



**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).

Rulemaking (R) 09-04-012

**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**

I. The Workshop Report Does Not Fairly Or Accurately Represent The Position Of The Cfc In This Rulemaking.

The Workshop Report erroneously describes the position of the Consumer Federation of California (“CFC”) on rules discussed at workshops. CFC is not, as Staff says, “in strong opposition to the structure of existing and proposed affiliate rules, which emphasize constraints of the actions of the utility,” CFC has argued throughout this proceeding that ‘constraints’ are essential. CFC’s position on each of the rules has been added (in pink) to the Excel Spreadsheet circulated by Staff as part of its Workshop Report.¹

In Comments filed July 16, 2009, CFC supported the adoption of rules which would prevent cross-subsidization, raiding of assets, increasing risk to the utility and other practices which contributed to the Great Depression and led to enactment of the Securities Exchange Act of 1934.² CFC described the holding company structures of California’s water utilities and instances when the water utilities were discovered to have ‘padded’ expenses to enrich their holding companies.

CFC went to great lengths to examine proposed rules, compare them with existing rules of energy utilities, as well as precedent established in prior Commission decisions, and offer constructive comments. See, July 16 Comments at pages 15-25. There is no

¹ The spreadsheet is not user friendly. CFC’s Comments may be found in odd places.

² It would be useful to re-examine constraints imposed after the depression to avoid a second happening, as in the financial industry.

support for the Staff's statement that CFC is "in strong opposition to the structure of existing and proposed affiliate rules."

In its "Response to the Comments and Prehearing Conference Statements of Others," filed August 20, 2009, CFC pointed out that many of the officers of the water company's parents also serve as officers of the water utilities, and described the inherent conflict of interest created by asking an officer to serve two masters. CFC advocated separation of the utility from affiliates, as Staff had originally proposed in its draft rules. CFC also included in its Response, a strong rebuttal of California-American's claim that few constraints should be imposed:

Thus, when CalAm cautions that the Commission "must ensure that it does not take away water utilities' ability to exercise their best business judgment in operating the water business ... , it fails to recognize that its business judgment, with respect to property devoted to the public's use, has been superseded by that of the Commission, for the public good. When CalAm argues that "these rules impose unnecessary and unduly restrictive requirements on California American Water," it fails to recognize that it devoted its property to a public use, and that it no longer has the freedom or 'flexibility' to do whatever it wants. The Commission has the authority, and must, restrict practices which are harmful to the public."³

CFC's "belief" that "court rulings have said that the Commission has direct jurisdiction over the actions of the utility's affiliates,"⁴ was expressed in response to CalAm's Comments.

CalAm claims that some of the rules proposed in Attachments A & B of the OIR "exceed the Commission's jurisdiction to regulate the activities of water utilities." The argument has already been made to a California court, and it disagreed. "[T]he PUC's exercise of limited jurisdiction over the holding companies is cognate and germane to its regulation of a public utility, namely, the utility subsidiary of the holding company."⁵

There is no need for CFC to "elaborate on the findings of these court cases,"⁶ as Staff proposes, since the Commission made these arguments to the California Court of Appeal in *PG&E Corp. v. Public Utilities Com.* (2004) 118 Cal. App. 4th 1174, 1198, review denied, *PG&E Corp. v. P.U.C. (Office of Ratepayer Advocates)*, 2004 Cal. LEXIS 8379

³ CFC Response (Aug. 20, 2010) at 2-3 (footnotes omitted), *citing*, OIR in Rulemaking No. 94-04-031, 1994 Cal. PUC LEXIS 336, *54-55

⁴ Inaccurately reported in Staff Workshop Report at Screen 2.

⁵ CFC Response (Aug. 20, 2010) at 4.

⁶ Staff Workshop Report at Screen 2.

(Cal., Sept. 1, 2004). The holding of the case is significant when an issue is raised about the Commission's jurisdiction to obtain information from a utility's affiliates, like the Staff's proposed Rule VIII.B., to which the utilities object:

VIII.B. The utility and its affiliated companies shall provide the Commission, its staff, and its agents with access to the relevant books and records of such entities in connection with the exercise by the Commission of its regulatory responsibilities in examining any of the costs sought to be recovered by utility in rate proceedings.

The Staff Report is also wrong when it states, "The CFC also disagrees with the concept underlying the production of NTP&S." CFC does disagree with the concept, without proof that customers actually, rather than theoretically, benefit from a utility's use of assets for which customers are paying. Other objections were fully discussed in CFC's July 15, 2009, Comments at pages 35 *et seq.* However, as applicable here, CFC has joined DRA's position on the draft rules. When one of several conflicts in scheduling occurred and CFC had to leave a workshop, CFC gave its "proxy" to DRA to make a judgment about which "buckets" should be used to capture various issues concerning NTP&S. CFC was aware of DRA's position when the proxy was given, and it is wrong to say, as Staff has done, that CFC "would oppose any action allowing such use of utility assets before appropriate analysis is performed."

It appears that what Staff meant in saying CFC was "in strong opposition to the structure of existing and proposed affiliate rules," is that CFC strongly opposed changes to the rules recommended by the utilities. This is not abnormal. Consumer representatives are generally protective of the rights of consumers.

II. The Utilities Are Uniformly Resistant To Any Limitations On Their Relationships With The Holding Companies And Affiliates.

At the outset of this proceeding, the Commission stated its "goal is to develop standard rules and procedures for water and sewer utilities governing affiliate transactions and the use of regulated assets for non-tariffed utility products and services."⁷

Currently, five of the nine Class A water utilities have authorized affiliate

⁷ Order Instituting Rulemaking 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" (Apr. 23, 2009) at 4.

transaction rules in place, and each utility's set of rules is unique. ... The Commission has also adopted rules that govern the water utilities' ability to provide non-tariffed products and services through the use of regulated assets and personnel (formerly called excess capacity rules). ... We believe consistent rules governing affiliate transactions and nontariffed utility products and services for all water and sewer utilities would provide appropriate Commission oversight and protect ratepayers.

Some general rules previously adopted by the Commission, are set out below, together with their numerical designation in rules proposed by Staff in this proceeding:

- Ratepayers should be indifferent as to whether a utility does or does not have affiliated companies. (CWA)
- **Safeguarding Resources.** The Utility shall avoid a diversion of management that would adversely affect the Utility. The Utility shall not use its directors and employees, including officers, to conduct unregulated operations if such use would adversely affect the Utility or its ratepayers. (Decision 04-01-051; D.02-12-068; D. 98-06-068; D.97-12-011 – now, Rule III.A.⁸)
- **Precise Accounting for Transactions.** The Utility and each of its affiliates, including the holding company, shall maintain their accounting records in accordance with Generally Accepted Accounting Principles and, where appropriate, the Commission's Uniform System of Accounts.” (D.98-06-068; D.97-12-011; D.02-12-068; Decision 04-01-051 – now, Rule IV.A.)
- **Avoidance of Cross-Subsidization.** “The Utility and each of its affiliates, including the holding company, shall allocate costs between them in such a manner that ratepayers of the Utility not subsidize any affiliate of the Utility.” (D.98-06-068 – now, Rule IV.B.)
- **Separation to Avoid Free-Loading.** To the greatest extent feasible, [utility] shall maintain its offices, facilities, and employees in locations physically separate from affiliated companies. Where such separation is not feasible, [utility] shall create and implement stringent management and accounting policies to ensure that [Utility's] public utility functions are not affected by the proximity of the affiliates, and that all affiliate costs are paid by the affiliate.” (D.04-01-051 – now, Rule IV.C.)
- **Fair Price Charged for Transferred Property.** All transfers of property other than real property or payment of dividends from [Utility] to any affiliated company shall be in writing and priced at the higher of cost or fair market value. [Utility] shall record any revenue resulting from the transfer of any such property in a

⁸ Line 44 of Excel spreadsheet included with Staff Workshop Report.

memorandum account for further disposition by the Commission. (D.04-01-051–now, Rule VI)

Unless in conflict with the Public Utilities Code or the Commission's policies, such asset or good transferred from an affiliate to the Utility shall be at cost or fair market value, whichever is lower. (D.97-12-011; D. 98-06-068 – now, Rule VI).

- **Fully Funded Utility.** The holding company shall use its best efforts to provide or cause to be provided equity to restore the capital structure of the Utility whenever the Commission has determined that it has not been reasonably maintained. (D. 04-01-051; D.02-12-068 – now, Rule VII.A. & C.)
- **VIII.B. Access To Books And Records.** The Utility and its affiliates, including the holding company, will provide the Commission, its staff, and its agents with access to the books and records of the holding company and each affiliate in connection with the exercise by the Commission of its regulatory responsibilities. (Decision 04-01-051, D.02-12-068; D.98-06-068; D.97-12-011; D.85-06-023 – now, Rule VIII.B.

The water utilities are attempting, by proposing deletion of these rules, to nullify previous rulings of the Commission. For example, the CWA draft would

- Delete the GAAP accounting requirement from Rule IV.A, contrary to several previous Commission decisions.
- Delete IV.C. which obligates the utility to physically separate its own operations from those of its affiliates.
- Delete Rule VIII.B. (Access to books) from Staff's spreadsheet, although required by several previous Commission decisions.
- Delete Rule VII.A., which requires the holding company to ensure the utility has adequate capital to fulfill all of its service obligations.
- Delete Rule VII.C., which requires that the capital structure adopted by the Commission to be maintained.

It is not clear from the spreadsheet whether Rule III.A., prohibiting a dilution of utility resources, would be deleted. The spreadsheet says, "This sentence was discusses [sic] and there was, according to the staff's notes, general consensus that, if the above phrasing was retained to DRA's and TURN's satisfaction, this sentence would be redundant."

It is very difficult to find substantive rules which CWA and the water companies are willing to accept. They have, admittedly, agreed to comply with the law (Rule I.D.). However, a careful examination of the spreadsheet circulated with the Staff's Workshop Report demonstrates that they have been unwilling to agree to much else..

CWA and the water utilities are unwilling to separate their operations (offices, employees) from those of their affiliates, although they have agreed to allocate some unspecified amount of joint costs to the affiliate. (Rules IV.C. & D.) They want to delete rules that would require them to track an employee's transfers between the utility and an affiliate, as well as the requirement that the affiliate pay for temporary or permanent use of a utility employee. (Rule IV.E.). They do not want any limits on the sharing of corporate support, even regulatory affairs, lobbying, and legal services departments where the Commission found there is a clear conflict of interest.⁹ (Rule V)

CWA and the water utilities are not willing to agree that they should be prohibited from providing leads to an affiliate, getting customers to consent to release of customer information, or sharing market analysis reports or any other types of proprietary or non-publicly available reports, including but not limited to market, forecast, planning or strategic reports, with their affiliates. (Rule III. B. 1, 4, & 5). They are not willing to agree to offering non-discriminatory access to utility information, services, and unused capacity or supply. (Rule III.C.) They are resisting rules which would require them to offer goods and services produced or developed for the market to all businesses, including the affiliates, on a non-discriminatory basis. (Rule VI.4.) And they are opposed to obtaining an independent appraisal of the value of goods and services transferred to their affiliates. (Rule VI.6)

CWA and the water utilities oppose a rule obliging the holding company to provide the utility with sufficient capital to fulfill all the service obligations imposed by the Commission, and they oppose a rule which would require that capital be maintained at the utility level in the same proportion as was approved by the Commission in the previous rate case. (Rules VII.A. & C.) They are also opposed to 'ring-fencing', the obligation the Commission has adopted to ensure that a utility is not called upon to satisfy

⁹ Decision 06-12-029, Sec. 3.2.4. "Rule V – Shared Services" at p. 22 (December 14, 2006).

the debts and other obligations of its holding company and affiliates, in the event of the bankruptcy of either. (Rule VII.D.)

CWA and the water utilities claim the Commission does not have authority to require holding company or affiliate personnel to open their books to the Commission staff, or appear before the Commission to answer questions. (Rules VIII.A. & B.) They don't want to be required to file compliance plans and they want to limit the number of entities about which they have to report. (Rules VIII.C. & F.) They don't want to have to "demonstrate both the specific mechanism and procedures that the utility and holding company have in place" to assure that the utility is not using the holding company or an affiliate to avoid compliance with the rules, e.g., reveal proprietary information, provide services or transfer employees in a manner not authorized by the rules. (Rule II.D.) They don't want anyone to audit their books. (VIII.E.)

III. GOOD AFFILIATE TRANSACTION RULES ARE NEEDED.

There is no reason to believe that water companies are any more virtuous than other utilities. They are subject to the same temptations and fiduciary obligations to the holding companies' shareholders as every other utility. Customers need the Commission's protection from the excessive rates which arise out of utilities' transactions with affiliated companies, *i.e.*, from cross-subsidization (A.08-01-004, Suburban Water Co.; D.04-03-039, Golden State Water Co.); inflated plant values (A.05-08-021, San Gabriel Water Co.); siphoning of resources (A.07-01-035, San Jose Water Co.); and preferential treatment of affiliates (D.08-11-025, California-American Water Co.). Customers need the ability to examine records showing a water company's dealings with affiliates, as described by DRA in its Prehearing Conference Statement filed in July 2009 (at page 5, discussing A.08-01-024, CalAm). Rules proposed by Staff address these issues and the parties have proposed changes based on different regulatory philosophies. Rules should be debated in public and should not be nullified through a workshop process conducted primarily through the exchange of spreadsheets.

WHEREFORE, CFC asks the Administrative Law Judge and the Commission to examine the Comments filed in this proceeding and determine what rules will provide appropriate Commission oversight and protect ratepayers.

DATE: May 7, 2010

CONSUMER FEDERATION OF CALIFORNIA

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CERTIFICATE OF SERVICE

I hereby certify that on May 12, 2010, I served by e-mail all parties on the service lists for R.09-04-012 for which an email address was known, true copies of the original of the following document which is attached hereto:

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The names and e-mail addresses of parties served by e-mail are shown on an attachment.

Dated: May 12, 2010

Respectfully submitted,

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