

Decision 11-10-034 October 20, 2011

**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).

Rulemaking 09-04-012  
(Filed April 16, 2009)

**MODIFIED DECISION REGARDING  
PETITION FOR MODIFICATION OF DECISION 10-10-019**

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Appendix A - Modified Rules for Water and Sewer Utilities Regarding  
Affiliate Transactions and the Use of Regulated Assets for  
Non-Tariffed Utility Services

**MODIFIED DECISION REGARDING  
PETITION FOR MODIFICATION OF DECISION 10-10-019**

**1. Summary**

The California Water Association (CWA) filed a Petition for Modification of Decision (D.)10-10-019, which established affiliate transaction rules for all Class A and Class B water and sewer utilities.

D.10-10-019 is modified to:

- a) clarify that specific entities are not subject to the affiliate transactions rules;
- b) move certain activities which could be shared among water utilities and their affiliates from the “prohibited” list to the “allowed” list; and
- c) streamline the process for filings related to creation of new affiliates.

All other requests by CWA for modification are denied.

**2. Background**

Order Instituting Rulemaking (R. or OIR) 09-04-012 was opened on April 16, 2009 to develop consistent rules governing affiliate transactions and non-tariffed utility products and services for all water and sewer utilities. The OIR stated that the purpose of the rules was to “... 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.” The OIR also stated that “(b)ecause 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.”

Decision (D.) 10-10-019 adopted standard rules for all Class A and B water and sewer utilities<sup>1</sup> regarding affiliate transactions and the use of regulated assets and personnel for non-tariffed utility products and services. The adopted rules were attached as Appendix A to that decision.

Before D.10-10-019, some water utilities operated under affiliate transaction rules adopted in Commission decisions approving applications to form holding companies. In those cases, the rules differed from case to case. Other water utilities had few or no affiliate transaction rules in place. The adopted affiliate transaction rules were intended to provide consistent and understandable rules for all subject water and sewer utilities.

As discussed in D.10-10-019, the adopted rules addressed our goals of protecting ratepayers, ensuring the financial health of the utility, and preventing anti-competitive behavior in the competitive marketplace. The adopted rules also provided flexibility to account for unique circumstances of certain utilities. One of the adopted rules, Rule X., governs the provision of non-tariffed products and services within water and sewer utilities.

### **3. California Water Association Petition for Modification**

On March 14, 2011, California Water Association (CWA) filed a Petition for Modification (Petition) of D.10-10-019. CWA filed the Petition on behalf of the following Class A and Class B water utility members of CWA: California American Water Company, California Water Service Company, Golden State Water Company, Park Water Company, Apple Valley Ranchos Water Company,

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<sup>1</sup> All water and sewer utilities with 2,001 or more service connections.

San Gabriel Valley Water Company, San Jose Water Company, Suburban Water Systems, Alisal Water Corporation, Del Oro Water Company and East Pasadena Water Company. The Petition seeks to modify several specific Rules, as discussed in the sections below.

On April 25, 2011, the Commission's Division of Ratepayer Advocates (DRA) and The Utility Reform Network (TURN), both of whom were parties in R.09-04-012, filed responses to the CWA Petition. DRA finds some of the Petition's proposed modifications to be unobjectionable and opposes others. TURN urges the Commission to reject most of the proposals made by CWA. The specifics of CWA's proposed modifications and the responses of DRA and TURN are discussed in the sections below.

#### **4. Standard for Review of Petition for Modification**

The Petition was filed pursuant to Rule 16.4 of the Commission's Rules of Practice and Procedure (Rule 16.4).

TURN contends the Petition is procedurally improper because CWA is arguing that D.10-10-019 contains errors of fact and is contrary to the record in the proceeding. TURN maintains that CWA erroneously is trying to substitute a Petition for Modification for an Application for Rehearing. DRA similarly argues that the Petition is more akin to an Application for Rehearing in that it alleges few, if any, new circumstances or facts. Further, DRA contends that CWA is simply attempting to re-litigate issues it already raised in the underlying proceeding.

Rule 16.4(a) states: "A petition for modification asks the Commission to make changes to an issued decision." Rule 16.4(b) states: "A petition for modification of a Commission decision must concisely state the justification for

the requested relief” and “Allegations of new or changed facts must be supported by an appropriate declaration or affidavit.”

The Commission has consistently stated that a Petition for Modification is not a substitute for the legal issues which may be raised in an Application for Rehearing. Neither CWA nor any party filed a timely Application for Rehearing. We will not consider any issues here which should have been raised in an Application for Rehearing.

CWA states the justification for the requested relief regarding several potential modifications in the Petition. We will not consider issues which are simply re-litigation of issues that were decided in D.10-10-019. To the extent that CWA has provided new or changed facts, properly supported by the appropriate declaration or affidavit, we will consider issues raised in the Petition. In addition, we will consider other non-controversial modifications that provide necessary clarification to D.10-10-019.

## **5. Specific Modifications of Affiliate Transactions Rules**

### **5.1. Rule II.E. -- Definition of Affiliate**

The adopted Rule II.E. states:

“Affiliate” means any entity whose outstanding voting securities are more than 10 percent owned, controlled, directly or indirectly, by a utility, by its parent company, or by any subsidiary of either that exerts substantial operational control.

For purposes of these Rules, “substantial operational control” includes, but is not limited to, the possession, directly or indirectly of the authority to direct or cause the direction of the management or policies of a company. A direct or indirect voting interest of more than 10 percent by the utility in an entity’s company creates a rebuttable presumption of substantial operational control.

For purposes of these Rules “affiliate” includes the utility’s parent company, or any company that directly or indirectly owns, controls, or holds the power to vote more than 10 percent of the outstanding voting securities of a utility or its parent company.

Regulated subsidiaries of a utility, the revenues and expenses of which are subject to regulation by the Commission and are included by the Commission in establishing rates for the utility, are not included within the definition of affiliate for the purpose of these Rules. However, these Rules apply to all interactions any such regulated subsidiary has with other affiliated unregulated entities covered by these Rules.

CWA requests that Rule II.E. be modified in three ways. First, CWA calls for a modification to clarify that the term “voting securities” is not intended to include mere voting interests, and to provide for certain entities in which a water utility may have more than a 10% ownership but not a controlling interest to be excluded from the definition of “affiliate.” Generally, CWA wants to ensure that the silence of the decision regarding the applicability of the rules to these entities will not be interpreted in the future to encompass such entities.

Second, CWA requests that non-profit mutual water companies be excluded from the definition of “affiliate.” CWA points to examples involving San Gabriel Valley Water Company and Suburban Water Company where mutual water companies deliver water only to their owners at cost. CWA claims that applying the affiliate transaction rules to mutual water companies would directly and adversely conflict with the Commission’s stated objectives of ensuring that ratepayers receive high quality water service, and of avoiding rules that cause excessive burden on utilities.

Third, CWA requests that the term “parent company” be removed from the definition of “affiliate.” CWA argues that restrictions on the utility/parent company relationship should be the exception, not the rule. CWA would remove

“parent company” from the general definition of an affiliate in Rule II.E., and only apply Rules to parents in Rules I.E (existing rules apply when the affiliate transaction rules do not address an item) and IV.C (listing of shared directors and officers in an annual report).

DRA objects to CWA’s request to exclude parent companies from the definition of affiliates. DRA contends that Rule II.E., along with other Rules, are what provide the Commission the ability to properly police the utility, include its holding company or parent, and oversee the utility-affiliate relationship to prevent improper cross-subsidization of affiliate activities by captive ratepayers. DRA argues that it is essentially impossible to determine all of the benefits that utilities confer on their parent companies and affiliates. Therefore, DRA maintains that CWA’s theory -- that restrictions on the utility/parent relationship should be the exception, not the rule -- would undermine the Commission’s regulatory authority as envisioned by D.10-10-019. DRA sees no harm in clarifying the Decision’s language so that the definition of an affiliate does not encompass mutual water companies, joint powers authorities, or court-appointed and supervised watermasters. DRA also has no concerns about CWA’s request to exclude mutual water companies from the definition of affiliate.

TURN partially accepts CWA’s proposal regarding “voting shares,” but reiterates its argument from the record that CWA’s scenarios are “red herrings” because it is clear that the affiliate transaction rules are not meant to apply. TURN proposes that CWA’s modification could be accepted with the further qualification that the utility is a “member or shareholder with a non-controlling interest.” TURN also suggests that the term “mutual water company” should be

deleted from CWA's proposed language, because non-profit affiliates still cause risks to ratepayers from cross-subsidy or favorable dealings.

TURN argues that elimination of the term "parent" from the definition of affiliate to fix alleged inconsistencies is an example of "throwing the baby out with the bathwater." Instead, TURN suggests consideration of more targeted clarifications.

### **Discussion**

The issue of including the parent company within Rule II.E. was specifically addressed in D.10-10-019. The decision determined that a 10% ownership threshold was reasonable to ensure that any affiliate with a significant relationship to a water or sewer utility is covered by the rules. The decision also carved out exceptions to accommodate issues of unique corporate structure, such as with California American Water.

CWA has presented no new facts regarding the issues of including parent companies within the definition of an affiliate, and has not provided a declaration or affidavit on this matter. CWA basically reargues its position in the underlying proceeding, which was fully litigated. CWA also attempts to make a distinction which does not exist; when the decision uses the phrase "any parent or other affiliate," this language provides certainty in any Rule that the parent company is included in that Rule, not (as CWA contends) to distinguish between a parent and other affiliates. While there may be a rationale for targeted changes regarding use of the term "parent" as TURN suggests, there is no specific rationale for any particular language changes. We will not modify the decision to exclude "parent" from the definition of an affiliate in any Rule.

Regarding the other Rule II.E. modifications sought by CWA, we find that these proposed modifications mostly are in the nature of clarifications. TURN is

correct that there is no indication that the affiliate transaction rules were intended to apply to water utility participation as voting entities in certain organizations. Nevertheless, it is reasonable to provide clarity on this point so as to avoid future misinterpretations.

In comments on the proposed decision, CWA, referencing Pub. Util. Code § 2705, reiterates that “mutual water companies by definition deliver water only to their owners or members at cost, i.e., on a not-for-profit basis” and therefore, “there is no need to apply the [Rules] to such entities”. CWA states that mutual water companies do not operate in any market, let alone a competitive market. Therefore, CWA claims that there is no opportunity or reason for a utility to subsidize a mutual water company.

Since mutual water companies must by statute sell water at cost, there is no potential of subsidy. While in theory it may be possible for a water utility to sell water or other goods or services to an affiliated mutual water company below cost (thereby advantaging the mutual water company and disadvantaging utility ratepayers), there is no evidence that this has ever occurred or would ever occur. To guard against a problem which is either non-existent or simply hypothetical, it is superior to rely on the general rate case process than to impose an additional regulatory burden on the regulated water companies. In reply comments on the proposed decision, TURN withdrew its objection on this point.

We will accept the modifications proposed by CWA, with one exception. CWA proposes to add the following language to this Rule: “For the purposes of this Rule, the term “voting securities” is not intended to include mere voting interests.” TURN would add at the end of the sentence the following phrase: “if the utility is a member or shareholder with a non-controlling interest.” To the extent that the proposed language regarding “voting interests” is related to

CWA's other proposed addition to this Rule (exempting various governmental, quasi-governmental and non-profit affiliates from the Rules), it is unnecessary because we are providing a categorical exemption for these entities. In addition, the Rule already contains language that "a direct or indirect voting interest of more than 10 percent by the utility in an entity's company creates a rebuttable presumption of substantial operational control." CWA's proposed additional language is either unnecessary or causes ambiguity on this point. Further, the proposed language with TURN's addition also may cause confusion or ambiguity in connection with the wording of other parts of this Rule; specifically, it is not clear how the term "non-controlling interest" should be interpreted *vis-à-vis* the term "substantial operational control" in the existing Rule. Since this sentence does not appear to add anything of value to the current Rule, we will not add this proposed modification.

Therefore, Rule II.E. is modified to state as follows:

"Affiliate" means any entity whose outstanding voting securities are more than 10 percent owned, controlled, directly or indirectly, by a utility, by its parent company, or by any subsidiary of either that exerts substantial operational control.

For purposes of these Rules, "substantial operational control" includes, but is not limited to, the possession, directly or indirectly of the authority to direct or cause the direction of the management or policies of a company. A direct or indirect voting interest of more than 10 percent by the utility in an entity's company creates a rebuttable presumption of substantial operational control.

For purposes of these Rules "affiliate" includes the utility's parent company, or any company that directly or indirectly owns, controls, or holds the power to vote more than 10 percent of the outstanding voting securities of a utility or its parent company.

Regulated subsidiaries of a utility, the revenues and expenses of which are subject to regulation by the Commission and are included

by the Commission in establishing rates for the utility, are not included within the definition of affiliate for the purpose of these Rules. However, these Rules apply to all interactions any such regulated subsidiary has with other affiliated unregulated entities covered by these Rules.

For the purposes of this Rule, "affiliate" shall not include a mutual water company, a joint powers authority, other governmental or quasi-governmental agency or authority, a public/private partnership, a watermaster board, a water basin association, or a groundwater management authority in which a utility participates or in which a utility is a member or shareholder.

## **5.2. Rule V. - Shared Corporate Support**

Rule V. establishes the rules for sharing corporate support services between a utility, its parent company and separate affiliates. Rules V.C. and V.D. are as follows:

### V.C.

Examples of services that may be shared include: corporate governance and oversight, payroll, taxes, shareholder services, insurance, financial reporting, financial planning and analysis, corporate accounting, corporate security, human resources (compensation, benefits, employment policies), employee records, regulatory affairs, lobbying, legal, and pension management.

### V.D.

Examples of services that may not be shared include: engineering, hedging and financial derivatives and arbitrage services, water or sewage for resale, water storage capacity, purchasing of water distribution systems, and marketing.

CWA proposes that certain shared services which are prohibited by Rule V.D. be moved into the permitted category of Rule V.C. Specifically, CWA requests that water or sewage for resale, water storage capacity, engineering, and purchase of water and wastewater facilities be permitted as shared services. CWA notes that, if these services are permitted to be shared among utilities and their affiliates, they would still be subject to the pricing requirements set forth in

the Rules, which were put in place to protect ratepayers from improper cross-subsidies or assistance to non-regulated affiliates.

In a Declaration attached to its Petition, F. Mark Schubert, Manager of Capital Assets and Planning of California American Water Company, declares that “it is significantly more expensive for California American Water to use the services of other outside engineering consultants instead of the services of the Corporate Engineering Team” (a current shared service). The Declaration also states “California American Water will not hire and retain engineering specialists because it would not be cost-effective to pay salaries for skills that are not needed on a regular basis.”

DRA is not opposed to CWA’s request. TURN contends that CWA has not provided any new information or changed circumstances which would justify a change to these Rules. However, TURN states that it is willing to defer to DRA on this issue.

CWA has provided a Declaration in support of its request for changing the categorization of engineering services, but not for its other requested modifications to Rule V. CWA in its comments on the underlying Proposed Decision (which became D.10-10-019) argued that the proposed Rule V.D. was too restrictive and that some services (such as employee recruiting and engineering) should be moved from the “prohibited” to the “permitted” list. In response to comments on the Proposed Decision, D.10-10-019 did move certain services from Rule V.D. (“prohibited”) to Rule V.C. (“permitted”). Specifically, Rule V.D. was modified to strike employee recruiting from the list of services prohibited from being shared between the utility and its affiliates.

D.10-10-019 states:

Staff Proposed Rule V lists examples of shared corporate services to which Rule V would apply, but does not limit applicability to this list. We recognize there may be other legitimate shared corporate services to which Rule V should apply. However, we do not intend to allow unlimited applicability. From the Staff Proposed Rule, we will retain a list of examples of services which cannot be shared under Rule V.

The specific services CWA requests to move to permitted status as shared services were not discussed at any length in the record or in D.10-10-019 (although the record alludes to such discussion in workshops). The lists of permitted and not permitted shared services came directly from affiliate transaction rules for energy utilities, with the recognition that “there may be other legitimate shared corporate services to which Rule V. should apply.” While there is no new information provided to support CWA’s request on this point other than regarding engineering services, there is also no objection to CWA’s request.

Regarding engineering services, we note that there are dual purposes for the adopted Rules: first, to protect ratepayers from higher costs from potential subsidies from utilities to affiliates; and second, to protect competitors from unfair competition due to subsidies to utility affiliates. In the case of engineering services, the provided Declaration supports the view that ratepayers would benefit from such services being shared among utilities and affiliates. There is no information in the Declaration that sharing engineering services would or would not harm competitors. We are to some extent concerned about potential competitive harm. However, the undisputed claims in the Declaration indicate that (at least for California American Water) the main employer of engineering services is less likely to be the utility than the parent or other affiliates. This

reduces the potential for competitive harm. To the extent that engineering services are centered in other water utilities, we caution those utilities to ensure costs are properly allocated when utility engineering services are provided to affiliates.

We will make the requested modifications.

Rule V.C. is modified to state as follows (modifications noted):

Examples of services that may be shared include: corporate governance and oversight, payroll, taxes, shareholder services, insurance, financial reporting, financial planning and analysis, corporate accounting, corporate security, human resources (compensation, benefits, employment policies), employee records, regulatory affairs, lobbying, legal, ~~and~~ pension management, engineering, water or sewage for resale, water storage capacity, and purchasing of water distribution systems.

Rule V.D. is modified to state as follows:

Examples of services that may not be shared include: ~~engineering,~~ hedging and financial derivatives and arbitrage services, ~~water or sewage for resale, water storage capacity, purchasing of water distribution systems,~~ and marketing.

### **5.3. Rule VIII.D. – New Affiliates**

Rule VIII.D. states:

**New Affiliates.** Upon the creation of a new affiliate, the utility shall immediately notify the Commission of its creation, as well as posting notice of this event on its web site. No later than 60 days after the creation of this affiliate, the utility shall file a Tier 3 advice letter with the Director of the Commission's Division of Water and Audits, with service on the Director of the Division of Ratepayer Advocates. The advice letter shall state the affiliate's purpose or activities and whether the utility claims these Rules are applicable to the new affiliate, and shall include a demonstration to the Commission that there are adequate procedures in place that will assure compliance with these Rules. The advice letter may include a request, including supporting explanation, that the affiliate transaction rules not be applied to the new affiliate.

CWA requests that the first sentence of Rule VIII.D. be modified to read (new language underlined): “Upon the creation of a new affiliate whose primary business is a water industry-related activity in California, the utility shall immediately notify the Commission of its creation, as well as posting notice of this event on its web site.” CWA contends that there is no benefit from the communication of information regarding new affiliates which have no connection to the utility’s operations or water markets in California. On the other hand, CWA claims that there is a burden to such reporting on the utility and to Commission staff. CWA believes its requested language change would limit the applicability of Rule VIII.D. to created affiliates which have a reasonable possibility or likelihood of affecting the utility’s business in California.

CWA also requests that the second sentence of Rule VIII.D. be modified to delete “a Tier 3 advice letter” and substitute either a Tier 1 advice letter (pursuant to Rule 7.3.1 of the Water Industry Rules of General Order 96-B) or an information-only filing (pursuant to Rule 6.1 of the General Rules of General Order 96-B). CWA maintains that energy industry affiliate transaction rules, which formed much of the basis for the adopted water industry rules in D.10-10-019, do not require a Tier 3 advice letter. CWA cites a March 16, 2011 Southern California Edison filing of a Tier 1 advice letter notifying the Commission of the creation of a new affiliate. CWA would require a Tier 2 advice letter if a water utility requests that the affiliate transaction rules not be applied to a new affiliate.

DRA opposes CWA’s first requested modification to Rule VIII.D. DRA contends that the fungibility of customer-provided revenues provides the potential for hidden or improper subsidies from utility customers to parent holding companies and their other affiliates. DRA points out that the language

in Rule VIII.D. was directly addressed in R.09-04-012, and that D.10-10-019 specifically rejected the arguments of water utilities that the non-California activities of those affiliates are not germane to the operations of California water utilities. TURN makes similar arguments as DRA.

Regarding the type of filing required for new affiliates, TURN recommends that Rule VIII.B. be revised to require a Tier 2 advice letter. TURN contends that this filing would not be burdensome for either utilities or Commission staff, but would provide the opportunity for protest and scrutiny of the advice letter. DRA proposes that an information-only filing would be appropriate, except that a Tier 3 advice letter should be required if a water utility requests that the affiliate transaction rules not be applied to a new affiliate.

DRA and TURN are correct that the issue regarding reporting of out-of-state affiliates was specifically considered in D.10-10-019. The decision specifically accepted certain arguments from water utilities and CWA to narrow applicability of the Rules, such as exempting from the Rules transactions between affiliates which are regulated by other state regulatory commissions. The decision also specifically rejected arguments to exclude out-of-state affiliates. CWA has provided no new facts or circumstances regarding this provision. We decline to change the Rule on this point.

We will modify the filing requirement, by combining the suggestions of TURN and DRA. If a water utility proposes that a new affiliate be subject to the affiliate transaction rules, there is little likelihood that any party would disagree. If a water utility proposes that a new affiliate not be subject to the affiliate transaction rules, there is a reasonable likelihood that a party would protest, at least from time-to-time. If there is no protest, the streamlined Tier 2 process (which only requires a staff disposition letter to go into effect) is sufficient. If a

protest raises substantive issues, or staff otherwise determines that the request is problematic, staff can prepare a disposition letter or a draft resolution for the Commission's consideration, as appropriate.

In sum, we modify Rule VIII.D. to state as follows:

**New Affiliates.** Upon the creation of a new affiliate, the utility shall immediately notify the Commission of its creation, as well as posting notice of this event on its web site. No later than 60 days after the creation of this affiliate, the utility shall file ~~a Tier 3 advice letter~~ an information-only filing, as provided for in Rule 6.1 of General Order 96-B, with the Director of the Commission's Division of Water and Audits, with service on the Director of the Division of Ratepayer Advocates. The advice letter shall state the affiliate's purpose or activities and whether the utility claims these Rules are applicable to the new affiliate, and shall include a demonstration to the Commission that there are adequate procedures in place that will assure compliance with these Rules. The advice letter may include a request, including supporting explanation, that the affiliate transaction rules not be applied to the new affiliate. If the utility requests that the affiliate transactions rules not be applied to the new affiliate, in lieu of an information-only filing, the utility shall file a Tier 2 advice letter making such a request, including an explanation of why these Rules should not apply to the new affiliate.

#### **5.4. Rule VIII.E. – Independent Audit**

Rule VIII.E. states:

**Independent Audits.** Commencing in 2013, and biennially thereafter, the utility shall have an audit performed by independent auditors if the sum of all unregulated affiliates' revenue during the last two calendar years exceeds 5% of the total revenue of the utility and all of its affiliates during that period. The audits shall cover the last two calendar years which end on December 31, and shall verify that the utility is in compliance with these Rules. The utility shall submit the audit report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates no later than September 30 of the year in which the audit is performed. The Division of Water and Audits shall post the audit reports on the Commission's web site. The audits shall be at shareholder expense.

CWA requests that Rule VIII.E. be modified to delete the last sentence, so that the independent audits called for in this Rule would be at ratepayer expense. CWA argues that the costs of the required audits would not be insignificant, and that there is no rationale for why the costs of conducting an independent audit should be treated differently from the costs of complying with other regulatory requirements, which are recoverable through rates. CWA acknowledges that energy utilities pay for similar independent audits required by their affiliate transaction rules. CWA attempts to differentiate the circumstances of water utilities from those of energy utilities by claiming that water utilities do not have affiliates operating in competitive water markets in California which could be harmed by the utility-affiliate relationship. Therefore, CWA contends that the primary purpose of the water utility affiliate transaction rules is to ensure that the ratepayers are not subsidizing the utility's affiliate, and therefore the ratepayers are the sole beneficiaries of the independent audits.

DRA opposes CWA's request. Contrary to CWA's contentions, DRA provides examples of water utility affiliates which operate unregulated businesses in California. DRA also argues that the issues related to utility-affiliate relationships were the result of voluntary decisions by water utilities to form holding companies and affiliates. DRA contends that while the water utilities have benefited from their affiliates, utility ratepayers have been exposed to financial risks. Therefore, DRA concludes that the Commission was correct to require utilities to pay for independent audits. TURN also opposes CWA's request. TURN claims that CWA's argument on this point was already rejected by the Commission.

We decline to modify Rule VIII.E. CWA here reargues the same points it and its member utilities made in comments on the Proposed Decision which

became D.10-10-019. There are no new facts or circumstances to justify a modification.

**5.5. Rule X.D.**

Rule X.D. states:

**Cost Allocation.** All costs, direct and indirect, including all taxes, incurred due to NTP&S projects shall not be recovered through tariffed rates. These costs shall be tracked in separate accounts and any costs to be allocated between tariffed utility services and NTP&S shall be documented and justified in each utility's rate case. More specifically, all incremental investments, costs, and taxes due to non-tariffed utility products and services shall be absorbed by the utility shareholders, i.e., not recovered through tariffed rates.

CWA requests that Rule X.D. be modified to delete the reference to indirect costs in the first sentence. CWA argues that indirect costs cannot be easily identified; to do so would require tracking and allocating these costs. CWA contends that because the Commission agreed that tracking and allocating of certain costs was not appropriate, indirect costs should not be included in the requirement of Rule X.D. to prevent recovery of the costs of non-tariffed products and services through tariffed rates.

TURN opposes the CWA proposed modification. TURN contends that the Commission already considered CWA's argument in comments on the Proposed Decision which led to D.10-10-019, and made some but not all of the changes advocated by CWA (but opposed by TURN and DRA) in the final decision. However, TURN acknowledges that Rule X.D. may lead to confusion based on the treatment of indirect costs in the Rules. TURN suggests that a reasonable outcome would be to require that a portion or equitable share of indirect costs should not be recovered through tariffed rates. TURN contends that this

modification would make it clear that some portion of indirect costs should be recovered through the offering of non-tariffed products and services.

This issue is one of clarification. Both CWA and TURN agree that there is a misalignment in Rule X.D. as presently constituted. In the final version of D.10-10-019, language from the Proposed Decision was modified which originally provided that non-incremental costs incurred for labor and capital jointly used for non-tariffed products and services and regulated services should be allocated between regulated and non-regulated services, and that revenues from these products and services should be shared between ratepayers and shareholders via an established mechanism. The requirement to allocate costs was deleted in the final version.

CWA agrees that direct costs associated with non-tariffed products and services should be allocated, per the current Rule X.D., because they are easily identified. CWA's argument that indirect costs should not be allocated is illogical - either costs should be allocated or they should not. The fact that it may be more difficult to identify indirect costs does not make it inappropriate to allocate these costs. On the other hand, D.10-10-019 at 87 did state that "(w)e do not believe there is a clear benefit to tracking such costs [and] thus we delete" the requirement to track costs.

We will not modify Rule X.D. D.10-10-019 arguably may be slightly inconsistent, but there is no contradiction between not seeing "a clear benefit" to track certain costs and a requirement to allocate indirect costs. The record shows that there is in fact a clear benefit from preventing ratepayers from subsidizing non-tariffed products and services. Therefore, it would be inappropriate to allow any identifiable costs (direct or indirect) related to non-tariffed products and services to be allocated to ratepayers. TURN's suggestion to require an equitable

portion of indirect costs to be allocated to non-tariffed products and services is neither consistent with the principle of preventing subsidy nor responsive to CWA's stated concern about tracking of indirect costs; therefore, we do not adopt it.

**6. Categorization and Need for Hearing**

This proceeding was categorized as quasi-legislative and hearings are not needed.

**7. Comments on Proposed Decision**

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on August 29, 2011, and reply comments were filed on September 6, 2011 by CWA, DRA, and TURN. Based on comments, the proposed decision was modified to exclude mutual water companies from the Rules, and to make minor formatting changes to Appendix A.

On September 20, 2011, the Proposed Modified Decision Regarding Petition for Modification of Decision 10-10-019, was mailed to the parties with additional modifications to Rule II.E. No comments were filed with regard to this modification.

**8. Assignment of Proceeding**

Michael R. Peevey is the assigned Commissioner and David M. Gamson is the assigned Administrative Law Judge.

**Findings of Fact**

1. D.10-10-019 found that the Commission's goals for this proceeding were that these affiliate transactions and non-tariffed products and services rules should be applied uniformly to all similar water and sewer utilities, that

cross-subsidy of affiliates by the utilities should be prevented, and that anti-competitive behaviors of the utilities, if any, should also be prevented.

2. No party filed an Application for Rehearing on D.10-10-019.

3. It is reasonable to modify D.10-10-019 in order to clarify the decision where ambiguity exists, or where all active parties agree with requested changes.

4. CWA has presented no new facts or circumstances to justify deletions or modifications related to the applicability of affiliate transaction rules to parent companies.

5. CWA has presented information in the nature of clarification regarding specific entities which arguably could be subject to the affiliate transactions rules.

6. Mutual water companies are required by statute to provide water to members at cost. There is no reason to believe that utility ratepayers are disadvantaged by affiliate relationships between water utilities and mutual water companies.

7. There is no dispute among active parties that certain activities which could be shared among water utilities and their affiliates should be moved from the "prohibited" list to the "allowed" list.

8. It is reasonable to modify D.10-10-019 to streamline the process for filings related to creation of new affiliates.

9. CWA has presented no new information to justify modification of the requirement that the utility pay for an independent audit of compliance with affiliate transaction rules.

10. CWA has presented no new information to justify modification of the requirement that both direct and indirect costs of non-tariffed products and services not be recovered from tariffed services.

### **Conclusions of Law**

1. A Petition for Modification cannot be used as a substitute for an Application for Rehearing.
2. D.10-10-019 should be modified to:
  - a) clarify that specific entities are not subject to the affiliate transactions rules;
  - b) move certain activities which could be shared among water utilities and their affiliates from the “prohibited” list to the “allowed” list; and
  - c) streamline the process for filings related to creation of new affiliates.
3. All other requests by CWA for modification of D.10-10-019 should be denied.

### **O R D E R**

1. Decision 10-10-019 is modified with regard to affiliate transactions and the provision of non-tariffed products and services for all Class A and Class B water and sewer utilities, as set forth in Appendix A of this order.
2. All requests in the Petition for Modification not incorporated into Appendix A of this order are denied.

3. This proceeding is closed.

This order is effective today.

Dated October 20, 2011, in San Francisco, California.

MICHAEL R. PEEVEY

President

TIMOTHY ALAN SIMON

MICHEL PETER FLORIO

CATHERINE J.K. SANDOVAL

MARK J. FERRON

Commissioners

# APPENDIX A

## **Modified Rules for Water and Sewer Utilities Regarding Affiliate Transactions and the Use of Regulated Assets for Non-Tariffed Utility Services**

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<sup>1</sup> Modifications from Affiliate Transaction Rules adopted in Decision 10-10-019 are noted herein. Additions are shown by underlining and deletions are shown by strikethrough.

**Appendix A**

**RULES FOR WATER AND SEWER UTILITIES REGARDING  
AFFILIATE TRANSACTIONS AND THE USE OF REGULATED  
ASSETS FOR NON-TARIFFED UTILITY SERVICES**

<b>RULE I.</b>	<b>Jurisdiction and Applicability to the Utility Affiliates. ....</b>	<b>1</b>
<b>RULE II.</b>	<b>Definitions .....</b>	<b>2</b>
<b>RULE III.</b>	<b>Utility Operations and Service Quality .....</b>	<b>4</b>
<b>RULE IV.</b>	<b>Separation .....</b>	<b>5</b>
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## **RULE I. Jurisdiction and Applicability**

### **I.A.**

These Rules apply to all Class A and Class B California public utility water and sewer corporations or companies subject to regulation by the California Public Utilities Commission (Commission).

### **I.B.**

These Rules apply to transactions between a Commission-regulated utility and another affiliated entity that is engaged in the provision of products that use water or sewer services or the provision of services that relate to the use of water or sewer services, including the utility's parent company, and to the utility's use of regulated assets for non-tariffed utility services, unless specifically modified or exempted by the Commission. Transactions between a Commission-regulated utility and an affiliated utility regulated by a state regulatory commission (whether the utility is located in California or elsewhere) are exempt from these Rules, except for provisions of Rule IV.B. and Rule X.

### **I.C.**

Utilities shall comply with all applicable State and Federal statutes, laws and administrative regulations.

### **I.D.**

Existing Commission rules for each utility and its parent company continue to apply except to the extent they conflict with these Rules. In such cases, these Rules supersede prior rules and guidelines, provided that nothing herein shall preclude (1) the Commission from adopting other utility-specific guidelines; or (2) a utility or its parent company from adopting other utility-specific guidelines, with advance Commission approval through Decision or Resolution. In the case of ambiguity regarding whether a conflict exists, there shall be a rebuttable presumption that these Rules apply.

### **I.E.**

Where these Rules do not address an item currently addressed in a utility's existing rules imposed by this Commission which govern that utility's transactions with its affiliate(s) or its use of regulated assets for non-tariffed utility services, the existing utility-specific rules continue to apply for that item only.

### **I.F.**

These Rules do not preclude or stay any form of civil relief, or rights or defenses thereto, that may be available under state or federal law.

### **I.G.**

A California utility which is also a multi-state utility and subject to the jurisdiction of other state regulatory commissions, may file an application with this Commission, served on all parties to this proceeding and its most recent general rate case, requesting a limited exemption from these Rules or a part thereof, for transactions between the utility solely in

its capacity serving its jurisdictional areas wholly outside of California, and its affiliates if such out-of-state operations do not substantially affect the utility's operations and the operating costs inside California. The applicant has the burden of proof.

**I.H.**

A California utility's affiliates that operate entirely outside of California are exempt from Rule III.B. and Rule III.C. of these Rules, for transactions between the utility and such affiliates if the affiliates' operations do not substantially affect the utility's operations and the operating costs inside California.

**I.I.**

These Rules shall be interpreted broadly, to effectuate the Commission's stated objectives of protecting consumer and ratepayer interests and, as an element thereof, preventing anti-competitive conduct.

**RULE II. Definitions**

**II.A. "Parent company" or "parent"**

"Parent company" or "parent" is the entity, including a holding company or corporation, that owns, or has substantial operational control (as defined in Rule II.E.) of, the regulated utility.

**II.B. "Utility"**

"Utility" (unless specified as a water utility) refers to all water utilities and sewer utilities regulated by the Commission.

**II.C. "Water utility"**

"Water utility" refers to all water utilities regulated by the Commission.

**II.D. "Sewer utility"**

"Sewer utility" refers to all sewer utilities regulated by the Commission.

**II.E. "Affiliate"**

"Affiliate" means any entity whose outstanding voting securities are more than 10 percent owned, controlled, directly or indirectly, by a utility, by its parent company, or by any subsidiary of either that exerts substantial operational control.

For purposes of these Rules, "substantial operational control" includes, but is not limited to, the possession, directly or indirectly of the authority to direct or cause the direction of the management or policies of a company. A direct or indirect voting interest of more than 10 percent by the utility in an entity's company creates a rebuttable presumption of substantial operational control.

For purposes of these Rules "affiliate" includes the utility's parent company, or any company that directly or indirectly owns, controls, or holds the power to vote more than 10 percent of the outstanding voting securities of a utility or its parent company.

Regulated subsidiaries of a utility, the revenues and expenses of which are subject to regulation by the Commission and are included by the Commission in establishing rates for the utility, are not included within the definition of affiliate for the purpose of these Rules. However, these Rules apply to all interactions any such regulated subsidiary has with other affiliated unregulated entities covered by these Rules.

For the purposes of this Rule, “affiliate” shall not include a mutual water company, a joint powers authority, other governmental or quasi-governmental agency or authority, a public/private partnership, a watermaster board, a water basin association, or a groundwater management authority in which a utility participates or in which a utility is a member or shareholder.

## **II.F. “Costs”**

“Costs” are used in these Rules to refer to the total expenses assigned or allocated to different projects or activities through the utility’s and parent company’s accounting systems. Cost categories include:

1. *Direct Costs.* Direct costs are costs that can be clearly identified to specific projects or activities because the resource in question, or some measurable portion of that resource, has been dedicated to the project or activity. An example would be the hours of a worker’s time spent on the effort, materials purchased and used specifically on that effort, or the proportion of a machine’s hours dedicated to the effort.
2. *Direct Overhead Costs.* For organizations that produce multiple outputs, direct overhead costs are the common costs of a subset of the organization, such as supervisors and support staff of a division not assigned or traceable to specific projects, or machinery shared among a subset of the company’s projects. Such overhead costs require allocation to specific projects through proxies and methodologies designed to accurately reflect the particular production aspects of each project; e.g., some processes are more capital-intensive than others and need less supervision input. Allocation methodologies for direct overhead costs can make use of several factors, often activity-based and often using “cost causation” as one of the principles in their design.
3. *Indirect Overhead Costs.* Indirect overhead costs are functions that affect the entire organization, such as the headquarters building, the Chief Executive Officer and Chief Financial Officer, General Counsel and associated legal support, personnel departments, security for this building or these offices, shareholder and public relations, insurance, depreciation, advertising, and similar functions. These are real costs of the organization and must be allocated to the ongoing projects and activities to determine the total cost of each. These are also sometimes called “General Overhead Costs.”

4. *Fully-loaded* (also known as fully-allocated) costs. Fully-loaded (or fully-allocated) costs refer to the total cost of a project or activity, which is the sum of Direct, Direct Overhead, and Indirect Overhead costs, as defined in Rule II.F.1, 2 and 3.

**II.G. “Transaction”**

“Transaction” means any transfer of an item of value such as a good, service, information or money between a utility and one or more of its affiliates.

**II.H. “Property”**

“Property” refers to any right or asset, tangible or intangible, to which an entity has legal or equitable title.

**II.I. “Real Property”**

“Real property” refers to any interest in real estate including leases, easements, and water rights.

**II.J. “Customer”**

“Customer” means any person, firm, association, corporation or governmental agency supplied or entitled to be supplied with water, wastewater, or sewer service for compensation by a utility.

**II.K. “Customer information”**

“Customer information” means non-public information and data specific to a utility customer which the utility acquired or developed in the course of its provision of utility services.

**II.L. “Cross-subsidy”**

“Cross-subsidy” means the unauthorized over-allocation of costs to captive ratepayers resulting in under-allocation of costs to a utility affiliate.

**RULE III. Utility Operations and Service Quality**

**III.A.**

A utility shall not allow transactions with affiliates to diminish water utility staffing, resources, or activities in a manner that would result in degradation of the reliability, efficiency, adequacy, or cost of utility service or an adverse impact on customer service. Utility management attention shall not be diverted to such transactions in a way that would result in such degradation. The 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.

### **III.B**

Except as otherwise provided by these Rules, a utility shall not

1. Provide leads to its affiliates;
2. Solicit business on behalf of its affiliates;
3. Acquire information on behalf of or to provide to its affiliates;
4. Share 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 its affiliates, except that a utility may share such information with a parent under the condition that the parent does not share the information with any other entity;
5. Request authorization from its customers to pass on customer information exclusively to its affiliates;
6. Give the appearance that the utility speaks on behalf of its affiliates; or
7. Represent that, as a result of the affiliation with the utility, its affiliates or customers of its affiliates will receive any different treatment by the utility than the treatment the utility provides to other, unaffiliated companies or their customers.
8. Provisions 3, 4 and 5 of Rule III.B shall not apply to utility affiliates which are non-profit and whose sole purpose is to serve the functions of regulated utilities, the parents of regulated utilities, governmental or non-profit entities, including non-profit affiliates of regulated utilities.
9. Utilities may file an Advice Letter seeking an exemption to Rule III.B.8 within ninety days of the effective date of the Commission decision adopting these rules, requesting that a non-profit affiliate subject to Rule III.B.8 be allowed to serve the functions of other affiliates, as long as those other affiliates provide no more than five per cent of the annual revenues of the non-profit affiliate.

### **III.C.**

Except as provided for elsewhere in these rules, if a utility provides customer or utility information, services, or unused capacity or supply to an affiliate, it must offer such customer or utility information, services, or unused capacity or supply to all similarly situated market participants in a non-discriminatory manner, which includes offering on a timely basis.

## **RULE IV. Separation**

### **IV.A.**

The utility shall maintain 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.

**IV.B.**

The utility, its parent and other affiliated companies shall allocate common costs among them in such a manner that the ratepayers of the utility shall not subsidize any parent or other affiliate of the utility.

**IV.C.**

The utility shall list all shared directors and officers between the utility and its affiliates in its annual report to the Commission. Not later than 30 days following a change to this list, the utility shall notify the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates of the change(s).

**IV.D.**

Employees transferred or temporarily assigned from the utility to an affiliate shall not use non-public, proprietary utility information gained from the utility in a discriminatory or exclusive fashion to the benefit of the affiliate to the detriment of unaffiliated competitors.

**IV.E.**

All employee movement between a utility and its affiliates, as defined in Rule I.B, shall be consistent with the following provisions:

**IV.E.1.**

A utility shall track and report to the Commission all employee movement between the utility and affiliates, consistent with Rule VIII.F.

**IV.E.2.**

When an employee of a utility is transferred, assigned, or otherwise employed by the affiliate, the affiliate shall make a one-time payment to the utility in an amount equivalent to 15% of the employee's base annual compensation. All such fees paid to the utility shall be accounted for in a separate memorandum account to track them for future ratemaking treatment on an annual basis, or as otherwise necessary to ensure that the utility's ratepayers receive the fees. This transfer payment provision does not apply to clerical workers.

**IV.E.3**

Utility employees may be used on a temporary or intermittent basis (less than 30% of an employee's chargeable time in any calendar year) by affiliates only if:

- a. All such use is documented, priced and reported in accordance with these Rules and existing Commission reporting requirements, except that when the affiliate obtains the services of a non-executive employee, compensation to the utility shall be priced at a minimum of the greater of fully loaded cost plus 5% of direct labor cost, or fair market values. When the affiliate obtains the services of an executive employee, compensation to the utility shall be priced at a minimum of the greater of fully loaded cost plus 15% of direct labor cost, or fair market value;

- b. Utility needs for utility employees always take priority over any affiliate requests;
- c. No more than 10% of full time equivalent utility employees may be on loan at a given time;
- d. Utility employees agree, in writing, that they will abide by these Rules; and
- e. Affiliate use of utility employees shall be conducted pursuant to a written agreement approved by the appropriate utility and affiliate officers.

## **RULE V. Shared Corporate Support**

### **V.A.**

A utility, its parent company, or a separate affiliate created solely to perform corporate support services may share with its affiliates joint corporate oversight, governance, support systems, and personnel as further specified in these Rules. Any shared support shall be priced, reported and conducted in accordance with these Rules as well as other applicable Commission pricing and reporting requirements.

### **V.B.**

Corporate support shall not be shared in a manner that allows or provides a means for the transfer of confidential information from the utility to the affiliate, creates the opportunity for preferential treatment or unfair competitive advantage, leads to customer confusion, or creates significant opportunities for cross-subsidy of affiliates. The restriction on transfer of confidential information from the utility to the affiliate does not apply to corporate support, shared services and access to capital.

### **V.C.**

Examples of services that may be shared include: corporate governance and oversight, payroll, taxes, shareholder services, insurance, financial reporting, financial planning and analysis, corporate accounting, corporate security, human resources (compensation, benefits, employment policies), employee records, regulatory affairs, lobbying, legal, and pension management, engineering, water or sewage for resale, water storage capacity, and purchasing of water distribution systems.

### **V.D.**

Examples of services that may not be shared include: ~~engineering~~, hedging and financial derivatives and arbitrage services, ~~water or sewage for resale, water storage capacity, purchasing of water distribution systems,~~ and marketing.

## **RULE VI. Pricing of Goods and Services between the Utility and Its Affiliate(s)**

To the extent that these Rules do not prohibit the transfer of goods and services between a utility and its affiliates:

**VI.A.**

Transfers from the utility to its affiliates of goods and services offered by the utility on the open market will be priced at fair market value.

**VI.B.**

Transfers from an affiliate to the utility of goods and services offered by the affiliate on the open market shall be priced at no more than fair market value.

**VI.C.**

For goods or services for which the price is regulated by a state agency, that price shall be deemed to be the fair market value, except that in cases where more than one state commission regulates the price of goods or services, this Commission's pricing provisions govern.

**VI.D.**

Goods and services produced, purchased or developed to be offered on the open market by the utility shall be provided to the utility's affiliates and unaffiliated companies on a nondiscriminatory basis, except as otherwise required or permitted by these Rules or applicable law.

**VI.E.**

Transfers from the utility to its affiliates of goods and services not produced, purchased or developed to be offered on the open market by the utility shall be priced at fully allocated cost plus 5% of direct labor cost.

**VI.F.**

Transfers from an affiliate to the utility of goods and services not produced, purchased or developed to be offered on the open market by the affiliate shall be priced at the lower of fully loaded cost or fair market value.

**VI.G.**

The utility shall develop a verifiable and independent appraisal of fair market value for any goods or services that are transferred to any affiliated company at fair market value under these Rules. 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, the utility shall hire an independent consultant acceptable to the Commission staff to reappraise the fair market value for these transactions.

**RULE VII. Financial Health of the Utility**

**VII.A.**

The parent shall provide the utility with adequate capital to fulfill all of its service obligations prescribed by the Commission.

**VII.B.**

If the parent is publicly traded, the utility shall notify the Director of the Commission's Division of Water and Audits and the Director of the Division of Ratepayer Advocates in writing within 30 days of any downgrading to the bonds of the parent, another affiliate, and/or the utility, and shall include with such notice the complete report of the issuing bond rating agency.

**VII.C.**

The creation of a new affiliate by the parent or another affiliate shall not adversely impact the utility's operations and provision of service.

**VII.D.**

Debt of the utility's parent or other affiliates shall not be issued or guaranteed or secured by the utility.

**VII.E.**

Financial Separation. Within three months of the effective date of the decision adopting these Rules, each utility with a parent company shall file a Tier III advice letter proposing provisions that are sufficient to prevent the utility from being pulled into the bankruptcy of its parent company. The process specified by the Advice Letter Filing shall include a verification that the provisions have been implemented and signed by the utility's senior management (e.g., the Chief Executive Officer, Chief Financial Officer, and General Counsel).

**VII.F.**

Rules VI, VII, VIII(B) and VIII(C) adopted in Decision 97-12-011 (applicable to California Water Service Company), and Rules 12, 13, 15 and 16 adopted in Decision 98-06-068 (applicable to Golden State Water Company), continue in effect for those companies only.

**RULE VIII Regulatory Oversight**

**VIII.A.**

The officers and employees of the utility and its affiliated companies shall be available to appear and testify in any proceeding before the Commission involving the utility. If, in the proper exercise of the Commission staff's duties, the utility cannot supply appropriate personnel to address the 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 the Commission staff.

**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 the utility in rate proceedings or in connection with a

transaction or transactions between the utility and its affiliates. The utility shall continue to maintain its books and records in accordance with all Commission rules. The utility's books and records shall be maintained and housed available in California.

### **VIII.C.**

**Compliance Plans.** Each utility shall include a compliance plan as part of its annual report, starting in 2011 with the 2010 annual report and biennially thereafter. The compliance plan shall include:

1. A list of all affiliates of the utility, as defined in Rule II.D, and for each affiliate a description of its purposes or activities, and whether the utility claims that Rule I.B makes any portion of these Rules applicable to the affiliate;
2. A description of the procedures in place to assure compliance with these Rules; and
3. A description of both the specific mechanisms and the procedures that the utility and parent company have in place to assure that the utility is not utilizing the parent company or any of its affiliates not covered by these Rules as a conduit to circumvent any of these Rules in any respect. The description shall address, but shall not be limited to (a) the dissemination of information transferred by the utility to an affiliate covered by these Rules, (2) the provision of services to its affiliates covered by these Rules or (c) the transfer of employees to its affiliates covered by these Rules in contravention of these Rules. A corporate officer from the utility and parent company shall verify the adequacy of these specific mechanisms and procedures to ensure that the utility is not utilizing the parent company or any of its affiliates not covered by these Rules as a conduit to circumvent any of these Rules.

### **VIII.D.**

**New Affiliates.** Upon the creation of a new affiliate, the utility shall immediately notify the Commission of its creation, as well as posting notice of this event on its web site. No later than 60 days after the creation of this affiliate, the utility shall file a Tier 3 advice letter an information-only filing, as provided for in Rule 6.1 of General Order 96-B, with the Director of the Commission's Division of Water and Audits, with service on the Director of the Division of Ratepayer Advocates. The advice letter shall state the affiliate's purpose or activities and whether the utility claims these Rules are applicable to the new affiliate, and shall include a demonstration to the Commission that there are adequate procedures in place that will assure compliance with these Rules. The advice letter may include a request, including supporting explanation, that the affiliate transaction rules not be applied to the new affiliate. If the utility requests that the affiliate transactions rules not be applied to the new affiliate, in lieu of an information-only filing, the utility shall file a Tier 2 advice letter making such a request, including an explanation of why these Rules should not apply to the new affiliate.

**VIII.E.**

**Independent Audits.** Commencing in 2013, and biennially thereafter, the utility shall have an audit performed by independent auditors if the sum of all unregulated affiliates' revenue during the last two calendar years exceeds 5% of the total revenue of the utility and all of its affiliates during that period. The audits shall cover the last two calendar years which end on December 31, and shall verify that the utility is in compliance with these Rules. The utility shall submit the audit report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates no later than September 30 of the year in which the audit is performed. The Division of Water and Audits shall post the audit reports on the Commission's web site. The audits shall be at shareholder expense.

**VIII.F.**

**Annual Affiliate Transaction Reports.** Each year, by March 31, the utility shall submit a report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates that includes a summary of all transactions between the utility and its affiliated companies for the previous calendar year. The 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 (although supporting documentation for each individual transaction shall be made available to the Commission staff upon request). These transactions shall include the following:

1. Services provided by the utility to the affiliated companies;
2. Services provided by the affiliated companies to the utility;
3. Assets transferred from the utility to the affiliated companies;
4. Assets transferred from the affiliated companies to the utility;
5. Employees transferred from the utility to the-affiliated companies;
6. Employees transferred from the-affiliated companies to the utility;
7. The financing arrangements and transactions between the utility and the affiliated companies;
8. Services provided by and/or assets transferred from the parent holding company to affiliate company which may have germane utility regulations impacts; and
9. Services provided by and/or assets transferred from affiliated company to the parent holding company which may have germane utility regulation impacts.

## **RULE IX. 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 P. U. Code § 583 and the Commission's General Order 66-C, or their successors.

## **RULE X. Provision of Non-tariffed Products and Services (NTP&S)**

### **X.A.**

Except as provided for in these rules, new products and services shall be offered through affiliates.

### **X.B.**

A utility may only offer on the open market the following products and services:

1. Existing products and services offered by the utility pursuant to tariff;
2. New products and services that are offered on a tariffed basis; and
3. Products and services that are offered on a non-tariffed basis (NTP&S) and that meet the following conditions:
  - a) The NTP&S utilizes a portion of the excess or unused capacity of a utility asset or resource;
  - b) Such asset or resource has been acquired for the purpose of and is necessary and useful in providing tariffed utility services;
  - c) The involved portion of such asset or resource may only be used to offer the product or service on a non-tariffed basis without adversely affecting the cost, quality or reliability of tariffed utility products and services;
  - d) The products and services can be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk being incurred by utility ratepayers, and no undue diversion of utility management attention; and
  - e) The utility's offering of the NTP&S does not violate any California law, regulation, or Commission policy regarding anticompetitive practices.

### **X.C.**

**Revenues.** Gross revenue from NTP&S projects shall be shared between the utility's shareholders and its ratepayers. In each general rate case, NPT&S revenues shall be determined and shared as follows:

1. Active NTP&S projects: 90% shareholder and 10% ratepayer.
2. Passive NTP&S projects: 70% shareholder and 30% ratepayer.
3. A utility shall classify all NTP&S as active or passive according to the table below. For a new NTP&S not listed in the table, which requires approval by the Commission by advice letter pursuant to Rule X.G, an “active” project requires a shareholder investment of at least \$125,000. Otherwise the new NTP&S shall be classified as passive. No costs recoverable through rates shall be counted toward the \$125,000 threshold.
4. Revenues received that are specified in a contract as pass-through of costs, without any mark-up, shall be excluded when determining revenue sharing. If an advice letter is required pursuant to Rule X.G, 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.
5. For those utilities with annual Other Operating Revenue (OOR) of \$100,000 or more, revenue sharing shall occur only for revenues in excess of that amount. All NTP&S revenue below that level shall accrue to the benefit of ratepayers.
6. For those utilities with annual OOR below \$100,000, there shall be no sharing threshold, and ratepayers shall accrue all benefits for non-tariffed products and services.

#### **X.D.**

**Cost Allocation.** All costs, direct and indirect, including all taxes, incurred due to NTP&S projects shall not be recovered through tariffed rates. These costs shall be tracked in separate accounts and any costs to be allocated between tariffed utility services and NTP&S shall be documented and justified in each utility's rate case. More specifically, all incremental investments, costs, and taxes due to non-tariffed utility products and services shall be absorbed by the utility shareholders, i.e., not recovered through tariffed rates.

#### **X.E.**

**Annual Report of NTP&S Projects.** Each utility shall include information regarding its NTP&S projects in its Annual Reports, including but not be limited to the following:

1. A detailed description of each NTP&S activity;
2. Whether and why it is classified active or passive;
3. Gross revenue received;
4. Revenue allocated to ratepayers and to shareholders, as established in the company's current general rate case;
5. A complete identification of all regulated assets used in the transaction;

6. A complete list of all employees (by position) that participated in providing the non-tariffed service, with amount of time spent on provision of the service;
7. If the NTP&S has been classified as active through advice letter submission, provide the number of the advice letter and the authorizing Resolution; and
8. If the NTP&S did not require approval through advice letter, provide the date notice was given to the Commission.

**X.F.**

When a utility initiates the offering of NTP&S that are designated as active or passive in the table below, the utility shall provide notice of such activity by letter 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.

**X.G.**

**Provision of New NTP&S.** Any water or sewer utility that proposes to engage in the provision of new NTP&S not included in the table below, using the excess capacity of assets or resources 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 (see Resolution ALJ-202) with the Director of the Division of Water and Audits seeking Commission approval. The advice letter shall be served on the service list for Rulemaking 09-04-012 and the service list for the utility's current or most recent general rate case. The advice letter shall contain the following:

1. A full description of the proposed NTP&S, including, without limitation, the identity of parties served (if known), revenue and cost forecasts, and the term of any contract to be employed.
2. A description of the accounting method to be used to allocate the incremental costs between tariffed services and caused by the NTP&S.
3. Copies of all operative documents for the proposed service.
4. A 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.
5. Complete identification of all utility regulated assets and personnel resources that will be used in the proposed transaction. Identify the particular excess capacity (or capacities) asset or resource to be used to provide the NTP&S.
6. A complete list of all employees that will participate in providing the service, with an estimate of the amount of time each will spend.

7. A showing that the proposed NTP&S may be offered without adversely affecting the cost, quality, or reliability of the utility services.
8. A showing of how the NTP&S 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.
9. A showing of how the NTP&S does not violate any law, regulation, or Commission policy regarding anti-competitive practices.
10. A justification for classifying the NTP&S as active. The utility shall demonstrate that there is or will be incremental shareholder investment above \$125,000.
11. A statement that all risks incurred through this proposed NTP&S project shall be borne by the utility's shareholders.
12. A description of the market served by the proposed NTP&S project, a list or description of the current incumbents in that market, and an analysis of how the utility's entry into the market will affect the market's competitiveness. Include in this analysis a description of how the utility will guard against using anti-competitive pricing in this market.
13. Any other information, opinions, or documentation that might be relevant to the Commission's consideration of the NTP&S.

**DESIGNATION OF ACTIVE AND PASSIVE  
NTP&S WATER AND SEWER UTILITY PROJECTS**

<b>CATEGORY</b>	<b>ACTIVITY</b>	<b>ACTIVE/PASSIVE DESIGNATION</b>
Use of Facilities	<ul style="list-style-type: none"> <li>• Placement of third party communications equipment, attachments, conduit and cable</li> <li>• Parking</li> <li>• Vehicle storage</li> <li>• Office space</li> </ul>	Passive
Use of General Facilities	<ul style="list-style-type: none"> <li>• Parking</li> <li>• Vehicle storage</li> <li>• Meeting/training</li> <li>• Office Space</li> <li>• Placement of third party communications equipment, attachments, conduit and cable</li> </ul>	Passive
Use of Heavy Equipment and Machinery	<ul style="list-style-type: none"> <li>• Use of heavy equipment such as cranes, machinery, equipment</li> </ul>	Passive
Geographic Information Systems Services	<ul style="list-style-type: none"> <li>• Mapping services</li> <li>• Map creation</li> <li>• Specialized geographic data base analysis and development</li> <li>• User training</li> </ul>	Passive
Miscellaneous Services	<ul style="list-style-type: none"> <li>• Training, technical certification, conferences and seminars</li> </ul>	Passive
License of utility Software	<ul style="list-style-type: none"> <li>• Utility developed software</li> <li>• Software licensed to the utility</li> </ul>	Active
Customer Account Management Services	<ul style="list-style-type: none"> <li>• Bill calculation, processing and presentation</li> <li>• Meter reading</li> <li>• Payment processing</li> <li>• Credit and collections</li> <li>• Phone center services (responding to customer billing questions, service establishment requests)</li> <li>• Other field services</li> </ul>	Active
Operation and Maintenance Contracts	<ul style="list-style-type: none"> <li>• Operation and Maintenance of Third Party Utility Systems</li> <li>• Leases of Third party utility systems</li> <li>• Design/Build contracts</li> </ul>	Active
Meter Services	<ul style="list-style-type: none"> <li>• Replacement of Water Meters for Third Party Utility systems</li> </ul>	Active
Customer Ancillary Services	<ul style="list-style-type: none"> <li>• Customer Facility Related Services, Including Maintenance Contracts</li> </ul>	Active

**(END OF APPENDIX)**