884

APPENDIX E

COST OF PROPERTY AND DEPRECIATION RESERVE

SAN DIEGO GAS & ELECTRIC COMPANY

COST OF PROPERTY AND
DEPRECIATION RESERVE APPLICABLE THERETO
AS OF SEPTEMBER 30, 1994

No.	Account	Original Cost	Reserve for Depreciation and Amortization
ELECTRIC DEPARTMENT			
302	Franchises and Consents	$ 222,841	$ 202,900
303	Misc. Intangible Plant	168,000	165,315
	TOTAL INTANGIBLE PLANT	390,841	368,215
310.1	Land	5,755,414	0
310.2	Land Rights	37,580	22,329
311	Structures and Improvements	127,780,232	80,756,621
312	Boiler Plant Equipment	123,618,836	93,163,877
314	Turbogenerator Units	89,104,562	56,638,983
315	Accessory Electric Equipment	19,646,484	12,629,355
316	Miscellaneous Power Plant Equipment	7,018,338	2,941,921
	TOTAL STEAM PRODUCTION	372,961,446	246,153,086
320.1	Land	1,177,135	0
320.2	Land Rights	283,677	39,102
321	Structures and Improvements	252,152,612	89,706,392
322	Boiler Plant Equipment	368,769,522	121,933,367
323	Turbogenerator Units	131,334,409	48,089,994
324	Accessory Electric Equipment	152,563,971	53,796,600
325	Miscellaneous Power Plant Equipment	161,191,816	35,661,842
	TOTAL NUCLEAR PRODUCTION	1,067,473,142	349,227,297
340.1	Land	185,491	0
340.2	Land Rights	2,428	2,304
341	Structures and Improvements	1,901,250	1,449,962
342	Fuel Holders, Producers & Accessories	4,975,779	2,971,692
344	Generators	38,291,348	34,281,447
345	Accessory Electric Equipment	966,253	671,946
	TOTAL OTHER PRODUCTION	46,322,549	39,377,351
	TOTAL ELECTRIC PRODUCTION	1,486,757,137	634,757,735

No.	Account	Original Cost	Reserve for Depreciation and Amortization
350.1	Land	$ 17,020,216	$ 0
350.2	Land Rights	44,207,917	4,227,578
352	Structures and Improvements	41,373,294	10,063,525
353	Station Equipment	232,559,545	59,702,842
354	Towers and Fixtures	89,723,033	36,735,017
355	Poles and Fixtures	57,432,144	27,778,560
356	Overhead Conductors and Devices	115,802,501	65,399,005
357	Underground Conduit	13,282,086	2,163,130
358	Underground Conductors and Devices	16,468,859	5,167,180
359	Roads and Trails	10,596,196	1,923,336
	TOTAL TRANSMISSION	638,465,791	213,160,173
360.1	Land	7,169,126	0
360.2	Land Rights	46,538,439	10,582,588
361	Structures and Improvements	3,373,793	1,977,830
362	Station Equipment	129,208,401	30,749,008
364	Poles, Towers and Fixtures	198,886,583	92,829,703
365	Overhead Conductors and Devices	157,697,043	36,271,042
366	Underground Conduit	405,204,595	103,140,304
367	Underground Conductors and Devices	437,242,282	158,881,374
368.1	Line Transformers	205,776,625	56,207,939
368.2	Protective Devices and Capacitors	23,198,759	3,415,126
369.1	Services Overhead	55,687,752	62,156,662
369.2	Services Underground	132,263,630	49,549,298
370.1	Meters	58,761,143	16,979,911
370.2	Meter Installations	25,159,974	6,992,590
371	Installations on Customers' Premises	4,625,603	3,309,030
373.1	St. Lighting & Signal Sys.-Transformers	0	0
373.2	Street Lighting & Signal Systems	17,892,477	16,795,770
	TOTAL DISTRIBUTION PLANT	1,908,686,225	649,838,175

No.	Account	Original Cost	Reserve for Depreciation and Amortization
389.1	Land	$ 416,599	$ 0
389.2	Land Rights	0	0
390	Structures and Improvements	11,512,868	2,997,135
392.1	Transportation Equipment - Autos	90,678	140,446
392.2	Transportation Equipment - Trailers	241,013	120,331
393	Stores Equipment	101,888	32,918
394.1	Portable Tools	5,304,621	1,213,583
394.2	Shop Equipment	505,669	228,731
395	Laboratory Equipment	1,108,505	562,066
396	Power Operated Equipment	120,382	176,862
397	Communication Equipment	51,059,938	18,337,562
398	Miscellaneous Equipment	445,227	199,895
	TOTAL GENERAL PLANT	70,907,388	24,009,528
101	TOTAL ELECTRIC PLANT	4,105,207,382	1,522,133,826
GAS PLANT			
302	Franchises and Consents	86,104	86,104
303	Miscellaneous Intangible Plant	646,979	318,336
	TOTAL INTANGIBLE PLANT	733,083	404,440
360.1	Land	122,606	0
361	Structures and Improvements	412,998	293,430
362.1	Gas Holders	989,283	900,740
362.2	Liquefied Natural Gas Holders	0	0
363	Purification Equipment	0	0
363.1	Liquefaction Equipment	0	0
363.2	Vaporizing Equipment	0	0
363.3	Compressor Equipment	558,651	497,614
363.4	Measuring and Regulating Equipment	0	0
363.5	Other Equipment	0	0
363.6	LNG Distribution Storage Equipment	407,546	127,645
	TOTAL STORAGE PLANT	2,491,084	1,819,429

No.	Account	Original Cost	Reserve for Depreciation and Amortization
365.1	Land	$ 908,918	$ 0
365.2	Land Rights	629,232	478,092
366	Structures and Improvements	9,650,914	2,432,806
367	Mains	39,839,786	14,425,863
368	Compressor Station Equipment	42,294,858	9,258,270
369	Measuring and Regulating Equipment	4,986,183	3,068,589
371	Other Equipment	268,686	138,129
	TOTAL TRANSMISSION PLANT	98,578,577	29,801,750
374.1	Land	102,187	0
374.2	Land Rights	3,697,552	1,987,800
375	Structures and Improvements	193,651	213,011
376	Mains	308,926,793	126,355,691
378	Measuring & Regulating Station Equipment	3,767,384	2,299,301
380	Services	173,124,881	112,728,269
381	Meters and Regulators	46,189,154	18,301,146
382	Meter and Regulator Installations	37,113,048	11,588,193
385	Ind. Measuring & Regulating Station Equipment	675,429	430,205
386	Other Property On Customers' Premises		
387	Other Equipment	6,407,377	836,616
	TOTAL DISTRIBUTION PLANT	583,197,456	274,740,232
392.1	Transportation Equipment - Autos	3,552	28,991
392.2	Transportation Equipment - Trailers	16,706	(14,172)
394.1	Portable Tools	2,608,762	410,189
394.2	Shop Equipment	187,544	101,317
395	Laboratory Equipment	594,785	247,005
396	Power Operated Equipment	230,777	(25,918)
397	Communication Equipment	2,500,810	585,247
398	Miscellaneous Equipment	587,328	169,761
	TOTAL GENERAL PLANT	6,730,264	1,502,420
101	TOTAL GAS PLANT	691,730,464	308,268,271

No.	Account	Original Cost	Reserve for Depreciation and Amortization
COMMON PLANT			
303	Miscellaneous Intangible Plant	$ 17,793,273	$ 9,710,481
350.1	Land	460,335	0
360.1	Land	5,391	0
389.1	Land	6,956,226	0
389.2	Land Rights	27,776	10,393
390	Structures and Improvements	66,717,723	18,633,201
391	Office Furniture and Equipment	28,042,877	2,152,586
392.1	Transportation Equipment - Autos	145,059	(228,715)
392.2	Transportation Equipment - Trailers	260,239	58,515
393	Stores Equipment	495,507	279,432
394.1	Portable Tools	954,796	753,485
394.2	Shop Equipment	1,163,314	366,580
394.3	Garage Equipment	3,486,772	120,967
395	Laboratory Equipment	1,894,090	543,230
396	Power Operated Equipment	216,250	22,642
397	Communication Equipment	47,301,223	10,826,617
398	Miscellaneous Equipment	3,171,737	(97,706)
118.1	TOTAL COMMON PLANT	179,092,588	43,151,709
	TOTAL ELECTRIC PLANT	4,105,207,382	1,522,133,826
	TOTAL GAS PLANT	691,730,464	308,268,271
	TOTAL COMMON PLANT	179,092,588	43,151,709
101 & 118.1	TOTAL	4,976,030,434	1,873,553,806
102	Plant Purchased or Sold		
	Electric	3,787	0
	Gas	0	0
	TOTAL PLANT PURCHASED OR SOLD	3,787	0
105	Plant Held for Future Use		
	Electric	255,160	0
	Gas	0	0
	TOTAL PLANT HELD FOR FUTURE USE	255,160	0

No.	Account	Original Cost	Reserve for Depreciation and Amortization
107	Construction Work in Progress	$	$
	Electric	77,410,612	(4,989,187)
	Gas	28,678,110	(378,771)
118.3	Common	18,634,638	(4,422,413)
	TOTAL CONSTRUCTION WORK IN PROGRESS	124,723,360	(9,790,371)
108.5	Accumulated Nuclear Decommissioning		
	Electric	0	208,725,219
	TOTAL ACCUMULATED NUCLEAR DECOMMISSIONING	0	208,725,219
111.3	Capitalized Leases		
	Electric	124,751,597	52,103,068
	Gas	0	0
	Common	28,628,977	14,821,569
	TOTAL CAPITALIZED LEASES	153,380,574	66,924,637
114	ELECTRIC PLANT ACQUISITION ADJUSTMENT	0	0
120	NUCLEAR FUEL FABRICATION	27,476,943	7,646,368
	UTILITY PLANT TOTAL	$ 5,281,870,258	$ 2,147,059,659

Book cost is calculated by taking Orignal Cost less Reserve for Depreciation and Amortization.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the **APPLICATION OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902-M)** has been served on all parties of record to A.94-05-013 and A.92-10-017, properly stamped and addressed.

BY: Nancy A. Lopez

Nancy A. Lopez

DATE: November 7, 1994

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Application No. 94-11-____
Exhibit SDG&E-2
Administrative Law Judge _____

PROPOSED CORPORATE REORGANIZATION OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902-M)

PREPARED TESTIMONY
OF
ROSE B. AFTRETH

November 7, 1994

Before the
PUBLIC UTILITIES COMMISSION
OF THE
STATE OF CALIFORNIA

B/7

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QUALIFICATIONS

OF

ROSE B. AFTRETH

My name is Rose B. Aftreth. I am Manager of the Accounting Systems Department of San Diego Gas & Electric Company. My business address is 101 Ash Street, San Diego, California 92101.

I received a Bachelor of Science degree, magna cum laude, from San Diego State University in Business Administration, with an emphasis in Accounting, in 1977. I joined SDG&E's Operations Analysis & Audit Department in 1983 after working six years in Public Accounting as an Auditor, Senior Auditor, and Audit Supervisor. I am a Certified Public Accountant.

I conducted operational and financial reviews for SDG&E departments during the six years I worked in the Operations Analysis & Audit Department as a Senior Auditor. I am a Certified Internal Auditor. In 1989, I became Senior Accountant in the Accounting Services Department responsible for fuel accounting and financial reporting. While in that position I assisted in identifying proposed merger benefits with Southern California Edison, and I coordinated the Administrative and General (A&G) portion of SDG&E's 1991-1995 Business Plan and the 1993 General Rate Case. In 1993, I became Principal Accountant in the General Accounting Department and was responsible for leading the Accounting Information Team. In August 1993, I became Manager of the General Accounting Department and was responsible for Payroll, Accounts Payable, and the Accounting Information Team. In 1994, I assumed my present position as Manager of the Accounting Systems Department responsible for providing strategic direction and support for the accounting systems

and related infrastructure.

I have previously provided testimony before the California Public Utilities Commission.

The purpose of my testimony is to sponsor Exhibit SDG&E-2 which addresses transactions between SDG&E, the holding company and SDG&E affiliates.

I.

INTRODUCTION

The purpose of this testimony is to describe policies and guidelines to be observed in all business transactions between San Diego Gas & Electric Company (SDG&E), its holding company SDO Parent Co., Inc. ("Parent Company"), and non-utility affiliates under the reorganized holding company structure. All transactions between these parties are to be guided by the policies and guidelines stated in Attachment A to this Exhibit, which have been developed to facilitate prompt and fair compensation or reimbursement for all assets, goods and services transferred between SDG&E, Parent Company and non-utility affiliates.

SDG&E, Parent Company, and each non-utility affiliate will be responsible for implementation of these policies and guidelines within its own organization. Each entity will develop procedures to ensure that its employees are cognizant of, and can properly implement, the policies and guidelines. All intercompany transactions will be adequately documented. Internal control measures will be reviewed, tested and monitored to ensure that policies are observed and that potential or actual deviations are detected and corrected. These policies and guidelines may be modified as experience dictates, in order to ensure fair reimbursement of costs associated with transactions between SDG&E and its affiliates on an ongoing basis. In addition, where warranted under the circumstances and approved by the California Public Utilities Commission ("Commission"), SDG&E and its affiliates may deviate from these policies and guidelines.

II.

BUSINESS ARRANGEMENTS BETWEEN SDG&E AND AFFILIATES

Pursuant to California Public Utilities Code Sections 587 and 797, the Commission currently reviews SDG&E's transactions with its affiliates to assure that utility customers are not disadvantaged by such dealings. The proposed reorganization will not diminish the Commission's ability to review such transactions effectively.

SDG&E will keep a record of all transactions, whether involving the transfer of assets or the use of goods and services, that occur between SDG&E and the Parent Company or its non-utility affiliates. This record will identify the nature of each transaction and the terms and conditions applying to it. SDG&E will work closely with the Commission Staff to refine this practice as necessary to ensure clear and complete recording of transactions that may require Commission review.

Attachment A outlines policies and guidelines for asset transfer-pricing which will govern these types of transactions within the proposed holding company structure. Should any transfer of a utility asset to any affiliate occur, SDG&E will charge the affiliate fair market value. If SDG&E acquires an asset of an affiliate, SDG&E will pay the affiliate the fair market value of the asset. If the affiliate's cost for the asset exceeds the fair market value, the affiliate will bear the loss; if the affiliate's costs are less than fair market value, it will receive the benefit. In either case, SDG&E customers will be fully protected and not disadvantaged by the transaction because no utility subsidy will occur. The effect on SDG&E customers will be no different than if SDG&E had acquired the asset from an independent third party.

Attachment A also outlines transfer-pricing guidelines for goods and services. SDG&E will charge affiliates the higher of fully loaded cost, or fair market value, for any goods or services not produced for sale which SDG&E may provide. SDG&E will pay affiliates the lower of fully loaded cost or fair market value, for any goods or services not produced for sale by them. Goods or services produced for sale by either SDG&E or its affiliates will be sold at fair market value to the other. These policies will eliminate the possibility of any subsidy occurring as a result of the affiliates' use of SDG&E services, or vice-versa.

In SDG&E's 1993 General Rate Case, SDG&E agreed to endorse the Commission's Division of Ratepayer Advocates' proposal to bill its affiliates "fully loaded costs plus 5%" for services SDG&E provides to them. However, in order to be consistent with the decision of the Commission on Southern California Edison's holding company application (27 CPUC 2d 347 (1988)), this methodology should be modified to attach the 5% markup to fully loaded labor only. SDG&E believes this methodology more appropriately identifies labor as the primary cost driver for services provided to its affiliates.

III.

UTILITY HUMAN RESOURCES

As further discussed in Attachment A, with the exception of the fully compensated sharing of a small number of corporate officers, SDG&E will follow a policy of maintaining at all times a utility management team dedicated solely to utility activities so that utility operations will not be neglected by management as a result of affiliate activities.

This concludes my testimony.

ATTACHMENT A

SDO PARENT CO., INC.

CORPORATE POLICIES AND GUIDELINES FOR AFFILIATE TRANSACTIONS

November 7, 1994

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DEFINITIONS

Affiliate: Any individual subsidiary company within the holding company structure.

Cost of Sales: The direct cost of goods sold during an accounting period (for SDG&E consists of fuel, purchased power and the provision for regulatory adjustment clause).

Fair Market Value: The price at which a willing seller would sell to a willing buyer, neither under a compulsion to buy or to sell. If no market is determinable, a surrogate formula of fully loaded costs will be used.

Fully Loaded Cost: The amount at which goods or services are recorded in the transferor's accounting records. It includes all applicable direct charges such as fully loaded labor costs (see Appendix A), indirect charges and overheads.

Fully Loaded Labor: Base pay, related labor loadings, plus a 5% markup. See Appendix A for detail.

Intangibles: An asset having no physical existence, its value being limited by the rights and anticipated benefits that possession confers upon the owner. Includes copyrights, patent rights, trade secrets, licenses, franchises, etc.

Net Book Value: The original cost of an asset, reduced by accumulated depreciation.

Non-utility Affiliate: Affiliate companies that are established and operated wholly at the risk of the shareholders and are not subsidized by utility customers. Non-utility affiliate profits or losses are assigned to the shareholders.

Parent Company: The abbreviated version of "SDO Parent Co., Inc.," which will be the interim name for the parent in the new holding company structure.

Personal Property: Movable property or assets such as automobiles, equipment, furniture, etc.

Real Property: Land and land improvements, including buildings, building improvements, etc.

Transfers of Goods and Services: Items of merchandise or work provided by one affiliate to another.

I. INTRODUCTION

A. Purpose

The purpose of these policies and guidelines is to set forth business practices to be observed in the transactions between San Diego Gas & Electric Company (SDG&E), non-utility affiliates, and Parent Company, after the reorganization of SDG&E into a holding company structure. All transactions between these parties are to be guided by the policies and guidelines stated herein. These policies and guidelines may be modified as experience dictates, in order to ensure fair reimbursement of costs associated with transactions with affiliates on an ongoing basis. In addition, where warranted under the circumstances and approved by the California Public Utilities Commission (CPUC), Parent Company, SDG&E and non-utility affiliates may deviate from these policies and guidelines.

These policies and guidelines have been developed to ensure that prompt and fair compensation or reimbursement is given/received for all assets, goods and services transferred between SDG&E, Parent Company and non-utility affiliates and that information reported to Parent Company meets the reporting requirements to which SDG&E and Parent Company are subject. The flow of information, and transfers of assets, goods and services among these parties is to be conducted in accordance with the policies put forth in this document.

B. Implementation

Each affiliate and Parent Company will be responsible for implementation of these policies within its own organization. Procedures will be developed by each affiliate to ensure that affiliate employees are cognizant of, and can properly implement, the following policies and guidelines. All intercompany transactions will be adequately documented. Internal control measures will be reviewed, tested and monitored to ensure that policies are observed and that potential or actual deviations are detected and corrected.

In the event a situation arises that has not been addressed by the policies and guidelines contained herein, the situation shall be brought to the attention of the applicable officers of SDG&E, if SDG&E is involved, otherwise officers of Parent Company, for review and/or approval.

C. Organizational Guidelines for Transactions with SDG&E

1. Non-utility Affiliates

As a general policy, resource sharing and intercompany transactions will be minimized to assure sufficient separation between SDG&E and the non-utility affiliates. The following corporate organizational objectives have been established to promote SDG&E/affiliate separation:

- Non-utility affiliates will acquire, operate and maintain their own facilities and equipment, where feasible.
- Non-utility affiliates, to the extent practical, will retain their own administrative staffs.
- Non-utility affiliates will provide, to the extent practical, their own financial needs, i.e., banking arrangements, credit lines, insurance requirements, etc.

2. Parent Company

Parent Company will be organized in a manner which results in effective control and efficient utilization of SDG&E services. Initially, there will be shared corporate officers and directors between SDG&E and Parent Company. This organizational structure will remain in effect until experience dictates the necessary staffing for Parent Company. The utilization of existing SDG&E departments to provide the minimal level of services required by Parent Company will result in efficiencies in the near term.

Corporate functions such as shareholder services, corporate accounting and consolidation, and business planning and budgeting will be performed by SDG&E employees; the fully loaded cost of these services will be billed to Parent Company and other affiliates. As discussed in detail in Section II-D, the cost of these services will be allocated by SDG&E using a three-step process:

- The first step consists of directly assigning to SDG&E, the Parent Company, and non-utility affiliates all costs for services which have been specifically requested by them. For example, direct labor costs of employees in the SDG&E Law Department which provide legal research requested by the Parent Company or non-utility affiliates, will

be directly charged based on the employees' wage rates, including all labor loadings plus 5% markup (see Appendix A). Some costs, such as organizational expenses related to the establishment of Parent Company, will not be allocated to SDG&E or non-utility affiliates.

- The second step involves allocating indirect costs of corporate functions which benefit more than one affiliate but the benefit to each affiliate is not quantifiable. Indirect costs which are functionally related will be allocated based on causal or beneficiary relationships. For example, the cost of shareholder services will be allocated based on equity investment and advances to affiliates.

- The third step consists of allocating remaining indirect costs by a formula representing the overall activity of each affiliate. The formula will be based on each affiliate's proportionate share of (1) total assets, (2) operating revenues, (3) operating and maintenance expense, and (4) number of employees. The factors included in the formula will be reviewed in conjunction with each general rate case, or other appropriate regulatory forum, in intervening years.

Fully loaded compensation and expenses of the shared utility corporate officers (including their support personnel) will be allocated to Parent Company and non-utility affiliates based upon the higher of (1) the fully loaded actual cost which reflects the executives' oversight provided or (2) five percent of the fully loaded costs of the shared officers and their support personnel.

II. TRANSFERS OF ASSETS, GOODS OR SERVICES

A. General

The purpose of the corporate transfer-pricing policies and guidelines in this section is to assign a monetary value to all assets, goods or services transferred between SDG&E and Parent Company or non-utility affiliates. The transfer-pricing methodology will ensure that transactions between SDG&E and the affiliates do not harm SDG&E or its customers.

The objectives to be achieved in accounting for transfers between affiliates involve the appropriate (1) identification, (2) valuation and (3) recording of transactions between SDG&E and Parent Company or non-utility affiliates. There are three general types of transfers that will occur:

- Transfers of assets or rights to use assets.
- Transfers of goods or services produced, purchased or developed for sale.
- Transfer of goods or services not produced, purchased, or developed for sale.

Transfers of assets or rights to use assets and transfers of goods or services produced, purchased or developed for sale will be priced at fair market value. Transfers of goods or services not produced, purchased or developed for sale will be priced at the higher of fully loaded cost or fair market value for sales from SDG&E to Parent Company or an affiliate, and at the lower of fully loaded cost or fair market value for sales from Parent Company or an affiliate to SDG&E.

B. Transfers of assets or rights to use assets

1. **Identification:** Transfers of assets include transfers of tangible real or personal property and intangible property used in a trade or business. Transfers of assets also include long-term rights to use assets through lease or other arrangements for in excess of one year.

   Real property includes:

   - Land
   - Buildings
   - Improvements

- Mineral rights

Personal property includes:

- Automobiles
- Power-operated equipment
- Computer hardware and related software applications
- Furniture

Intangible assets include:

- Copyrights
- Patent rights
- Trade secrets
- Royalty interests
- Licenses
- Franchises

Examples of intangible assets that may be transferred include patent rights, that arise out of research and development programs, and pole attachment rights.

2. **Valuation:** Transfers of assets or rights to use assets will be valued at fair market value, which will be determined through methods appropriate for the asset. Examples of methods that may be used include:

- Appraisals from qualified, independent appraisers.
- Averaging bid and ask prices as published in newspapers or trade journals.
- Conducting market surveys.

The determination of fair market value must be adequately documented to ensure that a proper audit trail exists.

Where product rights, patents, copyrights or similar legal rights are transferred from SDG&E to Parent Company or any non-utility affiliates, in addition to the payment of fair market value, a royalty payment may be required to ensure that utility customers receive appropriate compensation. Such royalty payments shall be developed on a case-by-case basis.

The Commission's disclosure procedures as set forth in OIR-2 or successor proceedings will apply to market, technological or similar data

relating to the production of electricity by a Qualifying Facility in which an affiliate has an ownership interest.

3. **Recording:** Transfers of assets or rights to use assets will be recorded through a direct charge based on fair market value to the recipient of the transferred asset. However, in order to ease administrative burdens for immaterial transfers, if the net book value and the estimated fair market value of a transferred asset are each equal to or less than $100,000, the transfer may be priced at net book value at the transferor's option.

C. Transfers of goods or services produced, purchased or developed for sale.

1. **Identification:** Transfers of goods or services produced, purchased or developed for sale includes those goods or services intended for sale in the normal course of the affiliate's business. (SDG&E's only service produced for sale is its regulated utility service. Therefore, SDG&E generally would not have transfers of goods or services that would be priced according to the guidelines outlined in this subsection.)

   Goods or services produced, purchased or developed for sale could include:

   - Office space rental
   - Engineering services
   - Facility operations and maintenance services

   The above goods or services would generally be transfers from one non-utility affiliate to another. Goods or services produced, purchased or developed for sale would usually be the product of resources which are planned and dedicated to providing the goods or services.

2. **Valuation:** Transfers of goods or services produced, purchased or developed for sale will be valued at fair market value. For purposes of applying this policy, fair market value may be based upon:

   - Reference to current realizable values in comparable cash transactions of similar goods or services between non-affiliated parties

- Published prices
- Rates established by a regulatory agency

The determination of fair market value must be adequately documented.

3. **Recording:** Transfers of goods or services produced, purchased or developed for sale will be recorded through a direct charge to the recipient based upon the fair market value of the goods or services.

D. Transfers of goods or services not produced, purchased or developed for sale.

1. **Identification:** Transfers of goods or services not produced, purchased or developed for sale represents services provided that are incidental to the main business of the provider of the services. This is not intended to include capital assets. Examples include:

   - Cost of services provided by SDG&E to Parent Company or other affiliates
   - Data processing
   - Incidental use of vehicles or office space
   - Small tools

   Corporate functions such as shareholder services, corporate accounting and consolidation, and business planning and budgeting will be performed for Parent Company by SDG&E employees. In addition, the affiliates may contract with SDG&E for the services of certain support personnel in those instances where it is not practical for the affiliate to have its own administrative staff. Use of SDG&E employees by the affiliates will require approval of the appropriate officer. These transactions are covered by the transfer-pricing guidelines contained within this subsection.

2. **Valuation:** Transfers of services not produced, purchased or developed for sale will be valued at the higher of fully loaded cost or fair market value for sales from SDG&E to Parent Company or an affiliate and at the lower of fully loaded cost or fair market value for sales from Parent Company or an affiliate to SDG&E.

3. **Recording:** Transfers and affiliate allocations will be performed and calculated by SDG&E. Costs will be distributed to Parent Company or non-utility affiliates depending on the nature of the transaction using a three-step process: 1) specifically identifiable costs will be charged directly to the entity requesting and benefiting from the services; 2) indirect costs which have a causal or beneficiary relationship will be proportionately allocated by that causal factor to Parent Company or non-utility affiliates; and 3) remaining indirect costs will be allocated by a multi-factor formula representing the overall activity of Parent Company or each affiliate. The detail of this three-step process follows.

i) Step #1: Costs will be directly assigned to the entity requesting and benefiting from the goods or services. Examples of direct charges include:

- Directly Assigned Labor Costs, including applicable loadings of employees in SDG&E departments which provide requested services to Parent Company or non-utility affiliates. This could include personnel in departments such as:
  - Operations Analysis and Audit
  - Accounting Operations
  - Business Planning and Budgeting
  - Law
  - Tax

Directly assigned labor costs will be based on the wage rates of assigned employees including supervisory and support personnel and the actual number of hours devoted to providing service. Labor loadings include paid time off, payroll taxes, and pensions and benefits. A five percent mark-up will be added to the fully loaded labor cost of SDG&E employees providing direct services to Parent Company or the affiliates. The five percent mark-up is intended to cover all unidentified costs, if any, which are related to non-utility operations but which are not otherwise included.

- Purchases of goods and services including:

- Materials, including applicable purchase and warehousing expense
- Office supplies
- Outside auditors' fees
- Outside legal fees

- Required Payments such as:

  - Income taxes (See Section IV)
  - Property taxes

- Office, Vehicle and Equipment Costs, which will be based on usage of:

  - Transportation vehicles
  - Construction equipment
  - Office equipment
  - Computer equipment
  - Facilities

ii) Step #2: Indirect costs for corporate functions performed by SDG&E will be allocated on the basis of causal or beneficiary relationships. Indirect costs relate to shared corporate functions for which it would be impractical or unreliable to record actual time incurred.

Indirect costs which are functionally related will be accumulated into cost pools and allocated on the basis of causal or beneficiary relationships. The allocated costs will include labor loadings, excluding the 5% markup. Examples of indirect costs and factors that will be used to allocate them include:

- Equity investment and advances to Parent Company or affiliates to allocate the cost of providing services, such as:

  - Shareholder services
  - Investor relations
  - Long-term finance

- Number of employees to allocate the cost of providing services such as:

- Payroll services
- Employee services
- Pension investment management

iii) Step #3: Remaining indirect costs will be allocated by a formula representing the overall activity of Parent Company or each affiliate.

Those indirect costs incurred by SDG&E that cannot be allocated using steps #1 and #2 above will be apportioned based on a formula which reflects the overall level of activity of Parent Company or each affiliate.

The allocation formula will be based upon Parent Company or each affiliate's proportionate share of the following factors:

- Total assets
- Operating revenues
- Operating and maintenance expense* (excluding cost of sales and income taxes)
- Number of employees (including equivalent personnel of affiliates providing direct services)

There will be an equal weighting of each factor, thereby recognizing each affiliate's portion of overall corporate activity as measured by total financial resources, revenues, cost of operations and employee force. The composite of the above factors will be used to allocate the fully loaded cost of SDG&E departments such as:

- Corporate communications
- Risk management (insurance costs other than certain premiums)
- Telecommunications

Some costs, such as organizational costs related to the establishment of Parent Company, and acquisition and development activities, will be absorbed by Parent Company or non-utility affiliates and not allocated to SDG&E.

* Operating and Maintenance Expense includes all labor costs of personnel of affiliates providing direct services, even if classified under cost of sales.

III. INTERCOMPANY BILLINGS AND PAYMENTS

A. General

Billings for intercompany transactions shall be issued on a timely basis, generally monthly for goods or services and at the time of transfer for assets. Sufficient detail will be provided to ensure an adequate audit trail and enable the prompt reimbursement from the recipient of the assets, goods or services.

B. Intercompany Billings

Intercompany billings issued for transfers of assets, goods or services will be accompanied by supporting documents. Transfer-pricing computations must be documented in order to facilitate verification of methods used to compute cost or fair market value of transferred assets, goods or services. Costs incurred on behalf of Parent Company, SDG&E or non-utility affiliates will be accumulated, priced and billed by the end of the following month to enable timely payment.

In order to simplify the accounting entries required, only the net non-utility affiliate portion of SDG&E's shared resources will generally be allocated to Parent Company. None of these costs are to be reallocated to SDG&E. To the extent practical, shared costs will be billed directly by SDG&E to non-utility affiliates on behalf of Parent Company. This policy will create a simplified and more direct audit trail.

C. Intercompany Payments

Payments for assets, goods or services received from an affiliate shall be made within thirty (30) days after receipt of the invoice. If reimbursements are not received by the payment due date, late charges will be assessed by the billing company. Intercompany billings and payments will be adequately documented so that an audit trail exists to facilitate verification of the accuracy and completeness of all billings and reimbursements. See Section IV for billing and payment procedures applicable to federal and state income taxes.

IV. INCOME TAX ALLOCATION

A. General

It is Parent Company's responsibility to file consolidated federal and state income tax returns which include the affiliates' taxable income or loss to the extent permitted by applicable laws and/or regulations. The tax liability or benefit resulting from the affiliates' taxable income or loss is passed on to the affiliate to coincide with Parent Company's cash payments or cash receipts related to income taxes.

B. Income Tax Allocation Methodology

The "stand-alone" method will be used to compute the income tax expense of SDG&E and the other affiliates. An affiliate with taxable income will pay Parent Company the amount indicated, while an affiliate with a taxable loss will receive current payment from Parent Company in the amount of tax refund. The payment made to an affiliate with a tax loss will equal the amount by which the consolidated tax is reduced by including the affiliate's net corporate tax loss in the consolidated tax return.

The "stand-alone" basis of income tax allocation requires that each affiliate account for the tax effects of the revenues, deductions and credits for which it is responsible. No affiliate will be allocated an amount for income taxes which is greater than the income tax computed as if such member had filed a separate return. This method is in agreement with the CPUC's established policy for income tax allocation, as discussed in Decision 84-05-036, resulting from Order Instituting Investigation No. 24.

C. Billing and Payment Procedures

Billings for federal and state income taxes will include all supporting calculations to facilitate timely payment. Estimated tax installments are paid to the Internal Revenue Service and the California Franchise Tax Board on the fifteenth day of April, June, September and December. A final payment is due by March 15 of the following year. If the total payments exceed the amount shown on the return, which is normally filed in September (federal) or October (state), a refund (or application to apply the overpayment to a subsequent estimated tax payment) will be requested at that time. The timing of payments made by the affiliates for their tax liabilities (or payments received by affiliates for their tax benefits) will coincide with the payments or refunds (or reduced payments in lieu of refunds) which the affiliates' taxable income or losses affected.

V. FINANCIAL REPORTING

A. General

All affiliates are expected to provide the monthly or other financial information necessary to compile Parent Company's consolidated financial statements and to comply with other internal or external reporting requirements.

B. Financial Reporting Requirements

The financial information to be reported by the affiliates is to include, but is not necessarily limited to, the following:

- Balance sheet
- Income statement
- Cash flow statement

C. Reporting of Intercompany Transactions

The following transactions between SDG&E and an affiliate must be reported in sufficient detail to include nature and terms thereof:

- Transfers of assets, goods or services
- Borrowings and loans
- Receivables and payables
- Revenues and expenses
- Interest
- Identification of utility employees who provide services to affiliates

D. Specifications

The financial reporting and intercompany transaction information forwarded by the affiliates must meet the following specifications:

1. **Consistent format:** The format of the financial information submitted by each affiliate will be dictated by Parent Company's reporting requirements.

2. **Time Constraints:** Affiliate companies' financial information must be submitted within the time constraints set by Parent Company. Conformance with the established time frame is required in order to meet the deadlines for preparing consolidated financial statements.

3. **Conformance with GAAP:** The management of each affiliate (with help from Parent Company as applicable) is responsible for accumulating and preparing financial information in accordance with generally accepted accounting principles (GAAP) applied on a consistent basis. Year-end audited financial statements are to be accompanied by notes summarizing significant accounting policies and other disclosures required by GAAP to make the financial statements more meaningful.

4. **Regulatory Agencies:** Accounting practices mandated by regulatory agencies are to be observed when an affiliate is within the agency's jurisdiction. In addition, affiliates are to comply with the reporting requirements placed on Parent Company by regulatory agencies. Information regarding intercompany transactions must be presented in a form and manner which will assist in the regulatory review of those transactions.

VI. INTERNAL CONTROLS

A. General

Internal accounting controls will be reviewed, tested and monitored by SDG&E, Parent Company and non-utility affiliates to provide reasonable assurance that:

1. Intercompany transactions are executed in accordance with management's authorization and properly recorded.

2. Assets are safeguarded.

3. Accounting records may be relied upon for the preparation of financial statements and other financial information.

B. Internal Control Requirements

The internal accounting controls include the following elements:

1. **Documented Procedures:** All accounting policies and procedures for transactions between SDG&E and Parent Company or non-utility affiliates will be fully documented. The affiliates will develop the necessary procedures and controls to ensure adherence to the corporate policies. The policies and procedures will be approved by Parent Company. Measures must be taken to ensure that the procedures are made available to and are observed by all employees. These procedures will be refined as necessary to ensure the accurate and complete recording of all transactions.

2. **Record Maintenance:** Records will be kept by each affiliate to substantiate its books and financial statements. All intercompany transactions will be documented by records of sufficient detail to facilitate verification of relevant facts. Transfer prices are to be approved by the appropriate officer and will be monitored to assure compliance with transfer-pricing policies.

   In addition to accounting records, each affiliate will maintain other pertinent records such as minute books, stock books, reports and correspondence. The affiliates' records will be retained for the period of time required by corporate and regulatory (IRS, CPUC, FERC, etc.) record-retention policies.

3. **Budgeting:** Affiliates will be responsible for allocating resources and controlling costs. Budgets will be prepared as required for capital expenditures, operating expenditures and personnel staffing. These budgets will be supported by subordinate budgets in sufficient detail to be used as a guide during the budget period.

   Managers will monitor budget performance and take action, if necessary, to control costs. Budgets will be used as a tool to detect and provide early warning of variances from planned expenditures. Explanations for substantial variances will be provided as soon as they are detected.

4. **Audits:** Each affiliate must retain auditors to provide audited financial statements. The audits may be performed by internal auditors or outside public accountants. The decision to use an outside public accountant or internal auditors to satisfy the affiliate's auditing requirements resides with the affiliate's Board of Directors. Parent Company has the right to initiate any audit of affiliate activities it deems necessary. The cost of auditing services performed for affiliate companies will be borne by the affiliate, even when Parent Company initiates the audit.

   Intercompany transactions and related transfer prices will be audited to ensure that policies are observed and that potential or actual deviations are detected and corrected in a timely and cost efficient manner. The CPUC has statutory authority to inspect the books and records of Parent Company and its non-utility affiliates as they regard transactions with SDG&E under the same terms as it may inspect SDG&E's books and records.

VII. EMPLOYEE TRANSFERS

A. General

Transfers of SDG&E employees between SDG&E and one or more of its affiliates will not come at the expense of the utility business.

B. Employee Transfer Guidelines

The following guidelines will be utilized for employee transfers:

1. The staffing of the non-utility affiliates will not be to the detriment of SDG&E.

2. In instances where it may be desirable to move an SDG&E employee to a non-utility affiliate, officer approval of both companies involved in the transfer will be required before the transfer can occur.

3. SDG&E employees will be free to accept or reject employment with the non-utility affiliates and no involuntary transfers will take place.

4. If an SDG&E employee elects to accept a position with a non-utility affiliate, he or she will be required to resign from SDG&E.

C. Reporting of Employee Transfers

SDG&E will provide to the CPUC an annual report identifying all employees transferred from SDG&E to Parent Company or to any non-utility affiliate.

APPENDIX A

COMPONENTS OF FULLY LOADED LABOR COST FOR SDG&E EMPLOYEES

- Wages and Salaries
- Paid Time Off
- Legally Required Payments
    - Social Security (FICA)
    - Unemployment Tax (FUTA & SUI)
    - Worker's Compensation
    - Other Employer Payroll Taxes

- Pensions and Benefits
    - Retirement Plan
    - Severance Payments
    - Savings Plan
    - Life Insurance
    - Health, Dental and Eye Care
    - Long-term Disability Payments
    - Employee Clubs and Recreation
    - Employee Moving Expense

- Five Percent Labor Mark-up*

* The mark-up of five percent on fully loaded labor cost is intended to cover all unidentified costs, if any, which are related to Parent Company or non-utility affiliates but which are not otherwise included. SDG&E intends that this labor cost mark-up take effect on January 1, 1996.

Application No. 94-11-____
Exhibit SDG&E-1
Administrative Law Judge _____

PROPOSED CORPORATE REORGANIZATION OF SAN DIEGO GAS & ELECTRIC COMPANY (U 902-M)

PREPARED TESTIMONY
OF
HENRY P. MORSE, JR.

November 7, 1994

Before the
PUBLIC UTILITIES COMMISSION
OF THE
STATE OF CALIFORNIA

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QUALIFICATIONS
OF
HENRY P. MORSE, JR.

My name is Henry P. Morse, Jr. I am a Division Manager responsible for overseeing San Diego Gas & Electric Company's proposed holding company organizational activities. My business address is 101 Ash Street, San Diego, California 92101.

I received a Bachelor of Science degree in 1973 and a Master of Arts in Management in 1986, both from the University of Redlands. I joined SDG&E in 1973 as an Associate Engineer. I have held numerous positions in the Company including Supervisor of Financial Planning, Manager of Investor Relations, Manager of Regulatory Affairs, Manager of Major Accounts Marketing, Manager of Financial Planning and Analysis, Group Manager - Strategic Plans and Projects, and Division Manager - Finance Division and Acting Treasurer.

I have previously testified before the Commission in various proceedings.

The purpose of my testimony is to sponsor Exhibit SDG&E-1 which is the policy testimony for SDG&E's proposed corporate reorganization.

CHAPTER I

REASONS FOR CORPORATE RESTRUCTURING

I.

THE HOLDING COMPANY STRUCTURE IS CONSISTENT WITH INCREASED COMPETITION AND INDUSTRY RESTRUCTURING

The purpose of this Application is to obtain authorization from the California Public Utilities Commission ("Commission") for San Diego Gas & Electric Company ("SDG&E") to reorganize into a holding company structure. Over the long-term, a holding company structure will facilitate SDG&E's progressive and efficient movement toward and into electric industry restructuring which, pursuant to the Commission's Restructuring OIR (the "Blue Book," OIR 94-04-031, April 20, 1994), is intended ultimately to lower customer energy costs. SDG&E anticipates that various existing utility business components which are now regulated will become part of a competitive industry and will, of necessity, need to be removed from the regulated utility business structure into separate unregulated or partially regulated business environments. A holding company structure such as is proposed herein, as compared to SDG&E's existing corporate structure, will facilitate and expedite these anticipated long-term developments.

SDG&E has operated as a vertically integrated electric utility for over a century. During this time, SDG&E has been completely responsible for planning, financing, constructing and operating the generation, transmission and distribution facilities required to serve its customers. Most recently, partial deregulation of electric service, through the implementation of the Public Utilities Regulatory Policy Act of 1978 ("PURPA"), introduced new suppliers of generation. Propelled by the proceedings initiated by the Blue Book, this advancement toward competition and restructuring has

increased in momentum. Ultimately, a central purpose of the restructuring of the electric utility business is to produce lower prices and better products and services for customers.

To restructure electric utility service and establish competition, many of the components of the electric delivery chain will become deregulated and more competitive. In effect, the electric utility business will "de-integrate." This has been the case in electric generation with the entry of qualifying facilities ("QFs") and independent power producers ("IPPs") into the marketplace. Over the last 3 years, over 50% of the newly constructed electric generation facilities in the United States has been built by non-utilities. During this period of change, SDG&E has worked hard to remain the supplier of choice, meeting customers' needs with the lowest electric rates among California's major investor-owned utilities. SDG&E intends to continue to be a key supplier of electric service in the new restructured environment providing products and services in regulated and competitive markets. As more of the traditional electric service becomes deregulated, however, it will become increasingly necessary to separate SDG&E's regulated activities from SDG&E's competitive enterprises. The separation afforded by a holding company structure is the best means to facilitate the goals of both customers and shareholders in the new restructured environment.

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II.

CONTINUED RESTRUCTURING OF OUR INDUSTRY REQUIRES A BUSINESS STRUCTURE THAT WILL PROTECT THE INTERESTS OF CUSTOMERS

The Commission has, through its policies to implement PURPA, facilitated the development of a new class of non-utility generators of electricity. The success of this policy over the past decade has introduced competition into the generation segment of the electricity business where once there was none. With the number of non-utility players involved, this competition will only increase.

The issuance of the Blue Book has most likely accelerated the inexorable process that was started in 1978 towards a new industry structure where generation is a non-regulated competitive business. The plan for SDG&E's reorganization will allow SDG&E to operate its remaining regulated utility efficiently and effectively, while providing the "platform" for separating the competitive generating business from the regulated utility business whenever that separation becomes appropriate.

As the utility industry continues to evolve, it is possible that current "monopoly" business segments other than generation will also evolve into competitive businesses, or will need to be separated from the core utility business for structural reasons. Three potential candidates for industry restructuring are the generation dispatch function, transmission facilities, and demand-side management programs and services. Again, the proposed reorganization provides the appropriate "platform" to facilitate such separations if and when that becomes appropriate. SDG&E believes that at present the opportunity exists to establish the holding company structure "platform" while the Commission considers

further evolution of the utility industry.

It is imperative that such separation ultimately take place to reduce the risk and increase the benefits to our regulated utility's customers. It is well known that competitive businesses by their nature are unpredictable, as that is the way of competition. That unpredictability leads potentially to volatile, fluctuating earnings. If that volatile earnings stream became a part of the core regulated utility, it would create earnings risk and volatility that could have an undesired impact on the assessment of the utility by the financial community, including bond rating agencies, which could precipitate a downgrade in bond ratings. Such a downgrade could increase capital costs for the core utility, causing a higher cost of service and higher rates than would otherwise be necessary. With the separation between the core regulated utility and competitive business segments provided by a holding company structure, the rating agencies would look only at the more stable utility to determine its appropriate bond rating, uninfluenced by the volatility of the earnings of the unregulated enterprises.

There has always been substantial separation between SDG&E and its unregulated subsidiaries. The proposed reorganization increases the degree of separation because SDG&E will no longer own the diversified companies, thus the only relationship between SDG&E and its affiliate subsidiaries will be the common ownership by the holding company, SDO Parent Co., Inc. ("Parent Company"). This structure will create a better-defined separation that will interpose an additional substantial legal barrier between the utility and creditors of an affiliate. This separation will benefit SDG&E's utility customers over both the short- and long-term by

strengthening barriers to utility subsidization of unregulated business activities.

III.

A HOLDING COMPANY STRUCTURE WILL ENHANCE SDG&E'S ABILITY TO RESPOND MORE QUICKLY TO INDUSTRY RESTRUCTURING

The proposed holding company structure will allow SDG&E the flexibility to respond efficiently to a deregulated marketplace. As previously mentioned, some of the more obvious considerations include: (1) the potential separation of generation assets selling power at market prices to customers that are within and outside of SDG&E's franchise territory; (2) the potential separation of transmission assets that can be consolidated with assets of other utilities at a broader market level; and (3) potential competition for the opportunity to provide demand-side management programs. All these proposals have one common theme -- the terms of electric service will be set by customers and competition. SDG&E's success will rely on SDG&E's ability to meet customer needs better than the competition. SDG&E's ability to respond quickly and efficiently to customers will depend on its capacity to deploy capital, labor and all other resources at a competitive cost with flexibility equal to that of other providers. SDG&E's success in this endeavor will benefit not only to its customers, but also state and local economies and the communities served by SDG&E.

As restructuring progresses, there will be some elements of the delivery chain that need to remain regulated or will take more time to evolve to a more competitive structure. As the de-integration of SDG&E evolves into utility and non-utility enterprises, the holding company structure will provide a clear separation, thereby insuring

that each business stands on its own. This separation will allow the Commission full authority to regulate utility service effectively while opening up for competition elements of electric service that will result in benefits to customers.

From a shareholder's perspective, a holding company structure is the most efficient platform from which to respond to the de-integration of the regulated utility. A holding company structure allows SDG&E shareholders the opportunity to maintain ownership of existing assets (generation, transmission, etc.) and preserve the value of these assets if they become separate businesses as a result of industry restructuring. The proposed reorganization continues ownership by existing shareholders, under one legal entity with ownership of common stock in Parent Company, while the fundamentals of the business change to regulated and non-regulated activities.

IV.

THE RESTRUCTURING WILL PROVIDE GREATER FINANCING FLEXIBILITY

The reorganized structure proposed herein will permit the use of financing techniques that are more directly suited to the particular characteristics and risks of non-utility operations, without any impact on the capital structure or credit of SDG&E. A holding company structure facilitates raising utility and non-utility capital by allowing financing to be done at the appropriate corporate level with optimal terms, providing benefits to utility customers and shareholders alike. Parent Company will be able to choose securities for the unregulated businesses tailored to specific risks or investors' requirements. Parent Company will also be able to design and implement the capital structure appropriate for each such enterprise.

The holding company structure will maintain the financial integrity of the regulated utility. Parent Company and SDG&E affiliates will raise capital for non-utility ventures consistent with the revelent provisions of Public Utilities Code so that utility assets are protected and preserved. Non-utility affiliates will rely on the financial markets to finance non-utility ventures based on the fundamentals of their proposed businesses. The Commission will retain its authority over SDG&E's capital structure and cost of capital for ratemaking purposes. Through this authority, the Commission can protect utility customers from any adverse financial effects that potentially could result from non-utility activities.

V.

CORPORATE OPERATIONS

The restructuring plan provides for a holding company that will not be an operating utility. The gas and electric utility business of SDG&E will, however, constitute the predominant part of Parent Company's earning power for the foreseeable future after the restructuring.

Following the restructuring, SDG&E will continue to operate as a public utility subject to the jurisdiction of the California Public Utilities Commission ("Commission") and the Federal Energy Regulatory Commission ("FERC"), and its securities issues will be subject to the jurisdiction of the Commission. The operations of SDG&E will continue to be conducted as they are at the present time, with the same plant and management. However, a stronger and more distinct separation will exist between SDG&E's utility operations and SDG&E's existing subsidiaries.

The quality of service provided to SDG&E's customers will be maintained under the reorganization. SDG&E has been and will remain committed to providing high quality service to its customers. Under the holding company structure, SDG&E will remain the largest element in the reorganized enterprise.

The Commission's ability to ensure high quality service to utility customers will not be reduced by the holding company structure. The Commission will have the authority to review utility resource plans to determine that facilities necessary for quality service are being constructed, to review the utility's operation and maintenance expenses to ensure facilities are operated efficiently and maintained in good working condition, and to evaluate periodically the quality of service SDG&E provides to its customers.

Moreover, the performance indicators specified in SDG&E's base rates performance-based ratemaking ("PBR") mechanism will continue to provide SDG&E strong monetary incentives to concentrate its efforts on utility service quality. Under this mechanism SDG&E can earn substantial awards, and receive substantial penalties, depending on its performance in maintaining system reliability, improving the safety of the work environment, producing high customer satisfaction, as well as lowering rates. The proposed holding company structure will not diminish these incentives.

VI.

CONCLUSION

By approving this plan of reorganization, the Commission will further demonstrate the progressive and pro-business philosophy of the state of California by allowing SDG&E to take an initial step to prepare it for the future highly-competitive energy marketplace,

while at the same time protecting SDG&E's customers by establishing discrete lines of separation between regulated and unregulated, competitive businesses. This demonstration of progressive regulation will also show that the Commission is committed to supporting SDG&E's financial integrity as the Commission goes forward in the restructuring of California's electric services industry and reforming the associated regulatory policy.

CHAPTER II

METHOD OF FORMATION

I.

PRESENT CORPORATE STRUCTURE

SDG&E is a public utility principally engaged in the generation, purchase, transmission and distribution of electric energy in San Diego County and a portion of Orange County, California. SDG&E is also engaged in purchasing, transmitting and distributing natural gas in San Diego County. SDG&E is a California corporation organized in 1905. Its principal place of business is the Electric Building, 101 Ash Street, San Diego, California.

SDG&E presently has four wholly-owned subsidiaries; Pacific Diversified Capital Company, Enova Corporation, Enova Energy Management, Inc., and Califia Company. Pacific Diversified Capital Company is a holding company that has two wholly-owned subsidiaries of its own: Phase I Development, Inc. and Phase I Construction, Inc. (inactive). Pacific Diversified Capital Company also is the majority shareholder of Wahlco Environmental Systems, Inc. Califia Company is primarily in the business of leasing computer equipment. Enova Corporation is primarily engaged in the business of investing in affordable housing projects throughout the United States. Enova Energy Management, Inc. was recently organized to engage in the business of energy procurement consulting services.

As a public utility, SDG&E is subject to the jurisdiction of the Commission with respect to rates, standards of service, issuances of securities, accounting and other matters. SDG&E is also subject to the regulation of the FERC with respect to rates for wholesale service, interconnections with other electric utilities, and certain other phases of its electric business.

As of September 30, 1994, SDG&E's utility operations

represented approximately 90 percent of the consolidated assets of SDG&E and approximately 93 percent of the common stock equity of SDG&E.

II.

FORMATION PROCEDURES

SDG&E is seeking authorization in this Application to implement a plan of reorganization resulting in a holding company structure. The plan of reorganization will result in a holding company structure under which SDG&E and its present subsidiary corporations will all be subsidiaries owned by the newly-formed Parent Company. SDG&E is using the term "holding company" as it is defined in the Public Utility Holding Company Act of 1935 ("PUHCA" or "Act").[1]

The corporate reorganization into a holding company structure will be implemented using a reverse triangular merger ("RTM"). In order to implement the RTM, SDG&E will cause to be incorporated two new California corporations, Parent Company and San Diego Merger Company ("Merger Company"), each of which has no stock issued at this time (pending approval of this Application) and no present business or properties of its own. Initially, SDG&E will own all the outstanding stock of Parent Company and Parent Company will own all the outstanding stock of Merger Company. SDG&E, Parent Company and Merger Company will enter into an Agreement of Merger under which, subject to certain conditions, including shareholder approval as required by California law, SDG&E will become a subsidiary of Parent Company through the merger of Merger Company into SDG&E (the "Merger"). A copy of the draft Agreement of Merger, in a form and having the content substantially similar to that which will be

[1] 15 U.S.C. Section 79 at seq.

executed by the parties, is attached hereto as Attachment A.

The RTM is a legal mechanism that will work as follows:

Beginning with SDG&E's current corporate structure as shown on Chart 1 of Attachment B to this Exhibit, upon approval of this Application, SDG&E will be issued stock in Parent Company creating a structure as shown on Chart 2 of Attachment B. Immediately thereafter, Parent Company will be issued stock of Merger Company creating the structure set forth in Chart 3 of Attachment B. Following all governmental, regulatory, and shareholder approvals, and satisfaction of the conditions in the Agreement of Merger, Merger Company will merge with and into SDG&E as shown in Chart 4 of Attachment B.[2] Simultaneously, the shares of SDG&E common stock which were outstanding immediately prior to the merger will be converted into newly issued shares of Parent Company common stock resulting in the structure shown in Chart 5 of Attachment B. This action will be pursuant to the Agreement of Merger, and consistent with the merger provisions of Chapter 11 of the California General Corporations law. Thereafter, and as part of the reorganization plan, all the stock of SDG&E's non-utility subsidiaries will be transferred to Parent Company in order to separate the non-utility and utility businesses. When the reorganization plan is completed, the new corporate structure will be as shown in Chart 6 of Attachment B.

None of the other securities of SDG&E, including its cumulative preferred stock, preference stock (cumulative) and debt securities, will be changed or affected by the reorganization. The outstanding

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[2] Merger Company will disappear by operation of law and the shares of Merger Company (which were held by Parent Company) will be converted into all the shares of SDG&E common stock which were outstanding immediately prior to the merger.

shares of cumulative preferred stock and preference stock (cumulative) will continue to be outstanding shares of SDG&E. Each outstanding share of SDG&E's cumulative preferred stock and preference stock (cumulative) will continue as one issued and outstanding share of its respective series of SDG&E's preferred stock, with the same voting powers, designations, preferences and relative, participating, optional or other special rights, or qualifications, limitations or restrictions on it as were applicable to such shares prior to the restructuring. In the case of SDG&E's first mortgage bonds, those debt securities will continue to be secured by a first mortgage lien on all the properties of SDG&E that are subject to such lien. No utility property owned by SDG&E prior to the restructuring will be transferred to another entity as a result of the restructuring.

By mutual consent of their respective Boards of Directors SDG&E, Parent Company and Merger Company may abandon the merger or amend, modify or supplement the Agreement of Merger in such a manner as may be agreed upon by them in writing at any time before or after approval of the restructuring by the shareholders of SDG&E. However, no such amendment, modification, or supplement shall, if agreed to after such approval by the shareholders, change any of the principal terms of the Agreement of Merger. SDG&E will notify the shareholders in the event of any material amendment, modification or supplement.

The Agreement of Merger provides that it may be terminated, and the merger abandoned, at any time, whether before or after approval of the restructuring by the shareholders of SDG&E, by action of the Board of Directors of SDG&E if the Board determines that the

completion of the restructuring would, for any reason, be inadvisable or not in the best interest of SDG&E or its shareholders. For example, the Board of Directors of SDG&E would be expected to terminate and abandon the restructuring if SDG&E has not received, within a reasonable period after shareholder approval, the approval of the Commission upon terms acceptable to SDG&E.

III.

REGULATORY MATTERS

Certain regulatory approvals, filings, and notifications must be finalized before the merger and the resulting reorganization into a holding company structure can be completed. These are described in the following sections.

A. CALIFORNIA PUBLIC UTILITIES COMMISSION APPROVAL

Commission authorization, as requested by this Application, is required for SDG&E to implement its plan of reorganization into a holding company structure.

B. INTERNAL REVENUE CODE MATTERS

Under the Internal Revenue Code ("IRC"), the proposed reorganization can be accomplished as a non-taxable event provided certain requirements of the IRC are met. The RTM has been utilized for utility holding company reorganizations because the utility's corporate structure remains unchanged. The Internal Revenue Service ("IRS") has ruled in similar cases where holding companies have been formed by other utilities that an RTM is not a taxable event. SDG&E will seek an opinion of counsel regarding the tax consequences to the participants in the reorganization plan and their shareholders.

In addition, the California Revenue and Taxation Code contains provisions which are virtually identical to the IRC, providing

parallel non-taxable treatment of the proposed reorganization plan for state tax purposes. Therefore, the proposed reorganization will be a non-taxable event under California law for the shareholders and corporations involved, since the requirements for tax-free treatment under the IRC will be satisfied.

No corporate income tax or property tax effects should result from the proposed reorganization plan. In particular, taxes for utility ratemaking purposes would continue to be calculated under the Commission's current practices.

C. SECURITIES AND EXCHANGE COMMISSION FILING

The proposed holding company will be subject to the Public Utility Holding Company Act ("PUHCA"). Congress enacted the PUHCA to regulate public utility holding companies and empowered the Securities and Exchange Commission ("SEC") to enforce the Act. Essentially, PUHCA divides utility holding companies into two categories: (i) non-exempt utility holding companies which must be "registered" with the SEC and; (ii) exempt utility holding companies.

The PUHCA allows utility holding companies to be exempt from most of the requirements imposed upon registered utility holding companies if certain conditions are met. The PUHCA specifically provides for an "intrastate" exemption under Section 3(a)(1). This exemption generally applies when the holding company and the utility subsidiary are predominantly intrastate in character and carry on their business substantially in a single state in which the utility and holding company are organized.

Procedurally, the exemption will be obtained by filing a claim of exemption with the SEC after the merger has been completed. Rule

2 (17 CFR, Section 250.2) allows a utility holding company to file an exemption statement, and once filed, the utility holding company is exempt, subject to certain annual filing requirements and certain residual SEC jurisdiction.

The SEC will also have the opportunity to review the registration statement, as further discussed in Section IV of this Chapter II.

D. NUCLEAR REGULATORY COMMISSION APPROVAL

The Nuclear Regulatory Commission ("NRC"), under specific provisions of the Atomic Energy Act, requires a utility-licensee such as SDG&E to obtain NRC authorization for holding company formation. Under the proposed reorganization plan, SDG&E would remain an owner of the San Onofre Nuclear Units. The NRC will require SDG&E, a utility-licensee, to demonstrate that the proposed reorganization will: (i) have no adverse financial impact on the assets of the license holder; (ii) not change the licensee's nuclear management at the station management or corporate officer level; and (iii) not result in a foreign entity obtaining an interest in the license. Given the fact that SDG&E will remain an owner and co-licensee of the San Onofre nuclear units, the proposed reorganization should meet the NRC's requirements.

E. FEDERAL ENERGY REGULATORY COMMISSION

The proposed reorganization will be subject to the approval of the FERC under Section 203 of the Federal Power Act, 16 U.S.C. § 824b, as a "disposition of facilities" (here, transmission facilities) that are subject to the jurisdiction of the FERC. (See Central Vermont Public Service Corp., 39 FERC ¶ 61,295 (1987)). The FERC must, under Section 203, grant the application if it finds that

the proposal is "consistent with the public interest." If the application is uncontested, it may be acted upon by the FERC staff under delegated authority. (18 C.F.R. § 375.308 (b)(1)).

IV.

INVESTOR APPROVALS

Under the California Corporations Code, certain shareholder approvals are required for a reorganization into a holding company structure. SDG&E expects to seek the required shareholder approvals of the reorganization plan at its annual shareholder's meeting in 1995. Prior to that meeting, SDG&E will file with the SEC a registration statement consisting of a combined preliminary proxy statement for SDG&E shareholders and prospectus for the Parent Company stock. Once the SEC has reviewed the combined proxy statement and prospectus, and the registration statement has been declared effective, these documents will be used to solicit shareholder approvals for the reorganization and also will constitute a prospectus for the Parent Company stock to be issued.[3]

V.

OTHER APPROVALS

Finally, under the terms of certain agreements to which SDG&E is a party, SDG&E will obtain approval from various creditors or provide the required notification of the proposed reorganization.

VI.

FORMATION COSTS

The cost of obtaining all the necessary approvals for the reorganization of SDG&E, and all other activities associated with

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[3] Pursuant to the Commission's General Order No. 65-A, these documents will be furnished to the Commission once they have been reviewed by the SEC.

forming the holding company, will be borne by SDG&E's shareholders. Costs will include all outside and internal expenses. These costs have been separately tracked since the time SDG&E began to pursue its reorganization into a holding company structure.

CHAPTER III

PROPOSED ORGANIZATIONAL STRUCTURE

I.

PROPOSED ORGANIZATIONAL STRUCTURE

SDG&E anticipates that the initial holding company corporate structure will be as shown on Chart 6 of Attachment B. SDG&E, and all of its present subsidiaries, will be subsidiaries of Parent Company. The subsidiaries of PDCC will continue to be subsidiaries of that corporation.

Initially, Parent Company will be an organization totally supported by SDG&E. Parent Company will have no employees of its own. This organizational structure will remain in effect until experience dictates the necessary staffing for the Parent Company. The Boards of Parent Company and SDG&E will have identical directors. The officers of Parent Company will be officers of SDG&E serving a portion of their time as officers of Parent Company. Any services required by Parent Company will be provided by SDG&E employees who will charge their time and other expenses to the Parent Company in accordance with the policies and guidelines described in Attachment A to Exhibit SDG&E-2. The location and address of Parent Company will be the same as for SDG&E.

The utilization of existing SDG&E departments to provide a minimum level of service as required by Parent Company will result in efficiencies and benefits to SDG&E ratepayers. Indirect costs for corporate functions which are currently the sole responsibility of SDG&E will be shared with Parent Company and SDG&E affiliates. SDG&E departments allocating a portion of their costs to Parent Company will include Shareholder Services, the Corporate Secretary's Office and Investor Relations. In addition, a portion of the

compensation and expenses of the common Board of Directors and the shared corporate officers (including their support staff) will be allocated to Parent Company.

The proposed corporate structure will maintain the existing quality of management for the utility. With the exception of the sharing of a small number of corporate officers, SDG&E will follow a policy of maintaining at all times a utility management team dedicated solely to utility activities. In addition, employee transfers between affiliates will be solely at the election of employees to pursue individual career opportunities. The proposed reorganization will be fair and reasonable to all utility employees. SDG&E is not proposing any changes to its current human resources policies, for either union or nonunion employees, as a result of the proposed restructuring.

CHAPTER IV

REGULATORY FRAMEWORK FOR SDG&E RESTRUCTURING

I.

CURRENT LAWS PERTAINING TO THE INSPECTION OF RECORDS AND MONITORING OF TRANSACTIONS WILL PROVIDE EFFECTIVE REGULATORY OVERSIGHT AFTER RESTRUCTURING

Pursuant to Public Utilities Code ("PUC") Sections 314(a) and (b) the Commission and representatives of the Commission may at any time inspect the accounts, books, papers, and documents of any public utility. They may also inspect the accounts, books, papers and documents of any business which is a subsidiary or affiliate of, or a corporation which holds a controlling interest in, a utility with respect to any transaction between the utility and the subsidiary, affiliate, or holding company on any matter that might adversely affect the interests of the customers of the utility. PUC Sections 581 through 584 complement Sections 314(a) and (b) by providing the Commission with access to all information and documents relating to a utility's property or affecting its business. After SDG&E's proposed reorganization these requirements will continue in full force and effect ensuring Commission access to all books and records necessary to regulate effectively SDG&E's relationships with Parent Company and unregulated affiliates.

There are numerous other statutes which provide the Commission with broad authority to monitor utility/affiliate transactions. One, PUC Section 587, directs utilities to file an annual report describing all "significant transactions" between a utility, its affiliates, or its parent company. The Commission adopted interim rules, presently in effect, in OIR 92-08-008 (effective August 11, 1992)* which standardized the reports required by PUC Section 587.

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* Reprinted but modified to a limited extent in D.93-02-019.

The annual reports allow the Commission to track, monitor, and audit all transactions between a utility and its affiliated entities. They must include detailed information on virtually all aspects of the utility/affiliate relationships, including: (1) a full description of the organizational structure of the utility and its relationship to all affiliates, (2) a summary of the business activities of the affiliates, (3) an explanation of all procedural and accounting safeguards in place to ensure proper accounting for all utility/affiliate transactions, including the basis upon which cost allocations and transfer pricing were established for the transactions, (4) a list of all contracts between the utility and its affiliates, (5) lists of all transfers of assets, goods or services, and employee transfers, and (6) various financial information relating to affiliate transactions. These annual reports will be required from SDG&E after formation of the holding company structure and will refer to all activities between SDG&E and Parent Company and/or affiliate companies. Additionally, although present Commission standards for utility accounting and record-keeping are sufficient to provide the oversight required to ensure that SDG&E's customers are unaffected by the reorganization, PUC Section 792 permits the Commission to prescribe additional accounting and record-keeping standards for SDG&E in order to maintain necessary regulatory oversight.

Another statute, PUC Section 797, also addressed by OIR 92-08-008, requires the Commission to periodically audit all significant transactions between a utility and its affiliates or its parent company. The Commission has stated its intent to audit each major investor-owned utility at least once every three years, usually in

conjunction with the utility's general rate case ("GRC"). (OIR 92-08-008, mimeo p. 21.) The Commission's staff performed such an audit as part of SDG&E's 1993 GRC. SDG&E expects, and the statute requires, these Commission audits to continue after SDG&E's restructuring.

Should SDG&E desire to transfer or encumber any necessary and useful utility asset to any third party, whether by sale, lease, or other form of transaction, it must seek the Commission's advance approval under PUC Section 851. The Commission reviews the terms and conditions of these transactions to ensure that utility customers are not harmed. This statute will continue to pertain to all SDG&E transactions, including those with affiliates, after reorganization.

If the Commission determines, as part of an audit or in any other proceeding, that SDG&E improperly subsidized an affiliate or otherwise caused harm to utility ratepayers, the Commission may take appropriate action under PUC Sections 451, 728 and 729 to ensure that SDG&E's rates are "just and reasonable." Furthermore, if SDG&E willfully makes an imprudent payment to, or receives less than a reasonable payment from, either Parent Company or any affiliate in violation of any Commission rule or order, PUC Section 798 provides the Commission with authority to extract treble damages from SDG&E should SDG&E attempt to recover such improper expense.

SDG&E has regularly provided the Commission with annual affiliate transaction reports as required by PUC Section 587 and OIR 92-08-008. As mentioned, affiliate transactions were audited as part of SDG&E's 1993 GRC and all appropriate recommendations of the Commission's staff resulting from that audit were adopted. In

Exhibit SDG&E-2, SDG&E proposes a revised set of guidelines governing accounting policies and procedures to take effect once the holding company structure is in place. To the extent these policies and procedures require further detail or definition, SDG&E is committed to working with Commission staff to develop those details.

In addition, the base rates PBR mechanism adopted for SDG&E imposes an annual cap, i.e., upward limit, on SDG&E's revenue requirement. This cap provides additional protection to ratepayers against any improper transfer of the operating costs of unregulated activities to utility ratepayers.

II.

CURRENT LAWS WILL PROTECT SDG&E'S FINANCIAL INTEGRITY AFTER RESTRUCTURING

PUC Section 701.5 will prevent SDG&E from issuing any bond, note, lien, guarantee, or indebtedness of any kind pledging SDG&E's assets or credit for or on behalf of any affiliate or Parent Company, except under specific circumstances which require Commission approval. Additionally, under PUC Section 830, Commission approval will continue to be required for any guarantee by SDG&E of the securities of any other company, including SDG&E affiliates, when the securities are payable at periods of more than 12 months. To ensure that SDG&E maintains its financial integrity, the Commission will continue to regulate the issuance of bonds or other forms of debt, preferred stock, and common equity by SDG&E pursuant to PUC Sections 816 et seq., thereby preventing significant deviations from SDG&E's approved capital structure.

SDG&E acknowledges that after its reorganization the Commission will determine SDG&E's capital structure and authorize a return on

common equity for ratemaking purposes on a stand-alone basis, independent of the operations of Parent Company or any affiliates. Because of this stand-alone approach, the SDG&E capital structure and overall rate of return will reflect only the risks and costs of SDG&E's operation. The reorganization will, in fact, assist the Commission in this process by more clearly separating utility and non-utility operations and performance.

III.

POLICIES AFFECTING UTILITY HUMAN RESOURCES

With the exception of the fully compensated sharing of Board of Director members and a small number of corporate officers, SDG&E will follow a policy of maintaining at all times a utility management team dedicated solely to utility activities so that utility operations will not be neglected by management as a result of non-utility businesses. Exhibit SDG&E-2 contains employee transfer guidelines that will be in effect upon the establishment of the holding company structure.

IV.

PROPOSED CONDITIONS TO SDG&E'S APPLICATION

SDG&E believes that with the aforementioned regulatory review and oversight mechanisms already in place, substantial safeguards exist to ensure that after reorganization into a holding company structure SDG&E will continue to be a financially strong utility whose operations will be isolated from, and wholly unaffected by, the successes or failures of either Parent Company or SDG&E affiliates. By adhering to the corporate policies and guidelines stated in Exhibit SDG&E-2, all transactions between SDG&E and either

Parent Company or any affiliate will be structured in a manner that no negative impact will be incurred by SDG&E's customers. If a transaction is executed that will be detrimental to SDG&E's customers, the Commission-regulated affiliate/holding company reporting and auditing processes will uncover them, allowing the Commission to provide the necessary regulatory response. Consequently, there is no need for SDG&E to propose conditions to the Commission's approval of this Application that would overlap, or replicate, existing statutory and regulatory mechanisms protecting SDG&E's customers. Many of these mechanisms have either been created, or further defined, since the Commission rendered its decisions on the holding company applications of SDG&E (20 CPUC 2d 660 (1986)) and Southern California Edison Company ("Edison") (27 CPUC 2d 347 (1988)). In fact, a substantial majority of the conditions adopted by the Commission in Edison's holding company decision are subsumed within either these regulatory mechanisms or the policies and guidelines described in Exhibit SDG&E-2.

SDG&E, however, does propose several conditions it believes are appropriate as part of the Commission's approval of this Application. These conditions address potential areas of concern with the holding company structure, discussed in the Edison holding company decision, that are not otherwise covered by existing statutes, regulations, or SDG&E's proposed policies and guidelines. The conditions are as follows:

1. The officers and employees of SDG&E's holding company and its subsidiaries shall be available to appear and testify in Commission proceedings as necessary or required.

2. SDG&E shall avoid a diversion of management talent that

would adversely affect the utility.

3. The dividend policy of SDG&E shall continue to be established by SDG&E's Board of Directors as though SDG&E were a comparable, stand-alone utility company.

4. 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 SDG&E's holding company and SDG&E.

5. Neither SDG&E's holding company nor any of the holding company's subsidiaries shall provide interconnection facilities and related electrical equipment to SDG&E, directly or indirectly, where third-party power producers are required to purchase or otherwise pay for such facilities and equipment in conjunction with the sale of electrical energy to SDG&E, unless the third party may obtain and provide facilities and equipment of like or superior design and quality through competitive bidding. The holding company and its non-utility subsidiaries may participate in any competitive bidding for such facilities and equipment.

Condition 1 is identical to Edison Condition 4, as set forth in the Edison holding company decision. SDG&E agrees with and commits to the principal that non-utility affiliates' officers and employees should be available to testify before the Commission on relevant matters. However, as Edison, DRA and the Commission agreed in Edison's holding company case, requiring such testimony without subpoena is unnecessary and an extra-jurisdictional act. It should not be imposed as a condition to holding company formation. SDG&E is cognizant of the Commission's reminder in the Edison holding company decision that it is SDG&E's burden to prove its contentions

in any proceeding before the Commission, and that to fail to produce witnesses as necessary or required on the technicality of non-jurisdiction would be a serious mistake.

Condition 2 is identical to the first sentence of Edison Condition 6. SDG&E believes it is important, and is willing to commit, that it will avoid a diversion of management talent that would in any way affect the utility operations of SDG&E. SDG&E does not see a reason to include the second sentence of Edison Condition 6 because it refers to an annual report identifying nonclerical personnel transferred to its parent holding company or any non-utility subsidiary. This information SDG&E must already report under the interim rules adopted in OIR 92-08-008.

SDG&E Condition 3 is identical to Edison's Condition 10. As part of SDG&E's commitment to continue operating the utility as a separate and distinct entity from Parent Company and non-utility affiliates, SDG&E will commit to maintaining a dividend policy at the utility which will be established by SDG&E's Board of Directors as if SDG&E were a comparable, stand-alone utility company.

SDG&E's Condition 4 is identical to Edison Condition 12. Again, this condition is reasonable given that once the holding company structure is in place, SDG&E's utility capital requirements must be the first priority of the common Board of Directors of Parent Company and SDG&E.

Condition 5 is identical to Edison Condition 15. The purpose of this condition is to ensure that third party power producers will not be disadvantaged by either SDG&E's holding company structure or any influence SDG&E might impose on third party power producers by virtue of its utility status.

This concludes my testimony.

ATTACHMENT A

AGREEMENT OF MERGER

THIS AGREEMENT OF MERGER ("Agreement") is made as of [_____ __], 199[_], by and among SAN DIEGO GAS & ELECTRIC COMPANY, a California corporation ("SDG&E"), San Diego Merger Company, a California corporation ("MergeCo"), and SDO Parent Co., Inc. a California corporation ("ParentCo"), with reference to the following facts:

A. SDG&E has authorized capital consisting of (i) 255 million shares of Common Stock, without par value ("SDG&E Common Stock"), of which [116,515,073] shares are issued and outstanding; (ii) 1,375,000 shares of Cumulative Preferred Stock, $20 par value ("Cumulative Preferred Stock"), of which [1,374,650] shares (consisting of [four] separate series) are issued and outstanding; and (iii) 10 million shares of Preference Stock (Cumulative), without par value ("Preference Stock"), of which [3,823,700] shares (consisting of [six] separate series) are issued and outstanding.

B. MergeCo has authorized capital consisting of 1000 shares of Common Stock ("MergeCo Common Stock"), of which 100 shares are issued and outstanding and owned beneficially and of record by ParentCo.

C. ParentCo has authorized capital consisting of 300 million shares of Common Stock ("ParentCo Common Stock"), of which 100 shares are issued and outstanding and owned beneficially and of record by SDG&E, and 30 million shares of Preferred Stock, none of which have been issued.

D. The Boards of Directors of the respective parties hereto deem it advisable to merge MergeCo with and into SDG&E (the "Merger") in accordance with the California General Corporation Law ("California GCL") and this Agreement for the purpose of establishing ParentCo as the parent corporation for SDG&E in a transaction intended to qualify for tax-free treatment.

NOW, THEREFORE, in consideration of the premises and agreements contained herein, the parties agree that (i) MergeCo shall be merged with and into SDG&E (the "Merger"), (ii) SDG&E shall be the corporation surviving the Merger, and (iii) the terms and conditions of the Merger, the mode of carrying it into effect, and the manner of converting and exchanging shares of capital stock shall be as follows:

ARTICLE 1

The Merger

1.1 Officers' Certificates. Subject to and in accordance with the provisions of this Agreement, officers' certificates of SDG&E, MergeCo and ParentCo shall be signed and verified and thereafter delivered, together with a copy of this Agreement, to the office of the Secretary of State of California for filing, all as provided in Section 1103 of the California GCL.

1.2 Effective Time. [The Merger shall become effective at the close of business on [_____ __], 1995 (the "Effective Time").] At the Effective Time, the separate existence of MergeCo shall cease and MergeCo shall be merged with and into SDG&E, which shall continue its corporate existence as the surviving corporation (SDG&E and MergeCo being sometimes referred to herein as the "Constituent Corporations" and SDG&E, as the surviving corporation, being sometimes referred to herein as the "Surviving Corporation"). SDG&E shall succeed, without other transfer, to all the rights and property of MergeCo and shall be subject to all the debts and liabilities of MergeCo in the same manner as if SDG&E had itself incurred them. All rights of creditors and all liens upon the property of each of SDG&E and MergeCo shall be preserved unimpaired.

1.3 Appropriate Actions. Prior to and after the Effective Time, ParentCo, SDG&E and MergeCo, respectively, shall take all such actions as may be necessary or appropriate in order to effectuate the Merger. In this connection, ParentCo shall issue the shares of ParentCo Common Stock into which outstanding shares of

SDG&E Common Stock will be converted on a share-for-share basis to the extent provided in Article 2 of this Agreement. In case at any time after the Effective Time any further action is necessary or desirable to carry out the purposes of this Agreement and to vest the Surviving Corporation with full title to all properties, assets, privileges, rights, immunities and franchises of either of the Constituent Corporations, the officers and directors of each of the Constituent Corporations as of the Effective Time shall take all such further action.

ARTICLE 2

Terms of Conversion and Exchange of Shares

At the Effective Time:

2.1 SDG&E Common Stock. Each share of SDG&E Common Stock issued and outstanding immediately prior to the Merger shall be automatically changed and converted into one share of ParentCo Common Stock, which shall thereupon be issued and fully-paid and non-assessable; provided, however, that such conversion shall not affect shares of holders, if any, who perfect their rights as dissenting shareholders under Chapter 13 of the California GCL.

2.2 SDG&E Preferred Stock. Shares of the Cumulative Preferred Stock and Preference Stock of SDG&E issued and outstanding immediately prior to the Merger shall not be converted or otherwise affected by the Merger. Each such share shall continue to be (i) issued and outstanding and (ii) a fully-paid and nonassessable share (of Cumulative Preferred Stock or Preference Stock, as the case may be) of the Surviving Corporation.

2.3 MergeCo Shares. The shares of MergeCo Common Stock issued and outstanding immediately prior to the Merger shall be automatically changed and converted into all of the issued and outstanding shares of Common Stock of the Surviving Corporation, which shall thereupon be issued and fully-paid and nonassessable, with the effect that the number of issued and outstanding shares of Common Stock of the Surviving Corporation shall be the same as the number of issued and outstanding shares of SDG&E Common Stock immediately prior to the Effective Time.

2.4 ParentCo Shares. Each share of ParentCo Common Stock issued and outstanding immediately prior to the Merger shall be canceled.

ARTICLE 3

Articles of Incorporation and Bylaws

3.1 SDG&E's Restated Articles. From and after the Effective Time, and until thereafter amended as provided by law, the Restated Articles of Incorporation, as amended, of SDG&E as in effect immediately prior to the Merger shall be and continue to be the Restated Articles of Incorporation, as amended, of the Surviving Corporation.

3.2 SDG&E's Bylaws. From and after the Effective Time, and until thereafter amended as provided by law, the Bylaws of SDG&E as in effect immediately prior to the Merger shall be and continue to be the Bylaws of the Surviving Corporation.

ARTICLE 4

Directors and Officers

The persons who are directors and officers of SDG&E immediately prior to the Merger shall continue as directors and officers, respectively, of the Surviving Corporation and shall continue to hold office as provided in the Bylaws of the Surviving Corporation. If, at or following the Effective Time, a vacancy shall exist in the Board of Directors or in the position of any officer of the Surviving Corporation, such vacancy may be filled in the manner provided in the Bylaws of the Surviving Corporation.

ARTICLE 5

Stock Certificates

5.1 Pre-Merger SDG&E Common. Following the Effective Time, each holder of an outstanding certificate or certificates theretofore representing shares of SDG&E Common Stock may, but shall not be required to, surrender the same to ParentCo for cancellation or transfer, and each such holder or transferee will be entitled to receive a certificate or certificates representing the same number of shares of ParentCo Common Stock as the shares of SDG&E Common Stock previously represented by the stock certificate(s) surrendered.

5.2 Outstanding Certificates. Until surrendered or presented for transfer in accordance with Section 5.1 above, each outstanding certificate which, prior to the Effective Time, represented SDG&E Common Stock shall be deemed and treated for all corporate purposes to represent the ownership of the same number of shares of ParentCo Common Stock as though such surrender or transfer and exchange had taken place.

5.3 SDG&E Stock Transfer Books. The stock transfer books for SDG&E Common Stock shall be deemed to be closed at the Effective Time and no transfer of shares of SDG&E Common Stock outstanding prior to the Effective Time shall thereafter be made on such books.

5.4 Post-Merger Rights of Holders. Following the Effective Time, the holders of certificates representing SDG&E Common Stock outstanding immediately prior to the Effective Time shall cease to have any rights with respect to stock of the Surviving Corporation and their sole rights shall be with respect to the ParentCo Common Stock into which their shares of SDG&E Common Stock shall have been converted by the Merger.

ARTICLE 6

Conditions of the Merger

Completion of the Merger is subject to the satisfaction of the following conditions:

6.1 Shareholder Approval. The principal terms of this Agreement shall have been approved by such holders of capital stock of each of the Constituent Corporations as is required by the California GCL.

6.2 SDG&E Preferred Vote. The principal terms of this Agreement shall have been approved by the holders of at least two-thirds of the combined outstanding shares of Cumulative Preferred Stock and Preference Stock.

6.3 ParentCo Common Stock Listed. The ParentCo Common Stock to be issued and to be reserved for issuance pursuant to the Merger shall have been approved for listing, upon official notice of issuance, by the New York Stock Exchange.

ARTICLE 7

Amendment and Termination

7.1 Amendment. The parties to this Agreement, by mutual consent of their respective boards of directors, may amend, modify or supplement this Agreement in such manner as may be agreed upon by them in writing at any time before or after approval of this Agreement by the pre-Merger shareholders of SDG&E (as provided in Sections 6.1 and 6.2 above); provided, however, that no such amendment, modification or supplement shall, if agreed to after such approval by the pre-Merger shareholders of SDG&E, change any of the principal terms of this Agreement.

7.2 Termination. This Agreement may be terminated and the Merger and other transactions provided for by this Agreement may be abandoned at any time, whether before or after approval of this Agreement by the pre-Merger shareholders of SDG&E, by action of the board of directors of SDG&E if such board of directors determines for any reason that the completion of the transactions provided for herein would for any reason be inadvisable or not in the best interests of SDG&E or its shareholders.

ARTICLE 8

Miscellaneous

8.1 Approval of ParentCo Shares. By its execution and delivery of this Agreement, SDG&E, as the sole pre-Merger shareholder of ParentCo, consents to, approves and adopts this Agreement and approves the Merger, subject to approval of this Agreement by the pre-Merger shareholders of SDG&E (as provided in Sections 6.1 and 6.2 above).

8.2 Approval of MergeCo Shares. By its execution and delivery of this Agreement, ParentCo, as the sole pre-Merger shareholder of MergeCo, consents to, approves and adopts this Agreement and approves the Merger, subject to approval of this Agreement by the pre-Merger shareholders of SDG&E (as provided in Sections 6.1 and 6.2 above).

8.3 No Counterparts. This agreement may not be executed in counterparts.

IN WITNESS WHEREOF, SDG&E, ParentCo and MergeCo, pursuant to approval and authorization duly given by resolutions adopted by their respective boards of directors, have each caused this Agreement to be executed by its chairman of the board or its president or one of its vice presidents and by its secretary or one of its assistant secretaries.

SDG&E:
San Diego Gas & Electric Company,
a California corporation

By:_____
Its:_____

By:_____
Its:_____

ParentCo:
SDO Parent Co., Inc.,
a California corporation

By:_____
Its:_____

By:_____
Its:_____

MergeCo:
San Diego Merger Company,
a California corporation

By:_____
Its:_____

By:_____
Its:_____

[Attachments: SDG&E, ParentCo and MergeCo Officers' Certificates]

ATTACHMENT B

CHART 1

EXISTING CORPORATE STRUCTURE

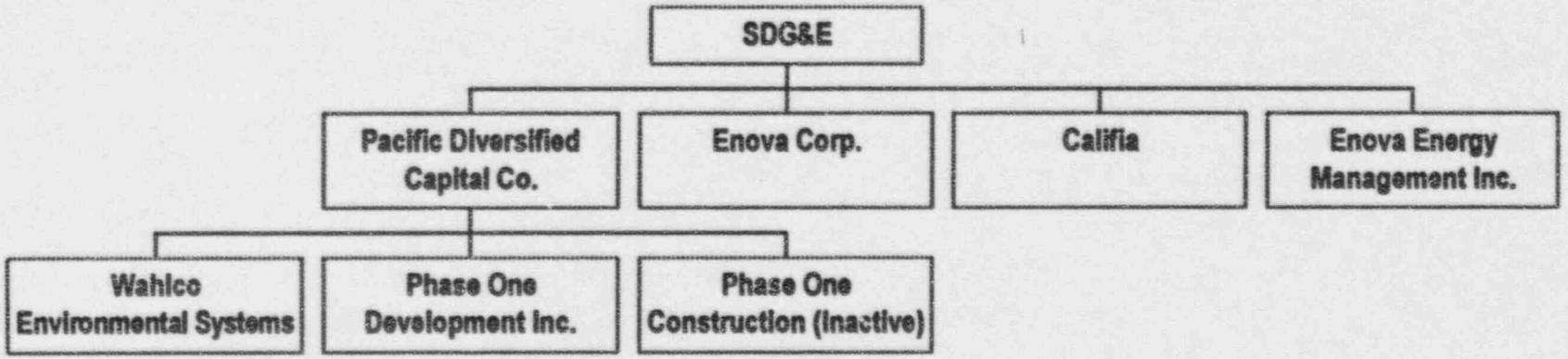


CHART 2

SDG&E ACQUIRES SDO PARENT CO., INC. STOCK

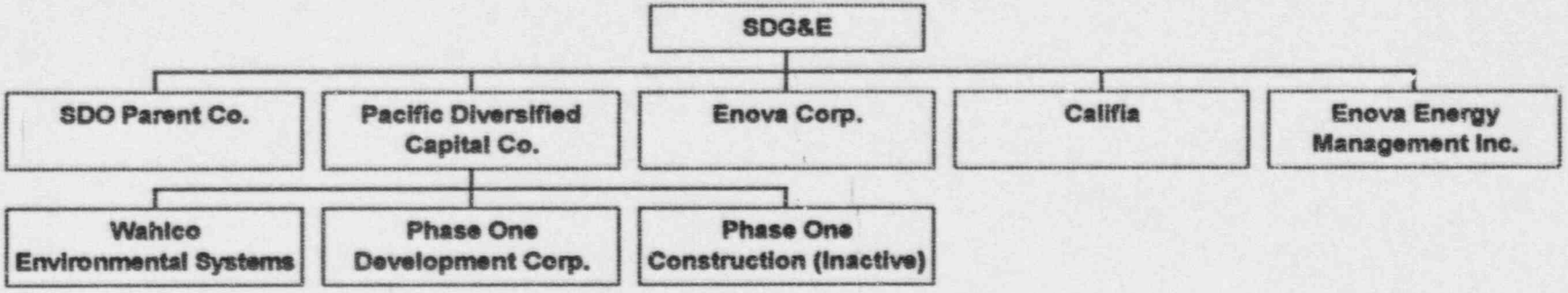


CHART 3

SDO PARENT CO. ACQUIRES

SAN DIEGO MERGER COMPANY STOCK

Timing: Immediately after SDG&E acquires SDO Parent Co., Inc. stock

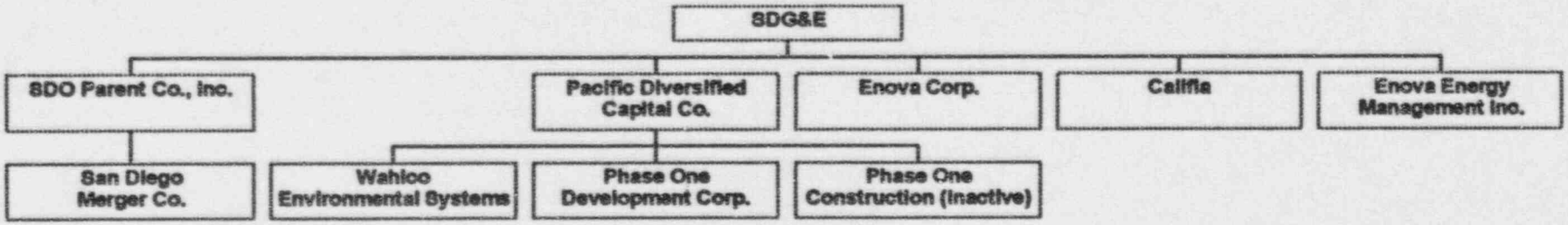


CHART 4

SAN DIEGO MERGER COMPANY MERGER WITH SDG&E

(Subsidiaries remain under SDG&E)

Timing: Following all governmental, regulatory and shareholder approvals.

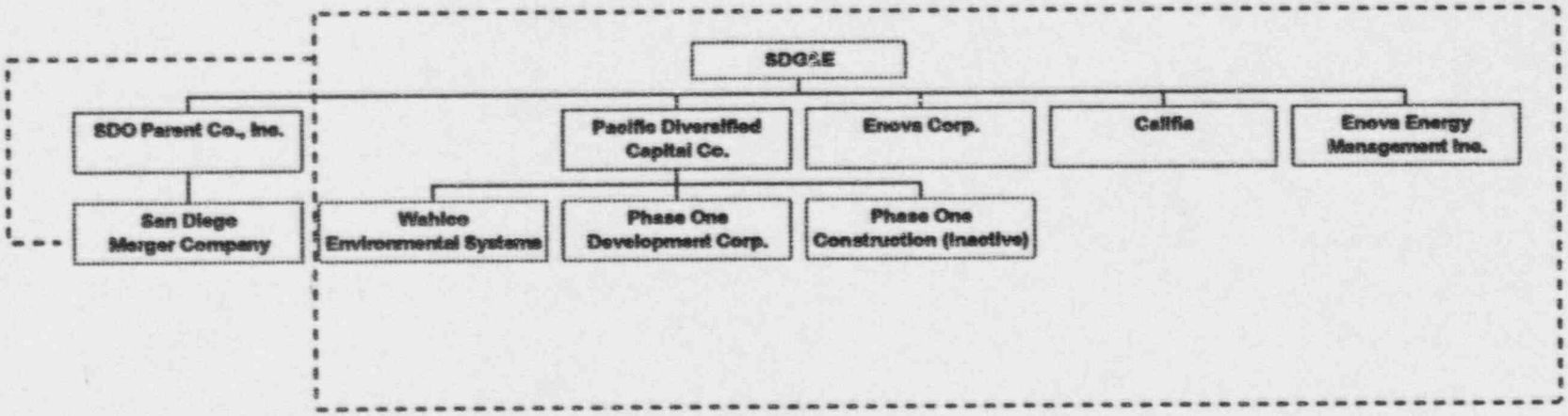
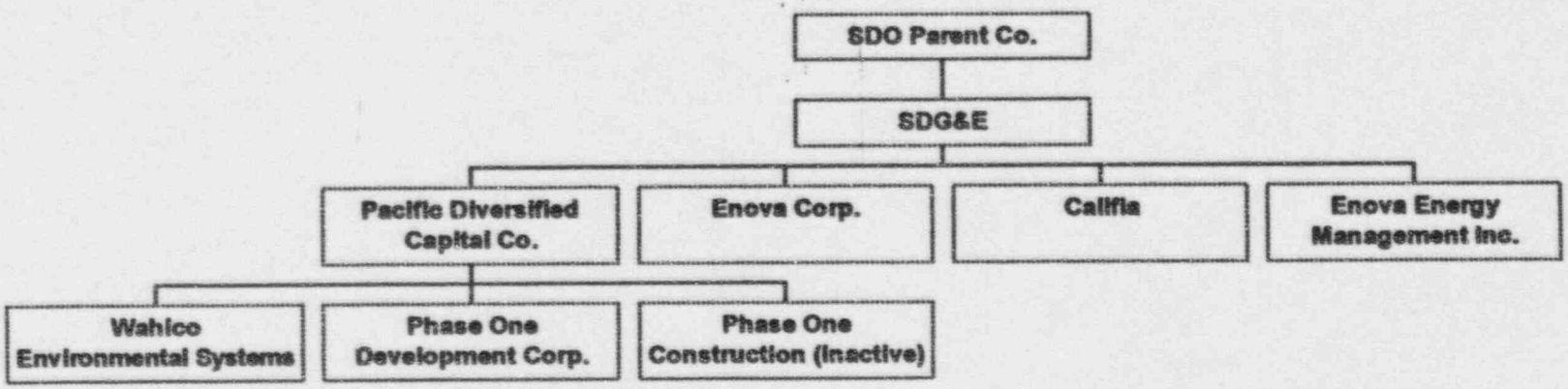


CHART 5

SDG&E COMMON STOCK EXCHANGED FOR SDO PARENT CO., INC. COMMON STOCK

Timing: Concurrent with merger shown in Chart 4



STEP 6

SDG&E TRANSFERS

STOCK OF ITS SUBSIDIARIES TO SDO PARENT CO., INC.

Timing: After the merger in Chart 5