

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**



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Order Instituting Rulemaking on the Commission's Own Motion to Develop Standard Rules and Procedures for Regulated Water and Sewer Utilities Governing Affiliate Transactions and the Use of Regulated Assets for Non-Tariffed Utility Services (formerly called Excess Capacity).

R.09-04-012  
(Filed April 16, 2009)

**REPLY COMMENTS OF CALIFORNIA-AMERICAN WATER COMPANY (U210W)  
ON THE STAFF WORKSHOP REPORT**

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**I. INTRODUCTION**

In accordance with the *Administrative Law Judge's Ruling Modifying the Schedule*, issued on April 21, 2010, California-American Water Company ("California American Water") respectfully submits these reply comments on the initial comments of the Division of Ratepayer Advocates ("DRA"), The Utility Reform Network ("TURN"), and Consumer Federation of California ("CFC"). Due to time restrictions, California American Water limits this reply to only the comments filed by proponents of the rules prepared by the California Public Utilities Commission ("Commission") Staff, submitted on April 26, 2010 (the "Staff Report"), governing (1) affiliate transactions; and (2) the use of regulated assets by utilities to provide non-tariffed products and services (referred to as the "excess capacity rules").<sup>1</sup>

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<sup>1</sup> As a general matter, California American Water supports the reply comments filed by California Water Association ("CWA") to the extent that the CWA comments question the need for the affiliate transaction rules and identify the flaws in the opening comments of DRA and TURN.

## II. SUMMARY OF CALIFORNIA AMERICAN WATER'S REPLY COMMENTS

In Section III of these reply comments, California American Water will address the affiliate transaction rules proposed by DRA, TURN and CFC for regulated water and sewer utilities. As set forth below, California American Water is extremely concerned that if the Commission were to adopt the proposals of DRA and TURN,<sup>2</sup> the rules would harm California American Water customers, exceed the Commission's jurisdiction, expand the scope of the affiliate transaction rules beyond the relevant statutes, potentially violate the Commerce Clause and principles of comity, and raise other serious potential legal challenges. These reply comments will also address some of the many proposed rules that are inappropriate due to the vast differences between the energy and water industries, especially those rules that were intended to foster retail competition in the energy sector. California American Water will not repeat in these reply comments the arguments it has made throughout this proceeding why it is wholly unjustified to adopt wholesale portions of the affiliate transaction rules applicable to energy utilities (the "Energy Rules").<sup>3</sup>

In Section IV of these reply comments, California American Water will address the excess capacity rules proposed by DRA, TURN and CFC for regulated water and sewer utilities. As explained in its Opening Comments, the Commission should not change the long-standing excess capacity rules, as proposed by DRA and TURN.

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<sup>2</sup> These reply comments will focus on the comments of DRA and TURN. CFC's comments inaccurately describe the utilities' position on the affiliate transaction rules and raise a number of issues that are unrelated and irrelevant to this proceeding, including the "practices which contributed to the Great Depression and led to enactment of the Securities Exchange Act of 1934." *See Comments of the Consumer Federation of California on the Staff Report to Commissioner Bohn and Judge Gamson re OIR.09-04-012 and Related Workshops*, filed May 7, 2010 ("CFC Opening Comments"), p. 1.

<sup>3</sup> The Energy Rules apply to utilities with gross annual revenues of \$1 billion or more. D.06-12-029, *Order Instituting Rulemaking Concerning Relationship Between California Energy Utilities And Their Holding Companies And Non-Regulated Affiliates*, 2006 Cal. PUC LEXIS 460 ("D.06-12-028, 2006 Cal. PUC LEXIS 460"), \*156, App. A-3.

**III. THE PROPOSALS OF DRA AND TURN REGARDING AFFILIATE TRANSACTION RULES WOULD HARM CALIFORNIA CUSTOMERS, EXCEED THE COMMISSION’S JURISDICTION, AND LACK EVIDENTIARY SUPPORT**

**A. The Proposed Rules Would Harm California Water Customers by Impairing California American Water’s Ability to Access Essential Services**

California American Water has already enumerated many customer harms that would result if the Commission adopted Staff’s proposed rules. As explained in California American Water’s Opening Comments, the potential adverse cost and service implications of rules that prevent California American Water from continuing to take essential services from its affiliates for customers are staggering.<sup>4</sup> Indeed, several of DRA’s and TURN’s proposals could impair California American Water’s ability to access cost effective capital through American Water Capital Corp. (“AWCC”)<sup>5</sup> and services it now receives on a shared basis from American Water Service Company (the “Service Company”). Both AWCC and the Service Company operate on a not for profit basis, and as such, many of the affiliate transaction rules should not apply in cases of affiliates providing shared services operating to serve regulated utilities on a not for profit basis. As discussed in California American Water’s Opening Comments, the rules should provide clear exemptions with regard to such transactions that provide services to the utility that are utilized to provide quality service to customers or necessary to provide access to cost effective capital.<sup>6</sup>

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<sup>4</sup> *Opening Comments of California-American Water Company (U210W) on the Staff Workshop Report*, filed May 7, 2010 (“California American Water Opening Comments”), pp. 9-14.

<sup>5</sup> California American Water’s Opening Comments discuss the benefits California American Water and its customers derive from the debt financing arrangement with AWCC, which consolidates the financing requirements of all American Water’s utility services. Page 8 of the Opening Comments contains a typographical error in reference to the credit rating of AWCC as “(B++)”. As a clarification, Standard & Poor’s current rating for AWCC is BBB+.

<sup>6</sup> California American Water Opening Comments, pp. 2-3.

Moreover, the rules proposed by DRA and TURN would directly contradict the OIR's stated objective of not stifling business development.<sup>7</sup> The affiliate transaction rules DRA and TURN propose in this proceeding contain provisions that will prevent California American Water from continuing to provide essential public utility services to its customers on a shared basis through a service company structure that has been in existence for many years. Indeed, the rules DRA and TURN have proposed will stifle business development, including the exchanges of technology and best operating practices, to the detriment of California American Water and its customers.

**B. Many of the Proposed Rules Exceed the Commission's Jurisdiction, are Illegal, and Violate Principles of Comity**

In their comments, DRA and TURN propose broad regulation of *all* utility affiliates, even when such affiliates have no transactions with the utility, have no connection to California, and are located outside of the United States. Many of DRA's proposals are based upon its mistaken belief that "[t]he burden should be on the regulated utility to prove whether a transaction between a parent and affiliate is *not* germane to the regulated utility."<sup>8</sup> DRA's position is illegal as it goes well beyond the Commission's legal authority of regulated utilities and turns the purpose of these rules on its head. The courts have repeatedly upheld the principle that "in the absence of specific legislation to the contrary, the commission has no jurisdiction to regulate [non-public utilities]."<sup>9</sup> The California courts also recognize that any regulation by the Commission must be *cognate and germane to the regulation of the public utility*.<sup>10</sup> The courts

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<sup>7</sup> *Order Instituting Rulemaking*, 09-04-012 at p. 6 (stating that the "overriding goal here is not to stifle business development.").

<sup>8</sup> DRA's Opening Comments on the Staff Report to Commissioner Bohn and Judge Gamson (R.09-04-012), filed May 7, 2010 ("DRA Opening Comments"), p. 4.

<sup>9</sup> *People ex rel. Public Utilities Commission v. Fresno* (1967) 254 Cal. App. 2d 76, \*81.

<sup>10</sup> *Southern California Gas Co. v. Public Utilities Commission* (1979) 24 Cal. 3d 653, 656 ("The Legislature is given plenary power to confer other powers upon the commission. This plenary power, (continued...)

have *not* held that *unless the utility proves that the regulation is not cognate and germane* the Commission may extend its regulation without limitation to any affiliates wherever situated regardless of any transactions involving California American Water. Such an interpretation would stand jurisdictional limitations on their head and presume that the Commission's jurisdiction applies to every affiliate and parent of a utility unless the utility can prove the regulation is not cognate and germane. Since the Commission cannot regulate a non-regulated parent and a non-regulated utility unless its regulation is cognate and germane to the rates and service of the utility, it would be unlawful for the Commission to adopt DRA's proposal to regulate *all* affiliates *unless the utility proves that the affiliates' activities are not cognate and germane to the regulation of the utility*.<sup>11</sup>

The Commission has the authority to regulate public utilities, including the power to fix rates and establish rules.<sup>12</sup> Public Utilities Code section 2701 defines a public water utility as, “[a]ny person, firm, or corporation [etc.] owning, controlling, operating, or managing *any water system within this State*, who sells, leases, rents, or delivers water to any person, firm, corporation, municipality, or any other political subdivision of the State.”<sup>13</sup> As the owner and operator of water systems within California, California American Water is a public utility subject to the jurisdiction of the Commission. However, California American Water's parent company and its affiliates are clearly not California public utilities and therefore do not fall under the basic

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however, is subject to the limitation that the additional powers bestowed upon the commission must be cognate and germane to the regulation of public utilities”) (internal citations and quotations omitted); *Consumers Lobby Against Monopolies v. Public Utilities Commission* (1979) 25 Cal. 3d 891, 905-906 (“Additional powers and jurisdiction that the commission exercises, however, must be cognate and germane to the regulation of public utilities”) (internal citations and quotations omitted).

<sup>11</sup> *See, generally, Gold v. Superior Court* (1970) 3 Cal. 3d 275, 285 (“It is our view that the person relying on the statutory exception should have the burden of establishing it”).

<sup>12</sup> *Hartwell Corp. v. Superior Court* (2002) 27 Cal. 4th 256, 264 (citing Cal. Const. art. XII, §§ 2, 4, 6).

<sup>13</sup> Cal. Pub. Util. Code § 2701 (emphasis added). Unless otherwise stated, all statutory citations refer to the California Public Utilities Code.

grant of regulatory authority to the Commission.<sup>14</sup> “In the absence of express statutory authority it has generally been held that a commission’s control over contracts between affiliated corporations is limited to disallowance of excessive payments.”<sup>15</sup> A generalized connection to rates and services is too attenuated to justify implying the statutory power of the Commission to service contracts between affiliate corporations.<sup>16</sup>

Many of the rules proposed by DRA and other parties seek to dramatically expand the Commission’s jurisdiction over non-regulated entities. For example, with respect to Rule III.B, DRA comments that the affiliate transaction rules should apply to affiliates that do not operate within California, claiming that such extraterritorial affiliates are “jurisdictional utility affiliates.”<sup>17</sup> DRA implies an ability by the Commission to inquire into and approve any transaction of the parent or any transaction of any regulated or non-regulated, non-California subsidiary of the parent. However, DRA provides no support or explanation for its contention that the Commission has the authority to regulate affiliates beyond its transactions with the California Commission-regulated utility.<sup>18</sup>

DRA’s approach exceeds the Commission’s jurisdiction and is contrary to the California courts’ determination that that the Commission’s jurisdiction is limited to the regulation of public utilities as defined in legislation: “As our Supreme Court has recognized, established doctrine declares that, in the absence of legislation otherwise providing, the [Commission’s]

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<sup>14</sup> *Television Transmission, Inc. v. Public Utilities Commission* (1956) 47 Cal. 2d 82, 84 (“Unless petitioner is a public utility, as defined in the Constitution or the Public Utilities Code, the commission was without power to issue the orders in question”).

<sup>15</sup> *Pacific Tel. & Tel. Co. v. Public Utilities Commission* (1950) 34 Cal. 2d 822, 830 (questioned on other grounds by *General Telephone Co. v. Public Utilities Commission* (1983) 34 Cal. 3d 817, 826).

<sup>16</sup> *Stepak v. American Tel. & Tel. Co.* (1986) 186 Cal. App. 3d 633, 642 (citing *Pacific Tel. & Tel. Co.*, 34 Cal. 2d at 642).

<sup>17</sup> DRA Opening Comments at p. 7.

<sup>18</sup> *Cf. PG&E Corporation v. Public Utilities Commission* (2004) Cal. App. 4th 1174, 1201 (“The mere fact that the holding companies do business with their utility subsidiaries is not the basis for the PUC asserting jurisdiction”).

jurisdiction to regulate public utilities extends only to the regulation of privately owned utilities.”<sup>19</sup> In its comments, DRA does not cite to any authority whatsoever for the proposition to reverse this long-standing principle.

DRA also recommends under Rule VII.A that the affiliate transaction rules obligate parent companies to “ensure that the regulated utility’s capital needs are met.”<sup>20</sup> This proposed rule would amount to the Commission exerting direct control over the conduct of a non-regulated company that operates outside of California. Under this rule, as proposed by DRA, the Commission could assert regulatory authority over California American Water’ parent company, American Water Works Company, Inc. (“American Water”), by requiring it to fund California American Water at the expense of all other potential liabilities, including creditors, pension obligations, or the capital needs of other regulated utilities outside of California.<sup>21</sup> The Commission does not have the authority to demand that American Water allow, for example, Missouri American Water to go bankrupt by diverting capital to California American Water, which DRA’s proposed rule, as written, could conceivably require.

DRA’s proposals under Rules VIII.A and VIII.B would similarly impose rules that seek to directly regulate the conduct of non-regulated entities outside of California.<sup>22</sup> DRA’s stated intent is to obtain the ability to command the presence of *any* and *all* executive and operating personnel within the holding company structure under any circumstance, as well as gain access

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<sup>19</sup>*Santa Clara Valley Transportation Authority v. Public Utilities Commission* (2004) 124 Cal. App. 4th 346, 357 (emphasis added) (internal citations and quotations omitted).

<sup>20</sup> DRA Opening Comments at p.14.

<sup>21</sup> While such a provision under the *PG&E* case may be appropriate for a holding company when tied to a statutory provision (Section 854) that confers limited jurisdiction to the Commission, it is unlawful to apply such a provision as a rule of general applicability that would confer general jurisdiction to the Commission.

<sup>22</sup> See DRA Opening Comments at p. 4 (stating that “in order to ensure compliance, it is imperative that the Commission, and its staff and agents should have access to the officers and employees of the regulated utility, its parent and other related affiliates.”).

to the books and records of all such entities. Rule VIII.A would require officers and employees of affiliates “who are involved in making day-to-day business decisions” to appear and testify in any proceeding before the Commission.<sup>23</sup> Rule VIII.B would require the utility to provide unlimited access to the books and records of the utility’s *parent* and its *related affiliates*.<sup>24</sup> These proposals to regulate the conduct of non-regulated entities go far beyond the permissible bounds of the Commission’s jurisdiction to regulate public utilities. Rather than imposing certain rules on the conduct of California American Water, these proposed rules seek to exert direct control over all companies within the holding company structure, regardless of whether there are any transactions involving the utility, whether the entity is incorporated in California, and whether the entity has any connection to California. DRA’s proposed expansion of Commission power is unprecedented, and it is not supported by California law.<sup>25</sup>

TURN contends that *PG&E v Public Utilities Commission, et al* (118 Cal. App 4th 1174(2004)) provides the Commission with authority to regulate holding companies. The *PG&E* case, however, did not grant plenary jurisdiction to the Commission to enact rules of general applicability to all water utility holding companies absent a statutory basis for doing so. Rather, the *PG&E* case determined that the Commission has *limited* jurisdiction over holding companies to enforce conditions imposed on those companies by the Commission in the context of a Section 854 change of control proceeding. Furthermore, absent an express grant of power to regulate, California courts have declined to extend the Commission’s jurisdiction under Sections 818 and 854.<sup>26</sup> Although a holding company may agree to certain conditions in the context of a change of control of a utility over which the Commission clearly has jurisdiction, this rule would permit

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<sup>23</sup> DRA Opening Comments at p. 4.

<sup>24</sup> DRA Opening Comments at p. 4.

<sup>25</sup> Pub. Util. Code § 701 (“The commission may supervise and regulate every public utility in the State”) (emphasis added).

<sup>26</sup> *Stepak v. American Tel. & Tel. Co.* (1986) 186 Cal. App. 3d 633, 643 (“Sections 818 and 854 being the sole bases for the commission’s assumption of jurisdiction, we must conclude that the commission exceeded its jurisdiction”).

the Commission to impose conditions against the holding company where it lacks such authority. Contrary to TURN's contention, *PG&E* does not support a conclusion that the Commission may unlawfully enact rules of general applicability to holding companies absent a statutory foundation.

1. The Commission Should Reject DRA's and TURN's Attempts to Expand Statutory Provisions Through This Rulemaking: Section 314(b) Does Not Apply to Water Utilities

Two proposals in DRA's and TURN's comments would unlawfully expand the current statutory provisions to apply to water utilities. First, DRA and TURN ask the Commission to require open-ended access to the books and records of the utility's parent and "related affiliates," without limitation. Second, DRA and TURN ask the Commission to allow DRA and Staff to call as witnesses out-of-state officers and employees of affiliates who are "involved in making day-to-day business decisions."<sup>27</sup> The proposed rule is not limited to the day-to-day decisions of the *California-regulated utility*, but rather would extend to the day-to-day decisions in general of any entity within the holding company structure. As discussed below in more detail, DRA's current proposal is unlawful, is inconsistent with applicable statutory provisions, and exceeds the Commission's jurisdiction. The standard proposed by DRA for open-ended access to the books and records of the utility's affiliates is inconsistent with its proposed standard for commanding the appearance of executives and operating personnel of affiliated entities. If combined, DRA's two proposed standards for the rules, may be appropriate, so that the rules applied only to transactions *between the utility and its affiliates* in connection with the exercise by the Commission of its regulatory responsibilities *in examining costs sought to be recovered by the utility in rate proceedings*.

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<sup>27</sup> DRA Opening Comments, p. 3.

a. Calling out-of-state employees and officers of affiliates

Under Rule VIII.A, DRA and TURN propose that the Commission require officers and employees of affiliates to appear and testify in “any proceeding before the Commission involving the utility.”<sup>28</sup> As proposed, these provisions purport to allow staff or the Commission to command the presence in California of *affiliate* officers and employees in any proceeding involving the utility, regardless of *whether the Commission is examining costs sought to be recovered by the utility in a rate proceeding*. These provisions are overly broad and exceed the Commission’s jurisdiction. Section 314(b), which authorizes Commission inspection of *records of utility affiliates*, does not apply to water utilities.<sup>29</sup> If the Legislature intended to require water utilities to comply with Section 314(b) it would have included water utilities in the statutory provision. It would be inappropriate for the Commission to impose a rule of general applicability without the requisite statutory authority.<sup>30</sup>

TURN cites to Section 701 in support of its proposition that the Commission can require officers and employees of affiliates to be available to appear and testify before the Commission. Section 701 provides that “[t]he commission may supervise and regulate every *public utility in the State* and may do all things ...which are necessary and convenient in the exercise of such power and jurisdiction.”<sup>31</sup> However, the courts have narrowly interpreted this statute, finding that “in the absence of specific legislation to the contrary, the commission has no jurisdiction to regulate [non-public utilities].”<sup>32</sup> Section 701 does not expand the Commission’s authority to

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<sup>28</sup> DRA Opening Comments at p.16 (stating that “DRA recommends keeping the rule as proposed by the staff on December 31, 2009.”).

<sup>29</sup> D.93-09-06, *Application of San Gabriel Valley Water Company for Authority to Increase Rates Charged for Water Service in Its Los Angeles County Division*, 1993 Cal. PUC LEXIS 629, \*5.

<sup>30</sup> D.08-04-062, *Application for Rehearing of Resolution ALJ-195. Resolution Establishing a Process for Resolving Timing, Format, Scope, and Burden Concerns Regarding Commission Staff’s Access to Information Outside a Formal Proceeding*, 2008 Cal. PUC LEXIS 147, \*\*14-20 (stating that the “precise limits of the Commission’s authority in any given case must necessarily be determined based on the facts and circumstances of each case.”).

<sup>31</sup> Cal. Pub. Util. Code § 701 (emphasis added).

<sup>32</sup> *People ex rel. Public Utilities Commission v. Fresno* (1967) 254 Cal. App. 2d 76, \*81. *See also* (continued...)

actions that go beyond the regulation of public utilities. In the context of this affiliate transaction rulemaking, the Commission cannot exceed its jurisdiction and authority by imposing regulations on California American Water's parent company and affiliates, which entities are not California public utilities, absent any transactions with California American Water. There is no statutory authority granting the Commission general jurisdiction over affiliates.

If the Commission were to accept DRA's proposal, it would permit DRA to command the presence of executives and operating personnel of affiliated entities regarding any transaction between or among themselves that have absolutely no connection with California. Given that American Water is based on the East Coast, and other California American Water affiliates are located throughout the country and abroad, requiring the employees and officers of those companies to appear before the Commission with respect to any affiliate transaction is wholly unreasonable. Nothing in the record of this proceeding or any other proceeding before the Commission and no California law justifies such a broad extension of the Commission's jurisdiction.

b. Open-ended access to books and records of the utility's affiliates

DRA contends that the Commission and its staff "should have complete access to the business records of a regulated utility, its parent, and *related affiliates*."<sup>33</sup> As described above, DRA proposes to modify the Commission's jurisdictional reach to include all business transactions between affiliates even if the transactions do not involve the utility itself. For the reasons discussed above, DRA's proposal to regulate all affiliates, with "the burden ... on the

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*Consumers Lobby Against Monopolies*, 25 Cal. 3d at 905-906 ("Additional powers and jurisdiction that the commission exercises, however, must be cognate and germane to the regulation of public utilities") (internal citations and quotations omitted); *Santa Clara Valley Transportation Authority*, 124 Cal. App. 4th at 357 ("when the Legislature first granted the PUC regulatory authority over the Los Angeles Metropolitan Transit Authority, it enacted such a specific statute and observed that in so doing it [had] made exceptions to a long established policy") (internal citations and quotations omitted).

regulated utility to prove whether a transaction between a parent and affiliate is *not* germane to the regulated utility” is highly problematic.

Section 314(a) provides that the Commission and its staff may “inspect the accounts, books, papers, and documents of *any public utility*.”<sup>34</sup> Unlike Section 314(a), which applies to water utilities, Section 314(b) applies only to electric, gas and telephone corporations and provides for the inspection of books and records of “the subsidiary, affiliate, or holding corporation on any matter that might adversely effect the interests of the ratepayers of the electrical, gas, or telephone corporation.” While the California legislature has the power to extend the Commission’s jurisdiction in certain narrow circumstances, the Commission cannot expand its own jurisdiction.<sup>35</sup> The Commission must reject DRA’s improper attempt to expand the statutory provision through this rulemaking to provide DRA the ability to engage in a fishing expedition of all utility affiliates records.

Similarly, under Rule VIII.D, DRA proposes that the Commission require the utility to report *any* formation of “new affiliates and business transactions that have the *potential* to affect its regulated operations.”<sup>36</sup> California American Water’s parent company, American Water, has dozens of affiliates, many of which are located outside of the United States. Requiring California American Water to report on any new affiliates or business transactions that have nothing to do with California would create an enormous regulatory burden. Furthermore, the

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<sup>33</sup> DRA Opening Comments, p. 3.

<sup>34</sup> Cal. Pub. Util. Code §314(a) (emphasis added to original).

<sup>35</sup> *Santa Clara Valley Transportation Authority*, 124 Cal. App. 4th at 357 (“when the Legislature first granted the PUC regulatory authority....., it enacted such a specific statute and observed that in so doing it [had] made exceptions to a long established policy”) (internal citations and quotations omitted).

<sup>36</sup> DRA Opening Comments at p.18 (emphasis added).

vague description of affiliates and business transactions with the “*potential*” to affect regulated operations is vague regarding the scope of the proposed discovery and reporting requirement.

2. The Commission Should Not Impose Rules that Place It at Odds with the Regulatory Actions of Other State Utilities Commissions and Potentially Violates the Commerce Clause

DRA claims that transactions between the utility’s parent and its affiliates, including those that have nothing to do with California, “have the potential to affect the operations and operating costs of the regulated utility” and therefore, the Commission must regulate all utilities’ affiliates, regardless of “whether the affiliate is regulated by another state’s commission.”<sup>37</sup> As described in California American Water’s Opening Comments, the Commission would not welcome this sort of jurisdictional claim by other state commissions regarding transactions that fall within the California Commission’s jurisdiction.

Moreover, the Commission’s direct regulation of activities that occur wholly outside the boundaries of California may be a violation of the Commerce Clause because it exceeds the inherent limits of a state’s authority.<sup>38</sup> Applying such extraterritorial regulations puts the out-of-state entity “in jeopardy of being subjected to inconsistent legislation arising from the injection of [the State’s] regulatory scheme into the jurisdiction of other states.”<sup>39</sup> A Commission’s attempt to impose affiliate transaction rules on non-California regulated utilities would have a disruptive effect as state utilities commissions’ are ultimately responsible for the regulation of utilities that operate within their boundaries. By asserting its own rules outside of California, the

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<sup>37</sup> DRA Opening Comments, p. 4.

<sup>38</sup> See U.S. Const. Art. I, § 8, cl. 3.

<sup>39</sup> *National Collegiate Athletic Ass’n v. Miller* (9th Cir. 1993) 10 F.3d 633, 639 (rejecting a Nevada statute requiring out of state NCAA organizations to provide certain procedural rights to Nevada residents).

California Commission would risk creating inconsistent requirements for non-California public utilities. This would create an unworkable scheme for those non-California public utilities, and it would impermissibly interfere with the independent regulatory authority of commissions in other states.

**C. DRA's and TURN's Comments Fail to Consider the Significant Differences Between the Energy and Water Industries**

DRA's and TURN's comments fail to consider the inherent differences between the energy and water industries, which has resulted in critical differences in the Commission's regulation of the utilities. In the particular context of the affiliate transaction rules, the Commission has already recognized that "water utilities [should not] be subject to the same requirements as electric utilities. Instead it recognized that '*energy utility ... process is predicated upon specific affiliate transaction framework adopted for that industry, a framework not applicable to the water industry.*'"<sup>40</sup> In addition, the Commission historically applied different ratemaking treatment for energy utilities to water utilities because of the inherent differences between the two industries.<sup>41</sup>

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<sup>40</sup> D.04-12-023, *Commission Order Instituting Rulemaking on the Commission's Own Motion to Set Rules and to Provide Guidelines for the Privatization and Excess Capacity as it Relates to Investor Owned Water Companies*, p. 4 (emphasis added).

<sup>41</sup> See, e.g., D.96-07-057, *In re Application of San Gabriel Valley Water Company (U337W) for Authority to Increase Rates Charged for Water Service in its Los Angeles County Division*, 1996 Cal. PUC LEXIS 809, \*23 (rejecting return on equity comparison to energy utilities); D.95-08-058, *In re Application of California Water Service Company (U 60 W), a corporation, for an order authorizing it to increase rates charged for water service in the Dixon district*, 1995 Cal. PUC LEXIS 663, \*32 ("[Cal-Water] does not face the same business risk as energy utilities and as such is not entitled to the increase in ROE by the same number of basis points"). See also D.92-01-025, *In re Application of the Southern California Water District (U 133 W) for an order authorizing it to increase rates for water service in its Desert District*, 1992 Cal. PUC LEXIS 25, \*29; D.92-03-094, *In re Application of Southern California Water Company for authority pursuant to Public Utilities Code Section 851 to sell, and, if necessary, lease back its headquarters property in Los Angeles, California*, 1992 Cal. PUC LEXIS 236, \*\*26-27 ("Traditionally, water utilities, unlike energy utilities, are not allowed to include AFUDC on plant additions. Instead,

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**D. The Proposals of DRA and TURN to Foster Competition and Prevent Anti-Competitive Conduct Have No Basis for Application to the Water Industry.**

DRA appears to believe that the Commission should foster competition and adopt anti-competitive rules because it is possible that affiliate operations may affect other competitive markets. As an initial matter, the proposed rules were taken from the energy industry's affiliate transaction rules and are therefore based in principles that make no sense for the water industry because they were intended to encourage competitive activity during the deregulation of the energy industry.<sup>42</sup> Unlike the Commission's deregulation of the energy market, the Commission has indicated no interest in creating end-use retail competition in the water industry.

In the extremely limited instances where utilities may be operating in potentially competitive markets, DRA and TURN have failed to provide any evidence that there is a need to adopt regulations to prevent harm in such areas.<sup>43</sup> Rather, the proposals of DRA and TURN are based upon speculation and unlikely scenarios about the effects that the water utilities may have on the competitive arena.

Moreover, as California American Water explained in its Opening Comments, there is no record of the water utilities using any market power to the unfair disadvantage of potential competitors, and certainly not the massive record, consisting of many thousands of pages with market analysis and expert opinion, that supported the energy affiliate transaction rules. Regulations should only be adopted to address proven harms or risks that exist in the water

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water utilities are allowed to include construction work in progress (CWIP) in rate base”).

<sup>42</sup> D.97-12-088, *Order Instituting Rulemaking to Establish Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates.*; *Order Instituting Investigation to Establish Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates*, 1997 Cal. PUC LEXIS 1139 (“D. 97-12-088, 1997 Cal. PUC LEXIS 1139”), \*10 (“Utility entities competing to provide energy services should face uniform rules so that no advantage or disadvantage accrues to a player simply because of differing regulations”).

<sup>43</sup> See e.g., DRA Opening Comments, pp. 1-2 (stating that “DRA disagrees that certain rules are unnecessary just because the utility itself may be operating in a closed or non-competitive environment, it is still possible for affiliate operations to affect other competitive markets...”).

industry.<sup>44</sup> Although DRA contends that there is no oversight of the shared services,<sup>45</sup> the reasonableness of the transactions between the utility and financing or shared service affiliates are routinely reviewed in general rate proceedings and other Commission proceedings, such as financing petitions.

To the extent affiliates provide ancillary services outside of the utility's service area, it is even less likely that the utility could affect competitive markets. In reality, the proposed restrictions could actually impede the utility's ability to compete in such markets, and thus prevent the utility from offering a valuable and beneficial service to its customers.

There is another fundamental reason why the rules formulated for the electric industry should not be applied to the water industry, especially not with the dearth of any evidence of a need for such rules, or any harm or unfairness that is occurring or may occur. The focus of the Commission's concerns with regard to the electric rules were services that fell squarely within a primary area of the Commission's jurisdiction: the provision of retail electric services to California citizens, the vast majority of whom were served by monopoly investor owned electric companies. In the energy context, the primary State and Commission policy objectives were to create retail, end-use competition for the provision of electric service where none at all existed and to promote competition in the generating capacity markets. In direct contrast, there is no State or Commission policy to promote retail competition in the water industry.

Moreover, the only services DRA has identified as examples of services affiliates could provide in the competitive arena are limited to municipal billing services, service line protection

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<sup>44</sup> See e.g., D.08-11-033, *Rulemaking Regarding Whether to Adopt, Amend, or Repeal Regulations Governing the Retirement by Incumbent Local Exchange Carriers of Copper Loops and Related Facilities Used to Provide Telecommunications Services*, 2008 Cal. PUC LEXIS 443, \*\*22-23 ("Neither CALTEL nor any other commenter in this proceeding has provided evidence of harm justifying rules such as those CALTEL proposes. ...We find that hypothetical problems do not provide a basis for new regulations").

<sup>45</sup> DRA Opening Comments, p. 11.

programs, and operating and maintenance (“O&M”) contracts.<sup>46</sup> These services have little if anything to do with the primary purview of the Commission with regard to investor owned water companies that it regulates,<sup>47</sup> which is the provision of high quality, reliable, and reasonably priced end use, retail water service to customers within the service territories of the utilities it regulates.

There has been no showing whatsoever on this record that whatever advantage, if any, affiliates of California American Water might receive from that affiliation constitutes an unfair, competitive advantage. DRA simply assumes that any relationship to the regulated utility would be an unfair advantage. That however is not the case. Existing competitors can consist of companies that are far larger than California American Water, or even American Water, they may be better entrenched in these markets, have a national presence that exceeds that of California American Water or American Water, and they certainly do not have to contend with the regulatory requirements and associated expense that pertain to California American Water affiliates with whom it may have transactions. The rules DRA proposes would in fact constitute an unfair competitive detriment to California American Water and its affiliates.

#### **IV. THE COMMISSION SHOULD DISREGARD THE PROPOSALS OF DRA AND TURN REGARDING EXCESS CAPACITY RULES**

California American Water does not address each of DRA’s and TURN’s contentions regarding the excess capacity rules that are currently in place because the rules provide adequate oversight and do not require modification.<sup>48</sup> As California American Water and other parties

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<sup>46</sup> DRA Opening Comments, p. 2.

<sup>47</sup> The Commission lacks jurisdiction to regulate the rates and services of municipal utilities. *Santa Clara Valley Transportation Authority*, 124 Cal. App. 4th at 356 (“The PUC has no jurisdiction over municipally owned utilities unless expressly provided by statute”) (quoting *Orange County Air Pollution Control District v. Public Utilities Commission* (1971) 4 Cal.3d 945, 953 at footnote 7).

<sup>48</sup> D.01-01-026, *Commission Order Instituting Rulemaking on the Commission’s Own Motion to Set Rules and to Provide Guidelines for the Privatization and Excess Capacity as its Relates to Investor Owned Water Companies*, p. 1; D.03-04-028, *Commission Order Instituting Rulemaking on the Commission’s*  
(continued...)

have stated throughout this proceeding, the Commission should not alter its current rules. Such rules provide incentives to maximize the use of underutilized non-tariffed goods or services, and utilities and their customers share the value of such activities.<sup>49</sup>

DRA and TURN assert that the Commission should alter its existing excess capacity rules to disallow the use of employees for excess capacity.<sup>50</sup> DRA claims that the existing excess capacity rules will lead to “a level of permanent inefficiency.”<sup>51</sup> This position ignores the clear benefits and efficiencies that the excess capacity rules provide to ratepayers. In D.96-07-036, the Commission recognized the benefit to ratepayers of using San Jose Water Company’s excess employee capacity in billing services to provide a contract to the city.<sup>52</sup> The ability of utility personnel to efficiently apply their unused time allows water utilities to maximize the benefits of these employees to the benefit of ratepayers. By disallowing employees from utilizing excess capacity, DRA would force the utilities to maintain the full cost of an underutilized employee without receiving any benefit for ratepayers. Rather than creating inefficiencies as DRA claims, the excess capacity rules allow for a *more* efficient use of water utility resources. DRA and TURN provide no evidence of abuse with respect to employee provision of non-tariffed products and services under the excess capacity rules, and the Commission should disregard their suggestion to eliminate this clearly beneficial system.

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(continued...)

*Own Motion to Set Rules and to Provide Guidelines for the Privatization and Excess Capacity as it Relates to Investor Owned Water Companies*, 2003 Cal. PUC LEXIS 242, \*\*12-13; D.04- 12-023, *Commission Order Instituting Rulemaking on the Commission 's own Motion to Set Rules and to Provide Guidelines for the Privatization and Excess Capacity as it Relates to Investor Owned Water Companies*, pp. 7-8.

<sup>49</sup> *Id.*

<sup>50</sup> DRA Opening Comments at p.21; TURN Opening Comments at pp. 19-20.

<sup>51</sup> DRA Opening Comments at p.21

<sup>52</sup> D.96-07-036, *In the Matter of the Application of San Jose Water Company (U-168-W), a corporation, for an order authorizing it to increase rates charged for water service*, 1996 Cal. PUC LEXIS 788, \*14 (“We find that SJWC’s contract with the City is advantageous to ratepayers since the additional revenue generated by using excess capacity in billing lowers the overall operational cost of the billing process”).

Dated: May 17, 2010

Respectfully submitted,

By:   
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**PROOF OF SERVICE**

I, Maria Domingo, declare as follows:

I am employed in the City and County of San Francisco, California. I am over the age of eighteen years and not a party to this action. My business address is MANATT, PHELPS & PHILLIPS, LLP, One Embarcadero Center, 30th Floor, San Francisco, California 94111-3719. On May 17, 2010 I served the within:

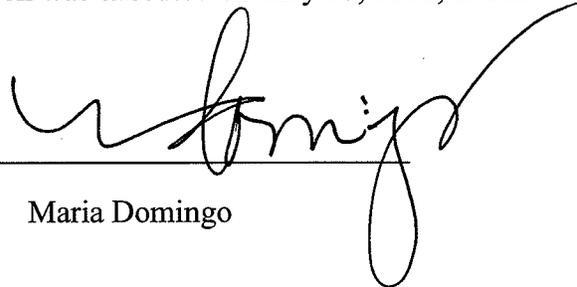
**REPLY COMMENTS OF CALIFORNIA-AMERICAN WATER COMPANY (U210W)  
ON THE STAFF WORKSHOP REPORT**

on the interested parties in this action addressed as follows:

*See attached service list.*

- (BY PUC E-MAIL SERVICE)** By transmitting such document electronically from Manatt, Phelps & Phillips, LLP, San Francisco, California, to the electronic mail addresses listed above. I am readily familiar with the practice of Manatt, Phelps & Phillips, LLP for transmitting documents by electronic mail, said practice being that in the ordinary course of business, such electronic mail is transmitted immediately after such document has been tendered for filing. Said practice also complies with Rule 1.10(b) of the Public Utilities Commission of the State of California and all protocols described therein.
  
- (BY U.S. MAIL)** By placing such document(s) in a sealed envelope, with postage thereon fully prepaid for first class mail, for collection and mailing at Manatt, Phelps & Phillips, LLP, San Francisco, California following ordinary business practice. I am readily familiar with the practice at Manatt, Phelps & Phillips, LLP for collection and processing of correspondence for mailing with the United States Postal Service, said practice being that in the ordinary course of business, correspondence is deposited in the United States Postal Service the same day as it is placed for collection.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on May 17, 2010, at San Francisco, California.

  
\_\_\_\_\_  
Maria Domingo

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[Updated April 22, 2010]**

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