

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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).

FILED
PUBLIC UTILITIES COMMISSION
APRIL 16, 2009
SAN FRANCISCO, CALIFORNIA
RULEMAKING 09-04-012

**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**

1. Summary

This Order Instituting Rulemaking (OIR or Rulemaking) is designed to create generic rules for all water and sewer companies with regard to transactions with a parent company and/or affiliates and with regard to the use of regulated assets and personnel for non-tariffed utility products and services.

2. Background

Currently, five of the nine Class A water utilities have authorized affiliate transaction rules in place, and each utility's set of rules is unique. Over the past 24 years, the Commission has adopted affiliate transaction rules for the following Class A water utilities:

Utility Name	Decision Number
San Jose Water Company (San Jose Water)	85-06-023
California Water Service Company (California Water)	97-12-011
Golden State Water Company (Golden State Water)	98-06-068
California-American Water Company (California-American)	02-12-068
Valencia Water Company (Valencia Water)	04-01-051

Adopted separately and at different times, they may be seen to represent the Commission's evolving thinking on the subject. The other Class A water utilities, as well as all of the Class B, C, and D water and all of the sewer utilities, do not have authorized affiliate transaction rules in place.

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). The primary decision on non-tariffed utility services is Decision (D.) 00-07-018, adopted in Rulemaking (R.) 97-10-049. Two subsequent decisions in that proceeding made corrections, and a third approved in part a petition to modify D.00-07-018.¹ These rules distinguish the types of non-tariffed utility offerings as

¹ The later decisions are D.01-01-026, D.03-04-028, and D.04-12-023.

either active or passive,² require water utilities to file advice letters for the provision of certain types of active services, and require that the utilities provide certain information regarding each active service and each passive service in their annual reports. The rules also include a methodology for water utilities to allocate revenue from non-tariffed utility services between ratepayers and shareholders depending upon whether the service is active or passive. These rules adopted in R.97-10-049 regarding non-tariffed utility services do not apply to sewer utilities.

For energy companies, the Commission undertook R.97-04-011 in 1997 to establish standards of conduct governing relationships between California's natural gas local distribution companies and electric utilities and their affiliated, unregulated entities, with energy utility affiliate transaction rules adopted in D.97-12-088. The energy utility affiliate transaction rules were revised most recently in R.05-10-030 for California's four largest energy utilities to require "more complete reporting to the Commission of utility-affiliate and utility-holding company communications, prohibiting problematic shared services," and to ensure a utility's financial integrity is protected from the riskier market ventures of its unregulated affiliates and holding company parent. D.06-12-029 adopted revisions to the affiliate transaction rules for the four largest energy

² D.00-07-018 adopted an Appendix A, which designated many potential non-tariffed offerings as either active or passive, and stated that any non-tariffed utility offerings not present on the list would be designated as active if the shareholders incurred incremental investments costs of \$125,000 or more. D.01-01-026 published that Appendix A.

utilities, which are contained in Appendix A-3 to that decision.³ Section VII of the energy utility affiliate transaction rules addresses utility products and services, including non-tariffed utility services.

3. Discussion

We believe consistent rules governing affiliate transactions and non-tariffed utility products and services for all water and sewer utilities would provide appropriate Commission oversight and protect ratepayers. Moreover, regulatory consistency would be improved by adopting standard affiliate transaction and non-tariffed utility service rules in a single rulemaking, as has been done for the energy utilities.

Because most Class A water utilities are now owned by holding companies that in most cases 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.

The rules on non-tariffed water utility services adopted in R.97-10-049 have been considered in several dockets.⁴ The combination of the four decisions in R.97-10-049 has made it somewhat confusing to determine the exact rules in effect. In several recent proceedings, the Commission has found considerable confusion regarding how each water utility is interpreting and operating under

³ The affiliate transaction rules for large energy utilities in Appendix A-3 to D.06-12-029 are available at <http://docs.cpuc.ca.gov/published/Graphics/63089.PDF>, which contains all of the attachments to D.06-12-029. D.07-03-049 corrected clerical omissions in D.06-12-029, Appendix B.

⁴ See, D.03-09-021 in Application (A.) 01-09-062 et al., D.04-03-039 in A.02-11-007, D.07-11-037 in A.06-02-023, D.07-12-055 in A.06-07-017 et al., and D.09-03-007 in A.08-01-004. Related issues are being considered in A.08-01-004, A.08-05-019, and A.08-07-004, which are still open.

the non-tariffed utility service rules. We are not certain that we are even aware of what non-tariffed utility services are currently being offered by the water and sewer utilities under our jurisdiction.

The rules governing the water utilities' use of regulated assets and personnel for non-tariffed services are particularly distinguishable from comparable rules for the energy industry in two ways: (1) the list of products and services for water utilities contained two additional categories, "Operation and Maintenance Contracts" and "Customer Ancillary Services"; and (2) water utilities were given authority to offer new non-tariffed services under these two broad categories without first filing an advice letter with the Commission.⁵ These two distinctions have provided flexibility to the water utilities, but they have also created confusion. Because of the freedom from filing an advice letter, it is unknown how many water utilities are providing non-tariffed services under these categories. The first formal opportunity for the Commission to review these services would be in the general rate case proceedings of individual utilities.

What we have learned from recent cases is that more guidance is necessary, in particular when the service offering involves the use of utility personnel and the assets used to provide basic utility service. Furthermore, the current non-tariffed utility service rules do not address the issues of: (1) providing either active or passive services to affiliates; (2) allowing an affiliate to use a regulated utility's personnel or facilities to provide its unregulated services; (3) the lag in time before the Commission is notified of those

⁵ See *Re Southern California Edison Co.* (1999) 1 CPUC3d 579, 596.

non-tariffed services that, pursuant to the rules adopted in R.97-04-011, do not require approval through an advice letter; and (4) possible confusion/crossover with affiliate transaction rules.

It will be beneficial to the utilities for the Commission to make the non-tariffed utility service rules more understandable and consistent with the affiliate transaction rules. This proceeding provides a forum for all water and sewer utilities to discuss the goals and objectives of the affiliate transaction rules and the non-tariffed utility service rules.

The overriding goal here is not to stifle business development, but to create a standard, generic set of rules that will ensure that ratepayers are protected against cross-subsidization and the unfair benefits that might otherwise go to the unregulated affiliates.

In this order, we provide a sample set of rules for affiliate transactions (attached as Appendix A) and a sample set of rules for the use of regulated assets and personnel for non-tariffed utility products and services (Appendix B) to start the discussion. We also ask a series of questions regarding issues that may be addressed in the final rules, and we give three examples for parties to discuss as they relate to both sets of rules. We intend to provide clear guidance to the regulated water and sewer utilities and protect the ratepayers from cross-subsidization at the conclusion of the proceeding.

Given the inconsistent and/or non-existent rules for water and sewer utilities, it is timely and appropriate to review, consolidate, and update the current rules in order to provide standard rules applicable to regulated water and sewer utilities, their provision of non-tariffed services, and their transactions with affiliated companies. We see great benefit in clarifying and standardizing the existing rules.

4. Preliminary Scoping Memo

As required by Rule 7.1(d)⁶ of our Rules of Practice and Procedure, this order includes a preliminary scoping memo as set forth below. The 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.

4.1. Issues to be Addressed

In developing these rules and procedures, the issues to be considered in this proceeding include the following:

4.1.1. Issues Regarding Affiliate Transaction Rules

- The proper goals and objectives for affiliate transaction rules.
- Identification of all laws, policies, practices, rules, and procedures that presently govern transactions between regulated water and sewer utilities and their parent and affiliates.
- Whether and, if so, how, existing affiliate transaction rules for individual water utilities should be updated and/or revised for purposes of standardizing the rules.
- Whether any of the affiliate transaction rules applicable to large energy utilities⁷ should be included in affiliate transaction rules for water and sewer utilities.

⁶ Rulemakings. An order instituting rulemaking shall preliminarily determine the category and need for hearing, and shall attach a preliminary scoping memo. The preliminary determination is not appealable, but shall be confirmed or changed by assigned Commissioner's ruling pursuant to Rule 7.3, and such ruling as to the category is subject to appeal under Rule 7.6.

⁷ Available at <http://docs.cpuc.ca.gov/published/Graphics/63089.PDF> in Appendix A-3 to D.06-12-029.

- Development of a standard set of rules to govern the relationship between regulated water and sewer utilities and their parent and affiliates, if appropriate.
- Whether the affiliate transaction rules adopted in this proceeding should apply equally to all water and sewer utilities or should vary depending, e.g., on the size of the utility.

4.1.2. Issues Regarding Rules for the Use of Regulated Assets for Non-Tariffed Utility Products and Services

- The proper goals and objectives for rules that allow the use for non-tariffed utility services of regulated assets and employees included in revenue requirements.
- Identification of all laws, policies, practices, rules, and procedures that presently govern the use of regulated assets and personnel for non-tariffed purposes.
- The appropriate types of non-tariffed utility products and services that should be allowed.
- Whether and, if so, how the utilities should be allowed to provide some non-tariffed services, or categories of non-tariffed services, without first obtaining approval through an advice letter process.
- Whether and, if so, how existing rules regarding the use of regulated assets and personnel for non-tariffed utility services should be updated and/or revised.
- Whether any of the rules for large energy utilities regarding the provision of utility products and services (i.e., Rule VII in Appendix A-3 to D.06-12-029) should be included in the rules for water and sewer utilities regarding the use of regulated assets and personnel for non-tariffed purposes.
- The implications for the use of corporate goodwill when a regulated water or sewer utility offers non-tariffed services, including whether the value of the corporate goodwill of the regulated utility should be considered in the allocation of revenues and expenses of non-tariffed services between ratepayers and shareholders.

- Whether it is appropriate to allow regulated utilities to provide services for which a competitive market exists.
- Whether utilities should be allowed to provide either active or passive services to affiliates.
- Development of a standard set of rules to govern the use of regulated assets and personnel for non-tariffed purposes by the regulated water and sewer utilities, if appropriate.
- Whether the rules adopted in this proceeding regarding the use of regulated assets and personnel for non-tariffed utility services should apply equally to all water and sewer utilities or should vary depending, e.g., on the size of the utility.

In developing rules, we will consider carefully the proper coordination between affiliate transaction rules and rules regarding the use of regulated assets and personnel for non-tariffed services, and whether the two sets of rules should be integrated or should remain as separate sets of rules.

4.2. Questions and Scenarios for Discussion

To help address the issues delineated above, we pose the following questions for all interested parties to comment on.

Examples of potential affiliate transaction rules and potential rules regarding the use of regulated utility assets and personnel for non-tariffed utility products and services are contained in Appendix A and Appendix B, respectively. These examples are based in large part on the existing affiliate transaction rules that have been adopted for individual water utilities and the existing rules on the use of regulated assets and personnel for non-tariffed water utility services that were adopted in R.97-10-049. We do not view these examples as *proposed* rules, but rather as a tool to help structure the discussions in this proceeding.

4.2.1. Questions Regarding Affiliate Transaction Rules

- (1) What should be the goals and objectives for affiliate transaction rules? Are those goals being achieved?
- (2) What laws, policies, practices, rules, and procedures presently govern transactions between regulated water and sewer utilities and their parent and affiliates?
- (3) Do the current affiliate transaction rules provide sufficient oversight of affiliate transactions?
- (4) What incentives are created by the current rules/accounting for affiliate transactions?
- (5) Should and, if so, how should existing affiliate transaction rules for individual water utilities be updated and/or revised for purposes of standardizing the rules? Provide detailed explanations of any changes you propose to the existing affiliate transaction rules.
- (6) Which, if any, affiliate transaction rules applicable to large energy utilities should be included in affiliate transaction rules for water and sewer utilities? Specifically, should the following items be included in the water and sewer utility rules?
 - a. Sharing of Officers.
 - b. Joint Marketing and Purchasing.
 - c. Sharing Name and Logo with Affiliate.
 - d. Prohibited Offerings.
- (7) For each water utility that has filed annual reports of affiliate transactions, please provide the past five reports.
- (8) For each water utility that has not filed annual reports on affiliate transactions, and for each sewer utility, identify whether any transactions with an affiliate occurred in the years 2007 and/or 2008. If so, looking to Appendix A for guidance, provide information to the extent it is available on those affiliate transactions for each of the years 2007 and 2008.
- (9) What standard set of rules should be developed to govern the relationship between regulated water and sewer utilities and

their parent and affiliates? Provide detailed explanations of any modifications you propose to the sample rules in Appendix A.

- (10) Should the affiliate transaction rules adopted in this proceeding apply equally to all water and sewer utilities? If not, on what basis and how should they differ for different water and sewer utilities?

4.2.2. Questions Regarding Rules for the Use of Regulated Assets for Non-Tariffed Utility Products and Services

- (11) What should be the goals and objectives for rules that allow the use for non-tariffed utility services of regulated assets and personnel included in revenue requirements? Are those goals being achieved?
- (12) What laws, policies, practices, rules, and procedures presently govern the use of regulated assets and personnel for non-tariffed purposes?
- (13) What types or categories of non-tariffed utility products and services should be allowed?
- (14) Should and, if so, how should water and sewer utilities be allowed to provide some non-tariffed services, or categories of non-tariffed services, without first obtaining approval through an advice letter process?
- (15) Do the current rules regarding non-tariffed utility services provide sufficient oversight?
- a. Should information regarding employees and assets that are used for non-tariffed services be included in the utility's General Rate Cases and Annual Reports to the Commission?
 - b. Should and, if so, for what purpose should the current active vs. passive demarcations for non-tariffed services be maintained?
 - c. If some non-tariffed products and services are permitted without an advice letter process, when and how should the utilities report them to the Commission?

- d. Are current program limitations sufficient to protect ratepayers from subsidizing non-tariffed activities?
- (16) What incentives are created by the current rules/accounting for non-tariffed services?
- a. Will the regulated operations be harmed or diminished?
 - b. What about times of disaster?
- (17) Should and, if so, how should existing rules regarding the use of regulated assets and personnel for non-tariffed utility products and services be updated and/or revised? Provide detailed explanations of any modifications you propose to the existing rules.
- (18) Which, if any, rules for large energy utilities regarding the provision of utility products and services should be included in the rules for water and sewer utilities regarding the use of regulated assets and personnel for non-tariffed purposes?
- (19) Should (a) regulated plant-in-service and (b) employees included in revenue requirements be allowed to be used for non-tariffed purposes?
- a. Should limits and boundaries be put in place?
 - b. If a particular utility or district is under financial and/or supply strain, should all non-tariffed uses of regulated assets and employees included in revenue requirements be suspended, pending a change in circumstances?
- (20) What are the implications for the use of corporate goodwill when a regulated water or sewer utility offers non-tariffed services? Should the value of the corporate goodwill of the regulated water or sewer utility be considered in the allocation of revenues and expenses of non-tariffed services between ratepayers and shareholders?
- (21) Should regulated water or sewer utilities be allowed to provide services for which a competitive market exists?
- a. If so, what are the economic implications?
 - b. What are the proper rules for engaging in such services?

- (22) Should and, if so, under what conditions should water and sewer utilities be allowed to make their assets and personnel available to affiliates?
- (23) For each water or sewer utility that has used regulated assets and/or personnel for non-tariffed services:
 - a. Describe the non-tariffed services provided for each of the past five years.
 - b. For non-tariffed services, provide total revenue allocated to ratepayers and provide total revenue allocated to shareholders, for each of the past five years.
 - c. For each employee who has been used for non-tariffed purposes in 2007 and 2008, provide the employee name, position, salary, and percent of time spent on non-tariffed services.
 - d. How are the time and incremental costs of employees working on non-tariffed services accounted for and charged?
- (24) For each water utility that has an "Excess Capacity and Non-tariffed Services" schedule in its Annual Report to the Commission, provide the last five years of Annual Reports.
- (25) Has the provision of non-tariffed services using regulated assets and/or employees included in revenue requirements benefited ratepayers? Shareholders?
- (26) What standard set of rules should be developed to govern the use of regulated assets and personnel for non-tariffed utility services? Provide detailed explanations of any modifications you propose to the sample rules in Appendix B.
- (27) Should the rules adopted in this proceeding regarding the use of regulated assets and personnel for non-tariffed utility services apply equally to all water and sewer utilities? If not, on what basis and how should they differ for different water and sewer utilities?

4.2.3. Questions Regarding Scenarios

Recent experience has generated a number of questions and concerns as they relate to the growing service offerings of utilities. The level of concern is

heightened when utility personnel and assets are utilized for unregulated services. To help bring to light the implications of using utility personnel and assets, we ask parties to comment on three types of services that either the utility, an affiliate, or some combination of the two might provide.

- (28) For each of the following types of services: (i) billing services, (ii) maintenance/service/insurance-type services, and (iii) marketing, address the following:
 - a. How these types of services are currently being offered.
 - b. How the existing or proposed rules relate to them.
 - c. Where possible, discuss the implications of how tariffed utility services are prioritized *vis a vis* these service offerings. For example, in an emergency situation, what is the guarantee that the regulated services the ratepayers are paying for are given top priority?
- (29) Should billing services be allowed to be provided by the regulated utility? Should billing services be allowed to be provided by an affiliate? If so, how?
- (30) Are regulated billing systems and services being replaced sooner or being sized larger than necessary?
- (31) Should utilities be allowed to put unregulated utility services, or services provided by an affiliate, in the regulated bill? Should utilities be allowed to utilize regulated utility employees and assets for this purpose?
- (32) Should maintenance/service/insurance-type services be allowed to be provided by the regulated utility? Should such services be allowed to be provided by an affiliate? If so, how?
- (33) Are there concerns about how ratepayers might perceive the use of utility personnel and assets to provide the types of services identified in Question 28?

4.2.4. Coordination of Affiliate Transaction Rules and Rules for the Use of Regulated Assets for Non-Tariffed Products and Utility Services

- (34) How should affiliate transaction rules and rules regarding the use of regulated assets and personnel for non-tariffed utility products and services be coordinated? Should they be integrated into a single set of rules or maintained as two separate sets of rules?

5. Proceeding Schedule

This proceeding will conform to the statutory case management deadline for quasi-legislative matters set forth in Public Utilities Code Section 1701.5. In particular, it is our intention to resolve all relevant issues within 24 months of the date of the assigned Commissioner’s Scoping Memo. In using the authority granted in Section 1701.5(b) to set a time longer than 18 months, we consider the number and complexity of the tasks that will be necessary as we review existing requirements and create new generic rules regarding affiliate transactions and the use of regulated assets and personnel for non-tariffed utility services.

The timetable for this proceeding will depend on the input we receive from the parties. For purposes of addressing the preliminary scoping memo requirements, we establish the following tentative schedule, which is subject to change by the assigned Commissioner or the assigned Administrative Law Judge (ALJ):

April 16, 2009	Issuance of Order Instituting Rulemaking
May 6, 2009	Parties request inclusion on service list
July 16, 2009	Prehearing Conference Statements, including responses to questions and scenarios in the OIR
August 13, 2009	Responses
September 2009	Prehearing Conference
October 2009	Scoping memo

November 2009	Workshop
December 2009	Comments on workshop issues
January 2010	Reply comments on workshop issues
June 2010	Proposed Decision mailed for comment
July 2010	Final Decision on Commission agenda

Interested parties may file Prehearing Conference Statements no later than July 16, 2009, which should include responses to the issues, questions, and scenarios identified in the preliminary scoping memo. Responses to questions should be complete and provide a rationale for the response. Comments should include recommended alternative approaches, and discuss the anticipated impact of the recommended approach. Interested parties may offer any other suggestions regarding policies, practices, rules, and procedures regarding affiliate transactions and the use of regulated assets and personnel for non-tariffed utility services. The Prehearing Conference Statements should follow the requirements of Rule 6.2 and should include any objections to the preliminary scoping memo regarding the category, need for hearing, issues to be considered, or schedule. Responses to the Prehearing Conference Statements may be filed no later than August 13, 2009.

Following the Prehearing Conference, the assigned Commissioner will issue a scoping memo that determines the category, need for hearing, scope, and schedule of this rulemaking. The ruling, only to category, may be appealed under the procedures in Rule 7.6. Through the scoping memo and other rulings, the assigned Commissioner, or the assigned ALJ with the assigned Commissioner's concurrence, may adjust the timetable as necessary during the course of the proceeding and establish the schedule for remaining events.

6. Parties and Service List

The possible rule development and/or changes to be considered in this Rulemaking could affect all Commission regulated water and sewer utilities. We will therefore direct that this rulemaking and its appendices be served on all Commission regulated water and sewer utilities; the Water Branch of the Division of Ratepayer Advocates (DRA); parties to water utility cases that have addressed affiliate transaction rules and the formation of a parent/holding company, or the use of regulated utility assets and personnel for the provision of non-tariffed utility services;⁸ and the California Water Association (CWA).

Such service does not confer party status upon any person or entity, and does not result in that person or entity being placed on the service list for this proceeding. The following procedures regarding party status and inclusion on the service list shall be followed. While all California regulated water and sewer utilities may be bound by the outcome of this proceeding, only those who notify us that they wish to be on the service list will be accorded service until a final decision is issued.

After initial service of this OIR, the Commission's Process Office will create a service list, which will be posted on the Commission's website at www.cpuc.ca.gov. Any person or representative of an entity interested in monitoring or participating in this proceeding should send a letter to the

⁸ A.96-12-029 (California Water), A.97-12-016 (Golden State Water), A.02-01-036 (California-American), A.03-08-014 (Valencia Water), R.97-10-049, A.01-09-062 et al. (California Water), A.02-11-007 (Southern California), A.06-07-017 et al. (California Water), A.08-01-004 (Suburban Water Systems), A.08-01-024 (California-American), A.08-05-019 (California Water), and A.08-07-004 (California Water). For San Jose Water, we serve parties to A.09-01-009 rather than A.85-02-031.

Commission's Process Office (process_office@cpuc.ca.gov), located at 505 Van Ness Avenue, San Francisco, California 94102. The letter should specify the docket number of this rulemaking in the subject line, and must include the name, address, phone number, organization and e-mail address of those who wish to be added to the service list. The letter should specify whether the person wishes to be a "Party" (i.e., those who actively participate in the proceeding by filing comments or appearing at workshops or hearings), "State Service" (i.e., employees of the State of California who will not be submitting comments), or "Information Only" (i.e., those who will not participate actively, but simply wish to follow the proceeding and receive electronic service of all documents in this rulemaking). Those who seek to be a "party" should indicate how they intend to participate in the proceeding. Individuals who intend to maintain party status must appear at the prehearing conference to confirm this. Letters may be sent either by electronic mail or regular mail, but must be received by the Commission by May 6, 2009.

In addition, pursuant to Rule 1.4(a), persons and entities may also gain party status by (a) filing comments in this rulemaking, or (b) filing a motion to become a party at a later date. Those seeking party status through filing comments or by a subsequent motion shall comply with Rule 1.4(b).⁹

A party to a Commission proceeding has certain rights that non-parties (those in "State Service" and "Information Only" service categories) do not have. For example, a party has the right to participate in evidentiary hearings, file

⁹ Rule 1.4(b) states that those seeking party status shall "(1) fully disclose the persons or entities in whose behalf the filing, appearance or motion is made, and the interest of

Footnote continued on next page

comments on a proposed decision, and appeal a final decision. A party also has the ability to consent to waive or reduce a comment period. Non-parties do not have these rights, even though they are included on the service list for the proceeding and receive copies of some or all documents.

Any party interested in participating in this rulemaking who is unfamiliar with the Commission's procedures should contact the Public Advisor's Office in Los Angeles at (213) 576-7055 or toll free at (866) 849-8391 or email public.advisor.la@cpuc.ca.gov, or in San Francisco at (415) 703-2074 or toll free at (866) 849-8390 or email public.advisor@cpuc.ca.gov. The TTY number is (866) 836-7825.

Parties are encouraged to serve documents electronically, in accordance with Rule 1.10 of the Commission's Rules of Practice and Procedure and Resolution ALJ-188. Consistent with those rules, a hard copy of all pleadings shall be served concurrently on the assigned ALJ.

All comments and pleadings 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.cpsc.ca.gov. Parties should ensure that they are using the most up-to-date service list by checking the Commission's website prior to each service/filing date.

such persons or entities in the proceeding; and (2) show that the contentions will be reasonably pertinent to the issues already presented."

7. Preliminary Categorization of Proceeding and Need for Hearing

Rule 7.1(d) requires that an order instituting rulemaking preliminarily determine the category of the proceeding and the need for hearing. As a preliminary matter, we determine that this proceeding is “quasi-legislative,” as defined in Rule 1.3(d). We anticipate that the issues in this proceeding may be resolved through a combination of workshops and filed comments, and that evidentiary hearings will not be necessary. Any person who objects to the preliminary categorization of this rulemaking as “quasi-legislative” or to the preliminary hearing determination, shall state the objections in their Prehearing Conference Statements. After considering the comments on the preliminary scoping memo and discussion at the prehearing conference, the assigned Commissioner will issue a scoping memo making a final category determination; this final determination is subject to appeal as specified in Rule 7.6(a).

8. Intervenor Compensation

Any party that expects to claim intervenor compensation for its participation in this rulemaking shall file its notice of intent to claim intervenor compensation no later than 30 days after the scoping memo is issued.

9. *Ex Parte* Communications

In accordance with Rule 8.2, *ex parte* communications in this proceeding are allowed without restriction or reporting requirement.

Findings of Fact

1. Currently, five of the nine Class A water utilities have authorized affiliate transaction rules in place.
2. Each set of water utility affiliate transaction rules is unique to the utility.

3. The other Class A water utilities, as well as all the Class B, C, and D water and the sewer utilities, do not have authorized affiliate transaction rules in place.

4. Most Class A water utilities are now owned by a holding company, an entity which has both regulated and non-regulated subsidiaries.

5. Commission regulated energy utilities follow a standard set of affiliate transaction rules authorized by the Commission.

6. Commission regulated energy utilities also have standardized rules to guide them on how to use regulated assets and personnel for non-tariffed purposes.

7. Uniform rules governing the use of regulated assets and personnel for non-tariffed water utility operations were developed in R.97-10-049 and adopted in D.00-07-018.

8. Rules governing the use of regulated assets and personnel for non-tariffed purposes are modeled in large part on energy utility rules and are often referred to as "excess capacity rules."

9. D.01-01-026 published Appendix A to D.00-07-018; that Appendix A provides a list of products and services designated as active or passive.

10. D.03-04-028 and D.04-12-023 provided clarifications to the non-tariffed utility operation rules.

11. The current rules addressing the use of regulated assets and personnel in the provision of non-tariffed utility services distinguish the types of service offerings as either active or passive, require water utilities to file advice letters for the provision of certain types of active services, and require that the utilities provide certain information regarding each active and passive service in their annual reports.

Conclusions of Law

1. The Commission should open a rulemaking in order to consider establishment of standard rules governing the relationships between regulated water and sewer utilities and their parent and affiliates, and standard rules governing the use of regulated assets and personnel for non-tariffed products and services by regulated water and sewer utilities.

2. Given the inconsistent affiliate transaction rules for some and the lack of any affiliate transaction rules for many water and sewer utilities, and the usefulness of standardized energy utility affiliate transaction rules, a consistent set of rules governing affiliate transactions should be adopted for all water and sewer utilities.

3. Given that the current rules for the use of regulated assets and personnel for non-tariffed services do not address the issues of: (a) providing either active or passive excess capacity services to affiliates, (b) allowing an affiliate to use a regulated utility's personnel or facilities to provide its unregulated services, (c) the lag in time before the Commission is notified of passive services and certain active services, and (d) possible confusion/crossover with affiliate transaction rules, a revised set of rules should be developed.

Therefore, **IT IS ORDERED** that:

1. A rulemaking on the Commission's own motion is instituted to develop standard rules and policies governing affiliate transactions of water and sewer utilities and the use of regulated assets and personnel for non-tariffed utility products and services by regulated water and sewer utilities.

2. This rulemaking is preliminarily determined to be a quasi-legislative proceeding as that term is defined in the Commission's Rules of Practice and Procedure, Rule 1.3(d).

3. This proceeding is preliminarily determined not to need a formal hearing.

4. The expected timetable for this proceeding is as set forth in the body of this order. The assigned Commissioner by scoping memo and other rulings, and the assigned Administrative Law Judge by ruling with the assigned Commissioner's concurrence, may adjust the timetable as necessary during the course of the proceeding, provided that in no instance shall this proceeding require longer than 24 months to complete after the scoping memo is issued.

5. The Commission's Division of Ratepayer Advocates shall, and Commission regulated water and sewer utilities and other parties may, file Prehearing Conference Statements as described in this order, including responses to the issues, questions, and scenarios contained in the preliminary scoping memo. The Prehearing Conference Statements shall be filed no later than July 16, 2009 unless that date is modified by the assigned Commissioner or assigned Administrative Law Judge.

6. Pursuant to Rule 6.2, parties shall include in their Prehearing Conference Statements any objections they may have regarding the category, need for hearing, issues to be considered, or schedule.

7. Parties may file Responses to the Prehearing Conference Statements no later than August 13, 2009, unless that date is modified by the assigned Commissioner or assigned Administrative Law Judge.

8. All comments shall conform to the requirements of the Commission's Rules of Practice and Procedure.

9. The Executive Director shall serve a copy of this Order Instituting Rulemaking and the appendices on all Commission regulated water and sewer utilities, the Water Branch of the Division of Ratepayer Advocates, the California Water Association, and the service lists in Application (A.) 09-01-009,

A.96-12-029, A.97-12-016, A.02-01-036, A.03-08-014, Rulemaking 97-10-049, A.01-09-062 et al., A.02-11-007, A.06-07-017 et al., A.08-01-004, A.08-01-024, A.08-05-019, and A.08-07-004.

10. The service list for this proceeding shall be formed following the procedures set forth in the Parties and Service List section in the body of this Order Instituting Rulemaking and shall be posted on the Commission's website (www.cpuc.ca.gov). Parties may also obtain the service list by contacting the Process Office at (415) 703-2021.

This order is effective today.

Dated April 16, 2009, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

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**EXAMPLE AFFILIATE TRANSACTION RULES
FOR ALL REGULATED WATER AND SEWER UTILITIES**

- I. *Applicability.* These Affiliated Transaction Rules (Rules) set forth the practices to be observed by all water and sewer utilities regulated by the California Public Utilities Commission (Commission). Where these Rules overlap with existing company-specific Commission-authorized affiliate transaction rules, these Rules shall take precedence. Where these Rules do not address an item in a water utility's existing company-specific Commission-authorized affiliate transaction rules, the existing company-specific rules shall apply for that item only.
- II. *Definitions.* For the purposes of these Rules the following definitions shall apply:
 - A. "Parent company" or "parent" refers to holding company or corporation that owns the regulated utility.
 - B. "Affiliated companies" refers to all entities that are under direct or indirect common ownership or control with utility, including holding company.
 - C. "Water utility" refers to all water utilities regulated by the Commission.
 - D. "Utility" (unless specified as a water utility) refers to all water utilities and sewer utilities regulated by the Commission.
 - E. Cost includes all fully allocated capital and expense amounts including all management, administration, overhead, and indirect allocations.
 - F. "Transaction" refers to all transactions between utility and parent and/or affiliated companies.
 - G. Property includes any right or thing to which an entity has legal or equitable title.
 - H. Real property includes any interest in real estate including leases, easements, and water rights.
- III. *Jurisdiction.*
 - A. Utility shall comply with all applicable State and Federal statutes, laws and administrative regulations.
 - B. The Commission shall retain jurisdiction over the rates and services provided by utility.

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- C. Parent company shall not assert in any Commission proceeding that Commission review of the reasonableness of any cost has been or is preempted by a regulator from another state or country.

IV. Utility Operations and Service Quality

- A. Transactions shall not result in any adverse changes in utility policies with respect to service to customers, employees, operations, financing, accounting, capitalization, rates, depreciation, maintenance, or other matters affecting the public interest or utility operations. Parent shall insure that there will be no adverse impact on customer service as a result of transactions. Parent company shall maintain utility's level of commitment to high quality utility service and shall fully support maintaining/improving utility's record for service quality.
- B. Utility shall continue to maintain its business headquarters in California together with fully operational field offices as appropriate to maintain the quality of its service. Utility shall not close any of its local offices as a result of any association with an out of state parent company. However, utility is not precluded from making local operational changes in connection with integrating systems acquired in other transactions.
- C. Utility shall not allow transactions to diminish water utility staffing that would result in service degradation of utility operations.

V. Protecting Utility's Financial Health

- A. Parent shall provide utility with adequate capital to fulfill all of its service obligations prescribed by the Commission.
- B. If parent is publicly traded, utility shall notify the Director of the Commission's Division of Water and Audits in writing within 30 days of any downgrading to the bonds of the parent/affiliate/utility, and shall include with such notice the complete report of the issuing bond rating agency.
- C. In each year, utility shall not exceed its five-year average¹ payout percentage (\$ amount of payout divided by \$ total Net Income) of transfer/payment of net income/dividend to parent company. If current year² payment/transfer percentage

¹ Five-Year Average is of the most recent historical five-year period.

² For example, it is January 2006 – For purposes of performing this analysis, Current Year is 2005 and Historical five-year period is 2000 – 2004.

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exceeds this five-year average, the utility shall notify the Director of the Commission's Division of Water and Audits.

- D. The creation of a new affiliate by parent or affiliates shall not adversely impact the utility's operations and provision of service.
- E. *Issuance of Debt for Parent/Affiliated Companies.* Debt of utility's parent/affiliated companies shall not be issued or guaranteed or secured by utility.

VI. *Regulatory Oversight*

- A. *Access to Officers and Employees.* The officers and employees of utility and its affiliated companies shall be available to appear and testify in any proceeding before the Commission involving utility. If in the proper exercise of Commission staff's duties, utility cannot supply appropriate personnel to address staff's reasonable concerns, then the appropriate staff of the relevant utility affiliated companies including, if necessary, its parent company, shall be made available to staff.
- B. *Access to Books and Records.* 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. Utility shall continue to maintain its books and records in accordance with all Commission rules. Utility's books and records shall be maintained and housed in California.
- C. *Annual Report.* Each year, by March 31, utility shall file a report with the Director of the Commission's Division of Water and Audits which includes a summary of all transactions between utility and its affiliated companies and parent company for the previous calendar year. Utility shall maintain such information on a monthly basis and make such information available to the Commission's staff upon request. The summary shall include a description of each transaction and an accounting of all costs associated with each transaction although each transaction need not be separately identified where multiple transactions occur in the same account (though supporting documentation for each individual transaction shall be made available to Commission staff upon request). These transactions shall include (a) services provided by utility to parent/affiliated company; (b) services provided by parent/affiliated company to utility; (c) assets transferred from utility to parent/affiliated company; (d) assets transferred from parent/affiliated company to utility; (e) employees transferred from utility to parent/affiliated company; (f) employees transferred from parent/affiliated company to utility; and (g) financing arrangements and transactions between utility and parent/affiliated company.

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VII. *Separation*

- A. *Accounting.* Utility shall maintain its accounting records in accordance with Generally Accepted Accounting Principles, the Commission's Uniform System of Accounts, Commission decisions and resolutions, and the Public Utilities Code.
- B. *Allocation of Common Costs.* Utility and its parent/affiliated companies shall allocate costs between them in such a manner that ratepayers of utility shall not subsidize any parent/affiliate of utility.
- C. *Preservation of Utility's Ability to Serve.* Utility's parent and affiliates shall not acquire utility assets at any price if such transfer of assets would impair the utility's ability to fulfill its obligation to serve or to operate in a prudent and efficient manner.
- D. *Unregulated Operations and Transfer of Employees.*
 - 1. Unregulated operations, if any, including pertinent contracts that are performed by utility shall be transferred to the appropriate affiliated company as soon as all requisite consent is obtained.
 - 2. Utility shall avoid a diversion of management that would adversely affect water utility.
 - 3. Utility shall not use its employees, including officers, to conduct unregulated operations if such use would adversely affect utility or its ratepayers.
 - 4. Utility shall endeavor to transfer to its parent/affiliated companies any work performed by an employee whose primary responsibility is to conduct unregulated operations, taking into consideration utility's obligations to its customers, to any such employee, and its obligations under any contract with its unions or others.
- E. *Transfer of Tangible Assets and Goods from Utility.* Any transfer of a tangible asset or good from utility to a parent/affiliated company shall be priced at cost or fair market value, whichever is higher, if the asset or goods are currently, or were at any time, included in utility's ratebase, including (a) any asset or goods booked to plant held for future use that is currently, or was at any time, included in utility's ratebase or (b) any asset or goods to which utility's ratepayers have contributed any carrying cost. Any gain resulting from the transfer of any such asset or goods shall be allocated in accordance with applicable provisions of the Public Utilities Code and other applicable law and consistent with policies of the Commission.

Utility shall develop a verifiable and independent appraisal of fair market value for any tangible asset or good that is transferred to a parent/affiliate under the paragraph

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above. The Commission's staff shall have access to all supporting documents used in the development of the fair market value.

- F. *Transfer of Intangible Assets and Goods from Utility.* Any transfer of an intangible asset or goods from utility to a parent/affiliated company shall be priced at cost or fair market value, whichever is higher, if the asset or goods are currently, or were at any time, included in utility's ratebase, including (a) any asset or goods booked to plant held for future use that is currently, or was at any time, included in utility's ratebase or (b) any asset or goods to which utility's ratepayers have contributed any carrying cost.

"Intangible assets and goods" shall mean all intellectual property (whether such property constitutes patents, trademarks, service marks, copyrights, or any intellectual property).

Utility shall develop a verifiable and independent appraisal of fair market value for any intangible asset or goods that are transferred to any affiliated company under the paragraph above. The Commission's staff shall have access to all supporting documents used in the development of the fair market value. If sufficient support for the appraisal of fair market value does not exist to the reasonable satisfaction of the Commission's staff, utility shall hire an independent consultant acceptable to the Commission staff to reappraise the fair market value for any such intangible asset or goods. The fair market value may be a single price, a royalty on the intangible asset or good, or a combination.

- G. *Transfers of Tangible and Intangible Assets and Goods to Utility.* Any transfer of a tangible or intangible asset or good to utility from a parent/affiliated company shall be in compliance with the applicable provisions of the statutes, law and consistent with Commission policies. Unless in conflict with the statutes, law or Commission policies, such asset or goods transferred from a parent/affiliated company to utility shall be at fair market value.
- H. *Pricing of Services from Utility to Affiliated Companies.* All services provided by utility to a parent/affiliated company shall be priced to recover at least utility's cost – such as the proportionate cost of (a) salary and benefits of any employee used in providing such services and (b) any equipment, including carrying costs with respect thereto, or supplies used in connection therewith.
- I. *Pricing of Services from Affiliated Companies to Utility.* Except for common costs allocated in the manner described in Paragraph VII.B above, the cost of services provided by a parent/affiliated company to utility shall be considered reasonable if it is at or below the lowest of (a) the cost which would have been incurred by utility if it provided such services on comparable terms, (b) the rate which would have been charged to utility by an unaffiliated party for the provision of comparable services on

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comparable terms, or (c) the rate which would have been charged by the parent/affiliated company to an unaffiliated party for the provision of comparable services on comparable terms.

- VIII. *Confidentiality.* Any records or other information of a confidential nature furnished to the Commission pursuant to these Rules that are individually marked Confidential are not to be treated as public records and shall be treated in accordance with Public Utilities Code Section 583 and the Commission's General Order 66-C.

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EXAMPLE RULES GOVERNING THE USE OF REGULATED ASSETS AND PERSONNEL FOR NON-TARIFFED UTILITY PRODUCTS AND SERVICES OFFERED BY WATER AND SEWER UTILITIES

1. Revenue sharing for non-tariffed utility products and services shall be as follows:
 - a. Active – 10%/90% ratepayer/shareholder, and
 - b. Passive– 30%/70% ratepayer/shareholder.
 - c. Revenues due to the pass-through of costs, without any mark-up, in contract terms shall be excluded in determining revenue sharing. If an advice letter is required pursuant to Rule 5 below, the utility shall specify in the advice letter any items other than postage, power, taxes, and purchased water for which it proposes pass-through treatment and must obtain Commission approval for such treatment.
 - d. For those utilities with “other operating revenue” of \$100,000 or more assumed in the most recent general rate case, revenue sharing shall occur only for revenues in excess of the level of “other operating revenue” assumed in the most recent general rate case. All revenue below that level shall accrue to the benefit of ratepayers.
 - e. For those utilities with “other operating revenue” assumed to be below \$100,000 in the most recent general rate case, there shall be no sharing threshold, and there shall be sharing of all revenues for non-tariffed products and services.
2. A utility may classify a non-tariffed utility product or service as active or passive according to the matrix below. For new non-tariffed products or services not listed in the matrix that a utility proposes to classify as active, the utility shall demonstrate in its advice letter submitted pursuant to Rule 5 below that there is or will be incremental shareholder investment above \$125,000, or the new product or service shall be classified as passive. No costs recoverable through rates shall be counted toward the \$125,000 threshold.
3. Cost allocation:
 - a. All incremental investments, costs, and taxes due to non-tariffed utility products and services shall be absorbed by the utility, i.e., not recovered through tariffed rates.
 - b. Ratemaking treatment of other (not incremental) investments and costs incurred for labor and capital jointly used for tariffed and non-tariffed products and services shall be considered in each utility’s rate cases.

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4. Each utility shall include information regarding its non-tariffed products and services in its Annual Reports, including but not be limited to the following:
 - a. Detailed description of each non-tariffed activity:
 - i. Type – active or passive.
 - ii. Dates services provided.
 - iii. Gross revenue.
 - iv. Revenue allocated to ratepayers and to shareholders.
 - v. All costs associated with the services provided.
 - vi. Incremental costs and any additional income tax liability associated with provision of this service and detailed description of how accounted for.
 - vii. Detailed description of how transaction costs and revenues were accounted for, and amount of each.
 - viii. Complete identification of all regulated assets used in the transaction.
 - ix. Complete list of all employees that participated in providing the non-tariffed service, with amount of time spent on provision of the service.
 - x. Names of all those that received the service.
 - xi. If classified as active and if submitted for approval by the Commission, provide the Number of the Advice Letter and the authorizing Resolution.
 - xii. If classified as passive, or if classified as active but without a requirement of Commission approval, provide the date that notice was provided to the Commission.
5. Any water or sewer utility that proposes to engage in a sale of non-tariffed goods or services provided, in whole or in part, by assets or employees reflected in the utility's revenue requirement, and which are proposed to be classified as active as described herein, shall file a Tier 3 advice letter seeking Commission approval, except for those activities designated as active in the matrix below.
6. Any such advice letter for non-tariffed goods or services shall comply with the following:
 - a. The advice letter shall contain the following:
 - i. Full description of the proposed service, including, without limitation, identity of parties, revenue and cost forecasts, term, contingencies.

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- ii. An accounting mechanism to allocate costs of assets in rate base, expenses in rates, and personnel in the revenue requirement between tariffed and non-tariffed services.
 - iii. Copies of all operative documents for the proposed service.
 - iv. Detailed description of proposed accounting for the non-tariffed service's costs and revenues.
 - v. Detailed description of any items other than postage, power, taxes, and purchased water for which the utility proposes pass-through treatment for purposes of calculating revenue sharing.
 - vi. Complete identification of all regulated assets and personnel that will be used in the proposed transaction.
 - vii. Complete list of all employees that will participate in providing the service, with an estimate of the amount of time each will spend.
 - viii. The proposed accounting system shall share gross revenues, excluding pass-through items:
 - 1. 10%/90% for active investments between ratepayers and shareholders, and
 - 2. 30%/70% for passive investments, between ratepayers and shareholders.
 - ix. Any income tax liability incurred due to the non-tariffed service shall be accounted for in such a manner as to require that shareholders bear the cost.
 - x. All contingencies and liabilities shall be addressed so as to eliminate ratepayer obligations.
 - xi. Any other information or opinions that might be relevant to the Commission's consideration of the non-tariffed service.
- b. In the advice letter, the utility shall show:
- i. The involved portion of utility assets or capacity that has been acquired for the purpose of and is necessary and useful in providing tariffed utility services,
 - ii. The involved portion of such asset or capacity may be used in offering the non-tariffed product or service without affecting the cost, quality, or reliability of the tariffed products,
 - iii. The non-tariffed product or service will be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk, and no undue diversion of utility management attention,

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- iv. The non-tariffed product or service does not violate any law, regulation, or Commission policy regarding anti-competitive practices, and
 - v. The justification for classifying the non-tariffed product or service as active. The utility shall demonstrate that there is or will be incremental shareholder investment above \$125,000. No costs recoverable through rates shall be counted toward the \$125,000 threshold.
7. When a water or sewer utility engages in the sale of non-tariffed goods or services that are designated as active or passive in the matrix below and that are provided, in whole or in part, by assets or employees reflected in the utility's revenue requirement, the utility shall provide notice of such activity via a written notice to the Director of the Division of Water and Audits and the Program Manager of the Division of Ratepayer Advocates-Water Branch, within 30 days of instituting such activity.

APPENDIX B**Page 5****DESIGNATION OF ACTIVITIES – ACTIVE & PASSIVE**

CATEGORY	ACTIVITY	ACTIVE/PASSIVE DESIGNATION
Use of Facilities	<ul style="list-style-type: none"> • Placement of third party communications equipment, attachments, conduit and cable • Parking • Vehicle storage • Office space 	Passive
Use of General Facilities	<ul style="list-style-type: none"> • Parking • Vehicle storage • Meeting/training • Office Space • Placement of third party communications equipment, attachments, conduit and cable 	Passive
Use of Heavy Equipment and Machinery	<ul style="list-style-type: none"> • Use of heavy equipment such as cranes, machinery, equipment 	Passive
Geographic Information Systems Services	<ul style="list-style-type: none"> • Mapping services • Map creation • Specialized geographic data base analysis and development • User training 	Passive
Miscellaneous Services	Training, technical certification, conferences and seminars	Passive
License of utility Software	<ul style="list-style-type: none"> • Utility developed software • Software licensed to the utility 	Active
Customer Account Management Services	<ul style="list-style-type: none"> • Bill calculation, processing and presentation • Meter reading • Payment processing 	Active

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	<ul style="list-style-type: none"> • Credit and collections • Phone center services (responding to customer billing questions, service establishment requests) • Other field services 	
Operation and Maintenance Contracts	<ul style="list-style-type: none"> • Operation and Maintenance of Third Party Utility Systems • Leases of Third party utility systems • Design/Build contracts 	Active
Meter Services	<ul style="list-style-type: none"> • Replacement of Water Meters for Third Party Utility systems 	Active
Customer Ancillary Services	<ul style="list-style-type: none"> • Customer Facility Related Services, Including Maintenance Contracts 	Active

(END OF APPENDIX B)