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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Application of Suburban Water Systems (U339W) to Establish a Holding Company.	A.09-07-015 (Filed July 13, 2009)

STATUS REPORT OF SUBURBAN WATER SYSTEMS

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Pursuant to the January 22, 2010 *Administrative Law Judge's Ruling Concerning Status Report* (ALJ Ruling), Suburban Water Systems ("Suburban") hereby files this status report regarding its application for authority to establish a holding company. As directed in the ALJ Ruling, Suburban's status report addresses the following issues: (1) the authority of the California Public Utilities Commission ("Commission") to approve the creation of a parent holding company, (2) the authority of the Commission to compel Suburban to request approval of a holding company, (3) the legal and factual issues regarding the creation of a holding company that the Commission must resolve in this proceeding, (4) the legal and factual issues regarding Suburban's request for a memorandum account that the Commission must resolve in this proceeding. As discussed in more detail below, although the Commission has the authority to approve the creation of a holding company, it overstepped its authority by compelling Suburban to file an application for a holding company. The Commission should therefore dismiss Suburban's holding company application. Finally, Suburban urges the Commission to authorize Suburban to track the costs of this proceeding in a memorandum account.

I. COMMISSION AUTHORITY TO APPROVE THE CREATION OF A HOLDING COMPANY

Section 854(a) of the California Public Utilities Code states:

> No person or corporation, whether or not organized under the laws of this state, shall merge, 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 merger, acquisition, or control activities which are subject to this section.

The Commission explored its authority to approve the creation of a holding company in a series of decisions in the mid-1990s.[1] In these decisions, the Commission found that the formation of a holding company is subject to Section 854 of the California Public Utilities Code.[2] The statutory language that allows the Commission to determine "what constitutes merger, acquisition, or control activities," however, grants the Commission the discretion to exempt a holding company formation from Section 854[3] on a case-by-case basis.[4]

In 1994, San Diego Gas & Electric Company ("SDG&E") applied "to undertake a plan of reorganization whereby it would become a wholly owned subsidiary of a holding company (Parent) formed for that purpose by SDG&E."[5] The merged holding company was "a pure legal fiction, which has no operations, no employees, no assets, and no purpose aside from facilitating the change of ownership of SDG&E common stock."[6] The Commission held that the transaction was not subject to Section 854 because the Commission had other bases to assure that the transaction would be in the public interest.[7]

In particular, the Commission noted, "the utility's remaining powers as a natural monopoly [must] be clearly vested in operating units that we may readily identify and regulate."[8]

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[1] D.95-05-021, 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, 1995 Cal. PUC LEXIS 440 (interim opinion); D.95-12-018, 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, 1995 Cal. PUC LEXIS 931;D.96-07-059, Application of Roseville Telephone Company (U 1015 C) for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure, 1996 Cal. LEXIS 811; D.96-11-017, Application of Pacific Gas and Electric Company for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure, 1996 Cal. PUC LEXIS 1141.

[2] D.96-07-059, 1996 Cal. LEXIS 811, *6; see also D.96-11-017, 1996 Cal. PUC LEXIS 1141, *9.

[3] All section references are to the Public Utilities Code, unless otherwise specified.

[4] Pub. Util. Code §854(a); D.96-11-017, 1996 Cal. PUC LEXIS 1141, *14.

[5] D.95-05-021, 1995 Cal PUC LEXIS 440, *1.

[6] D.95-12-018, 1995 Cal. PUC LEXIS, 931, *14.

[7] D.95-05-021, 1995 Cal PUC LEXIS 440, *4

[8] D.95-12-018, 1995 Cal. PUC LEXIS, 931, *16.

The Commission also emphasized the applicability of the Affiliate Transactions Order,[9] which required that each utility and controlling corporation have procedures and controls in effect to implement certain safeguards.[10] Moreover, the Commission cautioned that the formation of the holding company did not diminish its ability to "revise the affiliate transaction guidelines should they prove inadequate to protect ratepayers."[11]

In 1995, Pacific Gas and Electric Company ("PG&E") filed a similar application for a holding company formation. The Commission found that PG&E's application was "indistinguishable" from SDG&E's application "with respect to the relevant facts for determining whether we should evaluate the application under §854."[12] The Commission held that, consistent with the SDG&E decision, PG&E's proposed transaction was not an acquisition activity subject to Section 854.[13]

Similar to the SDG&E and PG&E holding companies, Suburban's proposed holding company is also "pure legal fiction." Like the SDG&E and PG&E holding companies, Suburban's proposed holding company has no operations, no employees, no assets, and no purpose aside from facilitating the change of ownership of Suburban. As with SDG&E and PG&E, Suburban's powers as a natural monopoly are clearly vested in operating units that the Commission can readily identify and regulate. Last, the Commission has instituted a rulemaking proceeding (R.09-04-012) to develop affiliate transaction rules for water companies. The resulting rules will apply to transactions between Suburban and SouthWest.

Under Section 854(a), the Commission has the authority to approve creation of a parent holding company by Suburban. However, as the SDG&E and PG&E decisions indicate, the Commission has generally chosen not to subject holding company formations to Section 854,

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[9] D.93-02-019, Order Instituting Rulemaking on the Commission's Own Motion to Adopt Reporting Requirements for Electric, Gas, and Telephone Utilities Regarding Their Affiliate Transactions, 1993 Cal. PUC LEXIS 80.

[10] D.95-12-018, 1995 Cal. PUC LEXIS, 931, *31.

[11] *Id.*, *43.

[12] *Id.*, *14.

[13] *Id.*, *15

relying instead on affiliate transaction rules to protect the public interest. Similarly, in this case, requiring Suburban to file a holding company application was unnecessary and instead the Commission should rely on the affiliate transaction rules that will emerge from the current rulemaking proceeding to safeguard the public interest.

II. LACK OF AUTHORITY TO COMPEL SUBURBAN TO FILE AN APPLICATION FOR A HOLDING COMPANY

In Suburban's most recent general rate case decision, the Commission summarized the transactional history of Suburban and its parent company, SouthWest:

> In 1975, Southwest requested Commission authority to purchase Suburban (Application 55655). At the time, both Southwest and Suburban were regulated water utilities. In its application, Southwest stated its intention to consolidate its California water utility operations, and that Suburban would remain as a certificated utility. The Commission approved this transaction in Decision (D.) 84466 (1976)...[14]

Noting that D.84466 did not authorize Suburban or Southwest to form a holding company, the Commission directed Suburban to file the current application for a holding company.[15] This directive is perplexing, in that such a holding company does not currently exist and Suburban did not express an intention to create such a holding company. The Commission did indicate an interest in affiliate transactions between SouthWest and Suburban, but explained that it would address these issues in the industry-wide affiliate transaction rulemaking.[16]

As defined above, a holding company is a corporate entity with "no operations, no employees, no assets, and no purpose" other than to own stock. Although the discussion in the rate case decision is limited, it appears that the Commission mistakenly believed that SouthWest/Suburban had an additional holding company. This is incorrect.

Suburban is a subsidiary of SouthWest. SouthWest owns regulated public utilities and also serves cities, utility districts and private companies under contract. During the general rate case proceeding, SouthWest witnesses differentiated between the Service Group, which

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[14] D.09-03-007, 2009 Cal. PUC LEXIS 148, **20-21
[15] *Id.*, **21-22.
[16] *Id.*, *22.

provides contract services, and the utility, Suburban.[17] These are internal organizational designations; they do not indicate separate corporate entities. It is possible, however, that the discussion of these internal organizational groups led to the misconception that an additional holding company existed.

D.84466 did not authorize the formation of an additional holding company. If such a holding company existed, therefore, an application would allow the Commission the opportunity for review. As discussed above, however, the Commission generally does not subject holding companies to Section 854 review and instead relies on affiliate transaction rules to safeguard the public interest. The water affiliate transaction rulemaking noted in the Suburban general rate case decision would provide that protection.

Since a holding company does not already exist, the Commission overstepped its authority by ordering Suburban to create one. It is well established that the Commission does not have the authority to dictate the corporate form of a public utility. As the Commission held in the SDG&E decision:

> [T]he form of organization and ownership of any for-profit venture ought lie, in the first instance, in the sound discretion of management, subject to the rights provided otherwise of the shareholders to consent, and subject to our oversight to the extent necessary to protect the public interest.[18]

Moreover, in that decision, the Commission stated,

> Pursuant to Rule 51.8 of our Rules of Practice and Procedure, we intend the principle expressed in the preceding sentence to be precedent for future similar proceedings.[19]

The Commission has affirmed this principle in subsequent proceedings.[20]

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[17] *Id.*, **4-5.

[18] D.95-12-018, 1995 Cal. PUC LEXIS 931, *12.

[19] D.95-12-018, 1995 Cal. PUC LEXIS 931, *12.

[20] D.96-07-059, 1996 Cal. LEXIS 811, *9-10; D.96-11-017, 1996 Cal. PUC LEXIS 1141, *20; D.98-06-068, Application of Southern California Water Company (U 133 M) a Corporation, for an Order Authorizing Southern California Water Company to Form a Holding Company Structure, 1998 Cal. PUC LEXIS 391, **11-12.

As Suburban noted in its application, the formation of a holding company will not change the ultimate control of the utility, nor will it affect the management or operation of Suburban. Creating this additional corporate layer does not in any way serve the public interest. By compelling SouthWest and Suburban to create a new holding company, the Commission has overstepped its authority and improperly dictated the form of organization and ownership of the utility.

III. ISSUES FOR THE COMMISSION TO RESOLVE IN THIS PROCEEDING

Suburban recommends that the Commission dismiss the current application. As discussed above, the Commission does not have the authority to dictate the form and organization of a utility by requiring SouthWest and Suburban to create a new holding company. Even if the Commission determines, despite Commission precedent to the contrary, that it does have the authority to compel Suburban to create a holding company and file an application for approval, it should still dismiss the current application. The holding company would be a meaningless corporate layer serving no purpose. The affiliate transaction rules that emerge from the current rulemaking will apply to interactions between SouthWest and Suburban; there is no need to create a holding company to provide this sort of protection.

IV. SUBURBAN'S REQUEST FOR A MEMORANDUM REQUEST

Whether the Commission dismisses the application or not, it should still grant Suburban's request for a memorandum account in which to track the costs of this proceeding. To do so, it will have to resolve the factual issue of whether the costs of this proceeding are already provided for in Suburban's current rates. Unlike other administrative costs, there is no provision for the cost of this proceeding in Suburban's current rates. Outside of its general rate cases, Suburban generally does not incur outside legal and regulatory costs. Therefore, the regulatory expenses that Suburban included in its application did not include an allowance for proceedings such as this.

Legally, the Commission must determine whether Suburban's request meets the criteria necessary for establishing a memorandum account, set forth in the Division of Water and

Audits' ("DWA") Standard Practice U-27-W. According to Standard Practice U-27-W, the costs must: (1) not be under the utility's control, (2) not have been reasonably forecast in the utility's last general rate case, (3) involve a substantial amount of money, and (4) have ratepayer benefits.

As discussed in Suburban's application, the costs are out of its control because its participation in this proceeding is not voluntary. The Commission explicitly ordered Suburban to file this holding company application, forcing it to incur the related costs.

Moreover, Suburban could not have reasonably forecast the costs of this proceeding in its last general rate case. The Commission approved SouthWest's purchase of Suburban over thirty years ago. Suburban since has filed many formal requests for rate increases and other matters. Its parent/subsidiary relationship with SouthWest has been transparent the entire time. At the time it filed its rate case application, Suburban had no idea that the Commission would require it to file a holding company application.

Furthermore, for a company the size of Suburban, the cost of participating in this proceeding is likely to be substantial. Pleading such as this status report involve complex legal issues. If the proceeding continues, it will likely be strongly contested, requiring a significant outlay on Suburban's part. When the Commission's exact holding company requirements for Suburban become known, a holding company will have to be created, articles of incorporation drafted, and appropriate cost sharing mechanisms developed and implemented.

Finally, ratepayers benefit from allowing Suburban to recover its costs for participating in this proceeding. Customers benefit when the Commission allows utilities to recover their reasonable expenses, particularly expenses related to participation in Commission-mandated proceedings.

The Commission must also determine the date from which Suburban may track the costs of this proceeding. Suburban filed an advice letter seeking recovery of its costs in both this proceeding, which DWA incorrectly rejected. If the Commission grants Suburban's memorandum account request as part of this proceeding, it should allow Suburban to track the

costs it has incurred since the date it filed its advice letter, in keeping with recent Commission decisions.

In the water conservation proceeding (I.07-01-022), the Commission allowed Suburban to track costs that Suburban incurred before the Commission authorized a memorandum account. In authorizing Suburban to track expenses associated with that proceeding, the Commission stated:

> [W]here the costs arise due to our requiring the utilities' participation in a generic proceeding to develop conservation rate designs and address non-rate design issues and where timely creation of a memorandum account was summarily rejected, it would be unjust to deny tracking these costs in memorandum accounts.[21]

The Commission recently reaffirmed its decision on rehearing. In that decision, the Commission observed that the prohibition against retroactive ratemaking did not apply and found that it would be unjust not to allow Suburban the opportunity to recover the costs of participation, even if it incurred some of the costs before the Commission authorized the memorandum account.[22] Suburban's situation in this proceeding is nearly identical; i.e. the Commission required Suburban's participation and Suburban's timely request for a memorandum account was summarily rejected. Therefore, the Commission should authorize Suburban to open a memorandum account and allow Suburban to track the costs for this proceeding that it has incurred since the date it filed its advice letter.

V. CONCLUSION

Although the Commission has the authority to approve the formation of a holding company under Section 854 of the Public Utilities Code, it usually exempts such transactions from Section 854 and instead relies on affiliate transaction rules to protect the public interest. The Commission has overstepped its authority by compelling Suburban to file an application for approval of the creation of a holding company. The Commission should therefore dismiss

[21] D.08-02-036, Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities, 2008 Cal. PUC LEXIS 72, *68

[22] D.09-06-053, Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities, 2009 Cal. PUC LEXIS 287, **14-15.

Suburban's holding company application and instead rely on the upcoming water affiliate transaction rules to regulate interactions between Suburban and its parent company, SouthWest. Finally, the Commission should authorize Suburban to track the costs of this proceeding that it has (and will) incurred in a memorandum account.

Dated: February 8, 2010

MANATT, PHELPS & PHILLIPS, LLP

By: */s/ Lori Anne Dolqueist*
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PROOF OF SERVICE

I, Cinthia A. Velez, 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 February 8, 2010, I served the within:

Status Report of Suburban Water Systems

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 February 8, 2010, at San Francisco, California.

Cinthia A. Velez

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[Updated January 25, 2010]

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