

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA



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Application of Suburban Water Systems  
(U339W) to Establish a Holding  
Company.

A.09-07-015  
(Filed July 13, 2009)

**STATUS REPORT OF THE DIVISION OF RATEPAYER  
ADVOCATES IN RESPONSE TO ADMINISTRATIVE LAW JUDGE'S  
RULING OF JANUARY 22, 2010**

**I. INTRODUCTION**

Pursuant to the January 22, 2010 Ruling of Presiding Administrative Law Judge Ryerson, the Division of Ratepayer Advocates (“DRA”) hereby submits its status report and response to the four questions that were posed in the ruling.

**Response to Question 1:**

In responding to the question of what authority confers jurisdiction on the Commission to approve the creation of a holding company by Suburban, DRA notes that the Commission has plenary jurisdiction over the utilities it regulates and may under Section 701 of the Pub. Util. Code “... 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.” (emphasis added). While Southwest Water Systems is not a traditional utility, its acquisition of Suburban Water Systems was approved by the Commission in Decision 84466<sup>1</sup>. Since that initial decision, Southwest has expanded the operations of its affiliates and now provides substantial water-related utility services via contract in

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<sup>1</sup> Ordering Paragraph 4 of this decision gives Southwest Water Company control of the outstanding capital stock of Suburban Water Systems.

numerous states. Southwest derives more revenues from its unregulated activities than it does from Suburban's traditional utility operations.

As was noted in DRA's protest to Suburban's application, DRA experienced substantial challenges in obtaining discovery from Southwest Water Company about the activities of its affiliates in its last general rate case application and in several instances Suburban simply refused to respond to DRA's discovery efforts. One of the reasons the Commission ordered Suburban to file the instant application is to clarify the relationship between Suburban and its affiliated operations. In DRA's view, if the Commission approves a holding company structure for Suburban it will clarify the relationship between the various entities involved in Southwest and Suburban and it delineate the holding company's obligations to respond to Commission inquiries about its activities.

The Code also includes other provisions that delineate the Commission's authority over the acquisition and control of California utilities such as Section 852 of the Pub. Util. Code, that prevents any type of corporation from acquiring the assets of or merging with a California utility unless it obtains Commission approval. The Commission relied upon Section 854 of the Code as one of the bases of its authority to approve Southern California Edison's initial holding company application in D.88-01-063, 27 CPUC 2d 347 (1988). In addition, Section 856 states that officers, agents or employees of public utilities or their affiliates or subsidiaries that have a controlling interest in a utility who violate any provision of Article 6 of the code is guilty of a misdemeanor. Thus, applicable statutes recognize the Commission's authority over many aspects of affiliate activities.

Over the years the Commission has issued numerous holding company decisions for most of the major utilities in California including San Diego Gas and Electric (first as an independent utility) and later after its merger with Southern California Gas Company as Sempra. In the communications area, AT&T and its various other operating names, i.e., Pacific Telephone, Pacific Bell and SBC, have had several different holding company structures approved by the Commission. Similarly holding company structures exist for Southern California Edison (Edison International), Pacific Gas and Electric,

California Water Service, California American Water, Golden State Water Company, Valencia Water Company and others. These various decisions include specific provisions governing relationships between affiliates, subsidiaries, the holding companies and the utilities the Commission regulates. Thus, the instant application can be viewed as part of long-established pattern of Commission oversight and approval of holding company structures.

DRA notes that one value of the holding company structure is that it provides a degree of insulation for the utility from the possible financial travails of the holding company. A recent example of the value of this structure involves Valencia Water Company whose parent corporation recently went through a bankruptcy and reorganization. Absent this functional separation, the financial problems of Valencia's parent would have adversely affected Valencia's customers and would have substantially downgraded Valencia's credit status. It should be noted that holding companies provide substantial value to the shareholders since the holding company structure allows the affiliated and subsidiary companies to engage in lucrative unregulated activities.

The Commission's interest and concern about the specific issues raised by affiliate transactions between the state's water utilities and their affiliated or subsidiary operations was noted in the rulemaking that the Commission issued in April of 2009, Rulemaking 09-04-012. In the Rulemaking the Commission noted that "Because most Class A water utilities have both regulated and non-regulated subsidiaries, it is essential that this Commission develop rules which address the relationship between the regulated water utility and its parent and affiliates." mimeo p. 5. Suburban's existing corporate structure (or lack thereof) is characterized by extensive activities by its affiliates, issues regarding the proper allocation of expenses between the affiliated firms and Suburban, and the reality that Southwest and its affiliated firms earn more revenues than Suburban does from its water utility operations in California.

Given the sweeping jurisdictional mandate encompassed within Section 701 of the Pub. Util. Code and the more specific provisions of Sections 852, 854 and 856 and past Commission orders approving holding company orders for other utilities (including the

following Class A water utilities: San Jose Water Company, D.85-06-023, California Water Service Company, D.97-12-011, Golden State Water Company, D. 98-06-068, California American Water Company, D.02-12-068 and Valencia Water Company, D. 04-01-051) and the concerns expressed in the aforementioned Rulemaking Order the Commission's authority to require Suburban to submit the instant Application is beyond dispute.

**Response to Question 2.**

The immediate impetus for Application 09-07-015 was Decision 09-03-007, a decision that the Commission issued to conclude Suburban's last general rate case. In D.09-03-007, the Commission ordered Suburban to file an application to establish a holding company. (See discussion pages 3, 15-17, finding of fact 9 and ordering paragraph 4). In part, this order arose out of a request from DRA to require Suburban to file such an application. One of the reasons the Commission included this provision in its order was to provide a vehicle for resolving some of the discovery disputes between DRA and Suburban for future proceedings and to regularize the relationship between Suburban and Southwest and its various affiliates.

**Response to Question 3.**

The Commission needs to obtain precise information from Suburban about the organizational structure of Suburban's proposed holding company. The holding company decision must include provisions guaranteeing that DRA and other Commission staff will have be able to obtain whatever data they deem necessary pursuant to Sections 309.5, 311 and 314 of the Pub. Util. Code regarding operations of the holding company, Southwest, and the activities of Southwest's various affiliates. In addition, the Commission must establish a structure that includes a "first priority" condition for ParentCo (a proposed newly formed parent holding company by Suburban in this instant application), i.e., the holding company decision must include a provision that the "first priority" of ParentCo must be a commitment to the financial integrity of Suburban. Moreover, the Commission must establish enforceable safeguards to ensure that transactions between Southwest, ParentCo and the various affiliates are transparent, do

not improperly burden Suburban's ratepayers, and do not afford ParentCo any improper competitive advantage in its operations as compared to other unregulated firms.

In terms of factual information, Suburban's application should be supplemented to include information about ParentCo's financial structure, stock offerings, governance provisions, by-laws, corporate charter, and in situations wherein expenses are commonly shared between Suburban, Southwest and its various affiliates, about the work duties and time allocations of employees that perform services for both ParentCo, Southwest or its affiliates and Suburban. Moreover, to the extent ParentCo intends to use common facilities to provide services to both Suburban and its unregulated operations, the Commission needs to establish a requirement of transparency in the holding company decision that ensures DRA and other Commission staff has full access to applicable data on how ParentCo makes its allocation decisions.

To the extent that the Commission makes overall affiliate transaction rules as part of Rulemaking 09-04-012, whatever decision is issued in the instant case may need to be revisited to ensure the two decisions are consistent.

#### **Response to Question 4.**

The Commission has used a long-standing set of criteria for determining whether a given type of utility expense is eligible for memorandum account treatment. For example, in Resolution W-4276 (issued July 12, 2001) the Commission stated that:

“Memorandum accounts are appropriate when the following conditions exist:

- a. The expense is caused by an event of an exceptional nature that is not under the utility's control;
- b. The expense cannot have been reasonably foreseen the utility's last GRC and will occur before the utility's next schedule rate case;
- c. The expense is of a substantial nature in the amount of money involved; and
- d. The ratepayers will benefit by the memorandum account treatment.”

Since these criteria are largely self-explanatory and were discussed to a certain extent in DRA's protest, it is not appropriate to engage in a discussion of the eligibility of the instant application for memorandum account treatment in this document, other than to state that as part of its inquiry in this proceeding, the Commission needs to make a determination whether the instant application merits this type of treatment. Since the cost of Suburban's participation in this case is largely unknown at this point, it is impossible to be able to determine if criterion c. will be met by this application.

In addition, the Commission's Division of Water and Audits (DWA) has already considered the same request for establishment of memorandum account by Suburban in its Advice Letter 262-W dated April 24, 2009 and after careful evaluation has denied the request through its resolution, W-4768.

Respectfully submitted,

/s/ JASON ZELLER

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February 5, 2010

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of “**STATUS REPORT OF THE DIVISION OF RATEPAYER ADVOCATES IN RESPONSE TO ADMINISTRATIVE LAW JUDGE’S RULING OF JANUARY 22, 2010**” in **A.09-07-015** by using the following service:

**E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

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Executed on **February 12, 2010** at San Francisco, California.

/s/ ALBERT HILL  
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