Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Concerning Relationship Between California Energy Utilities And Their Holding Companies And Non-Regulated Affiliates.	Rulemaking 05-10-030 (Filed October 27, 2005)

OPINION AMENDING ORDER INSTITUTING RULEMAKING

Summary

Today's order amends the Commission's October 2005 Order Instituting Rulemaking (OIR or R.), both as to scope and schedule, and attaches for public review and comment, staff proposals to revise (1) the Commission's Affiliate Transaction Rules and (2) its General Order (GO) 77-L, which governs the reporting of compensation paid to executive officers and employees of regulated utilities. The proposed rule revisions apply only to the previously designated Respondents, California's major energy utilities and their holding companies: Southern California Edison Company (Edison)/Edison International, Pacific Gas and Electric Company (PG&E)/PG&E Corporation, and Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E), both owned by Sempra Energy.

Background and Amended Scope

The Commission opened this OIR to review "the relationship of the major energy utilities with their parent holding companies and affiliates" in furtherance of two over-arching goals. (OIR, *mimeo.*, p. 1.) These goals are "to ensure that the utilities meet their public service obligations at the lowest reasonable cost" and "to ensure that the utilities do not favor or otherwise engage in preferential treatment of their affiliates." (*Id.*, p. 2.)

At least four factors militate for a review of the relationships now. First, as the OIR notes, the recent enactment of the Energy Policy Act of 2005 (EPAct 2005), Public Law 109-58, has repealed the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. §§ 79 – 79z-6. Under PUHCA, state commissions had recourse to the Securities and Exchange Commission (SEC) if state laws proved insufficient to protect utility ratepayers from abuses by utility holding companies. With the repeal of PUHCA, this Commission has lost one of the protections underpinning its approval of the formation of the holding companies that control Edison,[1] SDG&E,[2] and PG&E,[3] as well as a safeguard underlying

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[1] *See* Decision (D.) 88-01-063, 27 CPUC 2d 347 (Jan. 28, 1988) (Edison/EIX), regarding Edison International.

[2] *See* D.95-05-021, 59 CPUC 2d 697 (May 10, 1995) (SDG&E I); D.95-12-018, 62 CPUC 2d 626 (Dec. 6, 1995) (SDG&E II), regarding Enova Corporation.

[3] *See* D.96-11-017, 69 CPUC 2d 167 (Nov. 6, 1996) (PG&E I); D.99-04-068, 86 CPUC 2d 76 (April 22, 1999) (PG&E II), regarding PG&E Corporation.

approval of the SDG&E/SoCalGas merger, which resulted in the creation of Sempra Energy.[4]

Second, the utilities' inherent conflicts between serving their customers or helping their holding companies and other affiliates may be increasing. The Commission has long recognized such conflicts of interests with each of the California energy utilities and their affiliates.[5] In 1997, the Commission adopted the existing Affiliate Transaction Rules in an effort to prevent two kinds of abuses: using ratepayer assets to subsidize affiliates and exercising market power in favor of affiliates to the detriment of the development of competitive markets.[6] Subsequent to the Commission's issuance of the Affiliate Transaction Rules, the California energy utilities' holding companies and/or other affiliates have acquired or built electric generation plants and pipeline facilities, and currently are constructing liquefied natural gas (LNG) facilities and connecting pipelines, and/or acquiring equity interests in new pipeline proposals.[7] The repeal of PUHCA may result in further acquisitions by the holding companies that control California's energy utilities.

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[4] *See* D.98-03-073, 79 CPUC 2d 343 (March 26, 1998) (Sempra Merger), regarding Sempra Energy.

[5] *See* D.92-07-084, 45 CPUC 2d 241 (July 22, 1992) (SoCalGas/PITCO); D.93-03-021, 48 CPUC 2d 352 (March 10, 1993) (Edison settlement re: Mission Energy); D.97-08-055, 73 CPUC 2d 754 (August 1, 1997) (PG&E settlement re: PGT).

[6] *See* D.97-12-088, 77 CPUC 422, 449-452, as amended by D.98-08-035, 81 CPUC 2d 607 and D.98-12-075, 84 CPUC 2d 155.

[7] *See,* e.g., Sempra Energy's website at http://www.sempra.com/companies.htm; Edison's website at http://www.edison.com/ourcompany/affiliate_trans.asp.

Third, the reports submitted by the utilities and their holding companies in response to the OIR, as well as the affiliate audits and letters from the utilities, suggest a highly integrated relationship among the affiliated entities, with potentially detrimental consequences for ratepayers and competitors.[8] The solution would seem to be greater separation and more transparency.

Fourth, but not at all least, recent changes in state law and Commission policies have altered both utility procurement obligations and the oversight responsibilities this Commission bears. California is on a path to ensure resource adequacy on the supply side through the construction of new power plants, transmission lines, pipelines, and storage facilities to meet long-term needs for reliable energy supplies. These new projects may be built and owned by utilities and by non-regulated entities, including the utilities' affiliates. The Commission's regulation of utility resource procurement must meet statewide goals, including resource adequacy and environmental goals and, increasingly the Commission is utilizing pre-approval processes.[9] It is incumbent upon this Commission to ensure that interactions between and among the utilities, their

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[8] For example, in a June 21, 2004 letter from William L. Reed, SDG&E's and SoCalGas' Senior Vice President, to Paul Clanon, who was then Director of the Commission's Energy Division, Mr. Reed acknowledged that SDG&E and SoCalGas had violated the Commission's affiliate rules by providing nonpublic information to Risk Capital Management Partners (RCMP), a financial risk management consulting firm. As of November 16, 1999, RCMP had been a consultant for Sempra Energy, and as of January 22, 2001, Sempra Energy Trading, their unregulated marketing affiliate, had acquired a 49% financial interest in RCMP.

[9] *See,* e.g., Cal. Pub. Util. Code § 454.5 (electric procurement requirements); D.04-09-022, 2004 CalPUC LEXIS 522 (pre-approval of natural gas utilities' LNG contracts and interstate pipeline contracts).

holdings companies and other affiliates do not circumvent California's energy policies, including the important environmental goals they promote.

Each of these concerns also calls into question the ability or willingness of the utility holding companies to fulfill their obligations to make the utility's capital requirements a first priority, as the Commission's holding company decisions require (i.e., the first priority condition).[10]

In addition, the comments of the Greenlining Coalition (Greenlining), filed on December 13, 2005, observe that the scope of this OIR should include review of the impact of executive compensation on utilities and their holding companies. Some of Greenlining's suggestions appear to fall outside the jurisdiction of this Commission. However, we are prepared to consider suggestions within our authority, particularly requirements for more meaningful disclosure of all of the individual components that comprise the total compensation paid to highly compensated executives and employees. Such information is necessary both to ascertain the reasonableness of rates (to the extent monies received from ratepayers fund any part of executive or employee compensation packages, directly or indirectly) and to ensure that the structure of executive/employee compensation does not promote conflicts of interest that disfavor utility concerns over those of the holding company or other affiliates. We recognize that the Commission recently declined to amend General Order (GO) 77-L to include some of Greenlining's proposals. Now, following the repeal of PUHCA and concurrent with the SEC's movement for greater sunshine on executive compensation, we agree that we should reconsider certain of these issues.[11]

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[10] *See* D.88-01-063, 27 CPUC 2d at 376; D.95-12-018, 62 CPUC 2d at 651; D.96-11-017, 69 CPUC 2d at 201, as modified, D.99-04-068, 86 CPUC 2d at 126.

[11] *See* the SEC's Proposed Rule "Executive Compensation and Related Party Disclosure" 17 CFR Parts 228, 229, 239, 240, 245, 249, and 274. Comments are due by

Footnote continued on next page

Because the OIR did not include draft rules, we directed Commission staff to develop and propose rules to address the concerns articulated above. Accordingly, we amend the scope of this OIR to examine the staff proposals for revisions to two sets of regulations as they affect respondents, (1) the Affiliate Transaction Rules, and (2) the Commission's GO 77-L. These proposals are appended to today's order, respectively, as Attachment A and Attachment B, and are presented as red-lined edits to the existing rules to show where they would add or delete text to the existing rules.

Summary of the Proposed Rules

The proposed rule revisions seek to accomplish four things:

1. Strengthen the separation rules between the utility, its affiliates, and the holding company.
    - Clarify that parent or holding company is covered by these rules.
    - Restrict the number of shared activities allowed for corporate support by excluding financial planning, regulatory affairs, lobbying, legal, and risk management from shared services.
    - Extend the prohibition on joint employees to consultants and contractors.
    - Further limit the utility from making temporary or intermittent assignments of its employees to affiliates.
    - Require greater physical separation between the utility, its affiliates, and parent.
2. Increase the public disclosure requirements and the Commission's access to information so that it may fulfill its

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April 10, 2006.

regulatory responsibilities (e.g., enforcement of the Affiliate Transaction Rules and "first priority" condition).

- Increase the information provided the Commission annually regarding the details of the utility's executive compensation.
- Expand the electronic bulletin board notice requirements.
- Require discounts to affiliates to be reported regularly by advice letter, subject to Commission review.
- Require that annual affiliate rules compliance audits be directed by Commission staff, not the utility.
- Further specify disclosure to the Commission of all meetings between utility and affiliates and of other, non-public information relating to interactions between the utility and its affiliates.

3. Prohibit the utilities' procurement from their affiliates without prior Commission approval, such as under the procedures established by Commission decisions governing utility resource adequacy and procurement.

4. Add capital budget and capital structure disclosure requirements to ensure the utility can fulfill its public service obligations and to help lower the exposure of ratepayers to unnecessary risk.

A summary of the major rule revisions follows:

<u>Affiliate Transaction Rules Revisions, applicable to respondents:</u>

- Table of Contents – Added to rules.
- I A and II B – Rules clarified to be applicable to parent or holding company.
- III B – Narrow range of affiliate transactions permitted by expressly prohibiting affiliate sales to a utility of goods, etc., unless undertaken pursuant to Commission-approved

decisions or procedures, such as Commission-approved resource procurement.

- III F – Extend electronic bulletin board notice requirement to discounts to affiliates on products (not just services).

- III G – Require utility to record affiliate discounts in a memorandum account, advise the affiliate that the discount is subject to Commission approval, and file, quarterly, an advice letter containing discount information.
- IV B – Further specify controls on provision of non-customer specific non-public information, and authorize audits, to be directed by the Commission or its staff.
- IV C – Delete requirements on utility to create and disseminate lists of service provider information.
- V C – Require greater physical separation between a utility and its affiliates.
- V E – Narrow permitted sharing of services for corporate support by expressly prohibiting sharing of these services: risk management, regulatory affairs, lobbying and legal.
- V G 1 – Extend prohibition on joint employees to consultants and contractors; further limit ability of corporate officers and board directors to serve both utility and affiliates.
- V G 2 – Delete 12/31/98 provision, since no longer applicable; further limit utility from making temporary or intermittent assignments of employees to affiliates.
- VI A – Require new compliance plans by March 29, 2007.
- VI C – Require Energy Division, rather than a utility, to arrange for audits.
- VIII – This enforcement section, adopted by D.98-12-075, added to body of rules.
- IX – add Capital Budget and Capital Structure requirements.

GO 77-M – Provisions added to require that respondents' annual filings include:

- For executive officers or employees earning $250,000 or more per annum, details of the total, aggregate compensation package, whether paid in the prior fiscal year or awarded, but not yet paid (i.e., cash compensation, benefits, equity-related interests, and any other retirement or other post-employment benefits).
- A statement explaining the method for determining compensation to the utility's executive officers and employees and how that method avoids tying compensation to the profitability of the utility's holding company.

Service of Amended OIR; Eligibility to File Comments and Participate in Oral Argument

This amended OIR will be filed on the service list established to date for this proceeding and also on the service list for R.97-04-011 and R.03-08-019, the rulemakings (now closed) in which the Commission adopted the current versions, respectively, of the Affiliates Transaction Rules and GO 77-L. To be eligible to file comments in this proceeding, R.05-10-030, or thereafter to participate in oral argument, a person or entity must be listed as an Appearance on the service list for this proceeding, or must become an Appearance. Likewise, to receive further service for the purposes of monitoring this proceeding, a person or entity must be listed in the State Service or Information Only sections of the service list for this proceeding or must ask to be added to the service list.

To be added to any category of the service list for this proceeding, the steps set forth in Ordering Paragraph 4 should be as followed. All comments on the proposed rules attached to today's order must be filed in this proceeding, and served on the current service list for this proceeding, as of the date service is undertaken. Commission service lists, updated on an ongoing basis, are available from the Commission's website: www.cpuc.ca.gov.

As provided for in the OIR, service of all documents is to be made by electronic means and will be used in lieu of paper mail when an electronic address has been provided. (See Rule 2.3(a) and Rule 2.3.1 of the Commission's Rules of Practice and Procedure.) Assigned Commissioner Geoffrey F. Brown (gfb@cpuc.ca.gov) and Administrative Law Judge Jean Vieth (xjv@cpuc.ca.gov) are to be served electronically at the email addresses indicated. Any party on the service list who has not provided an electronic mail address shall serve and take service by way of paper mail. (See Rule 2.3(a) of the Commission's Rules of Practice and Procedure.)

Content of Comments

The OIR contemplates that "this proceeding will be conducted through a written record" and we invite all interested persons and entities to participate in the several rounds of written comment and oral argument scheduled. Our release, today, of the staff work product marks the commencement of what we hope will prove to be a candid public discussion.

Comments, filed in accordance with the schedule set forth below, should focus on the attached proposed rules and should (a) indicate support or opposition for a rule, (b) explain the reasons for that position, and (c) in the case of opposition, suggest an alternative or alternatives to accomplish the rule's objectives. Comments should focus, in particular, upon the cost or relative burden of implementing a rule and the magnitude of the harm likely if the rule is not implemented, to the extent qualification and/or quantification of the of latter can be approximated.

Schedule

The preliminary schedule in the OIR is amended as follows:

Opening Comment on Proposed Rules	May 25, 2006
Reply Comment on Proposed Rules	June 22, 2006
Draft Decision Mailed	July 21, 2006
Comment on Draft Decision	August 10, 2006
Reply Comment on Draft Decision	August 15, 2006
Oral Argument	August 17, 2006 1:30 – 3:30 p.m.
Draft Decision on Commission Public Meeting Agenda	August 24, 2006

The schedule revisions set forth above have been developed to provide ample time for thoughtful written comment and reply comment, as well as oral argument before the assigned Commissioner and any other Commissioners who are available to attend. Nonetheless, the schedule revisions retain fidelity to the Commission's preference for a prompt resolution of this matter.

Category of Proceeding and Need for Hearing

As stated in the initial OIR, this OIR is preliminarily determined to be quasi-legislative, as that term is defined in Rule 5(d) of the Commission's Rules of Practice and Procedure. It is contemplated that this proceeding will be conducted through a written record, with no evidentiary hearing for this phase, and that an order will issue based on the comments timely filed in this docket.

Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Jean Vieth is the assigned Administrative Law Judge in this proceeding.

Ex Parte Communications

This proceeding is subject to Rule 7 of the Commission's Rules of Practice and Procedure, which specifies standards for engaging in ex parte communications and the reporting of such communications. Because we have preliminarily categorized this proceeding as quasi-legislative, pursuant to Rules 7(a)(4) and 7(d), ex parte communications will be allowed without any restrictions or reporting category as provided for in Rules 6(c)(2) and 6.4. Following the Commissioner's determination, the applicable ex parte communication and reporting requirements shall depend on such determination unless the determination is modified by the Commission pursuant to Rule 6.4 or 6.5.

O R D E R

IT IS ORDERED that:

1. The Order Instituting Rulemaking (OIR) that initiated this proceeding on October 27, 2005 is amended as set forth herein to include review of the proposed revisions to the Commission's Affiliate Transaction Rules, found in Attachment A, and the proposed revisions to the General Order 77-L, found in Attachment B, both applicable only to Respondents.

2. Respondents to the OIR, as amended by Ordering Paragraph 1, above, continue to be California's major energy utilities and their holding companies: Southern California Edison Company/Edison International, Pacific Gas and Electric Company/PG&E Corporation, and Southern California Gas Company and San Diego Gas & Electric Company, both owned by Sempra Energy.

3. The Commission's Executive Director shall cause today's order to be served on respondents, as well as the service list for this proceeding and the service lists for Rulemaking (R.) 97-04-011 and R.03-08-019.

4. Persons or entities who are not now listed on the service list for this proceeding and who wish to be placed on it shall follow the directions below.

(a) Appearance category. By April 28, 2006, contact the assigned Administrative Law Judge (ALJ) in writing, via e-mail (xjv@cpuc.ca.gov) or at CPUC, 505 Van Ness Ave., San Francisco, CA 94102 and describe your interest in the proceeding, how you intend to participate, and list all relevant contact information (name; person or entity represented; mailing address; telephone number; e-mail address).

(b) Information Only category or State Service category. If you intend only to monitor this proceeding, contact the Commission's Process Office by April 28, 2006 in writing, via e-mail at (Process_Office@cpuc.ca.gov) or at CPUC, Process Office, 505 Van Ness Ave., San Francisco, CA 94102), to specify the service category desired and list the same contact information detailed in subparagraph (a), above.

The assigned Commissioner or assigned ALJ may modify the above procedure for a person to be placed on the service list.

5. The schedule for this proceeding is set forth herein. Appearances listed on the service list for this proceeding, or those added at the direction of the assigned ALJ may file comments and participate in oral argument.

6. The schedule may be changed, if necessary, by ruling of the assigned Commissioner or assigned ALJ.

7. The category for this rulemaking is preliminary determined to be "quasi-legislative" as that term is defined in Rule 5(d) of the Commission's Rules of Practice and Procedure.

This order is effective today.

Dated _____, at San Francisco, California.

Vieth Appendix A Amending OIR

Vieth Appendix B Amending OIR