BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking Concerning Relationship Between California Energy Utilities And Their Holding Companies And Non-Regulated Affiliates.	R. _____

ORDER INSTITUTING RULEMAKING CONCERNING RELATIONSHIP BETWEEN CALIFORNIA ENERGY UTILITIES AND THEIR HOLDING COMPANIES AND NON-REGULATED AFFILIATES

I. SUMMARY

This Order Instituting Rulemaking (OIR) is issued to allow the Commission to re-examine the relationship of the major energy utilities with their parent holding companies and affiliates. The current parent holding companies were formed more than 10 years ago, and these companies have made significant investments in distribution and transmission lines, natural gas pipelines and terminals, powerplants, trading companies, marketing companies and other energy service companies ("energy infrastructure") both overseas and within the United States. The Commission through this OIR will review current investments of the parent holding companies that is part of the overall energy infrastructure that California consumers depend upon. The Commission also will review the capital budgets of the utilities and their parent holding companies to better understand the amount of capital that is expected to be allocated to either the utilities or an affiliate for investment in energy infrastructure that will meet any part of California's need for reliable supplies of energy.

This OIR also is issued in response to the recent enactment by Congress of the Energy Policy Act of 2005 (EPAct 2005), Public Law 109-58, which, among other things, repealed the Public Utility Holding Company Act of 1935 (PUHCA), 15 U.S.C. §§ 79 – 79z-6, and ordered the Federal Energy Regulatory Commission to review its rules regarding dispositions, consolidations, or acquisitions made by FERC-jurisdictional

entities pursuant to the Federal Power Act. As a result, the parent holding companies of the California energy utilities may try to expand the unregulated activities of the utilities' affiliates, may try to merge with or acquire other companies or may be acquired by other companies. It is therefore necessary for this Commission to review its existing regulations and to consider whether additional, new rules or regulations are needed.

The Commission's goals remain the same: (1) to ensure that the utilities meet their public service obligations at the lowest reasonable cost and (2) to ensure that the utilities do not favor or otherwise engage in preferential treatment of their affiliates.

The Commission also needs to ensure that the California energy utilities retain sufficient capital and the ability to access such capital in order to meet their customers' needs. Additional rules or regulations may be necessary to address the potential conflicts between the utilities' ratepayers' interests and the parent holding companies' and affiliates' interests in order to ensure that these conflicts do not undermine the utilities' ability to meet their public service obligations at the lowest possible cost.

As an initial step, we require California's four largest energy utilities, Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (Edison) (collectively the "Utility Respondents") and their parent holding companies Sempra Energy, PG&E Corporation and Edison International (collectively the "Parent Holding Companies") to provide the Commission with current information concerning their capital budgets for the next 5 years, i.e. 2006-2010. We also require the Parent Holding Companies to provide financial statements for any current investments in energy infrastructure serving California as well as estimates of the participation, if any, of their affiliates in the development, financing, construction, operation, management or ownership of energy infrastructure that will meet any part of California's expected need for reliable supplies of energy.

After reviewing this information the Commission may propose additional rules or regulations regarding, but not necessarily limited to, (1) reporting requirements for the allocation of capital between utilities and their non-regulated affiliates by the parent holding companies, (2) changes to the Commission's Affiliate Transaction Rules. The Commission also may clarify requirements as to the Commission's access to documents of the parent holding company or affiliates.

Each of the above-mentioned California utilities are respondents in this proceeding and are required to submit a report on 2006-2010 capital budgets for the utilities. The Parent Holding Companies also are respondents and are required to submit capital budgets for affiliates participating in the development, financing, construction, management or ownership of energy infrastructure that will meet any part of California's need for reliable sources of energy as well as financial statements for any affiliate that has a financial interest in energy infrastructure serving California.

II. BACKGROUND

Public utilities owning electric transmission and distribution lines and/or owning natural gas pipelines and distribution facilities are natural monopolies. They have the ability to exploit consumers in the early 1900s, in some instances did so which is precisely why state commissions across the nation have been regulating them ever since. *See General Motors Corp. v. Tracy* (1997) 519 U. S. 278, 288-92 & nn. 5-7. Although changes in regulatory laws have led to increased entry into the wholesale natural gas and electric power markets, utilities owning or controlling transmission or distribution facilities still enjoy a natural monopoly, which they can exploit to favor their own sales or sales from their unregulated affiliates and exclude or burden their competitors. *See, e.g., Cal. Independent System Operator Corp. v. FERC* (2004) 372 F.3d 395, 396.

With their control of public utilities, parent holding companies can require unreasonable fees from their utility subsidiaries, preferential treatment for their affiliates, or otherwise affect adversely the accounting practices and the rate and dividend policies of the utility subsidiaries. These were among the reasons why Congress enacted PUHCA

in 1935, as well as why this Commission promulgated its Affiliate Transaction Rules. *See North American Co. v. SEC* (1946) 327 U. S. 686, 701-02; *see also Southern Union v. Missouri PSC* (8th Cir. 2002) 289 F.3d 503, 507-08.

The Commission has issued decisions approving the formation of holding companies for each of the largest California energy utilities: PG&E Corporation[1], Edison International,[2] Enova Corporation[3], and Sempra Energy (merger of parent companies of SDG&E and SoCalGas).[4] When the Commission approved the Utility Respondents' applications to form holding companies or for the merger of their parent companies into a new holding company, the Commission's concerns about potential abuses in the relationship between the holding company and the utility subsidiaries led to the imposition of certain conditions, including the condition that the capital requirements of the utility must be given the first priority by the holding company and the utility. (First Priority Condition). *See PG&E Corp. v. PUC* (2004) 118 Cal.App. 4th 1174, 1183-84, 1201. Although the Parent Holding Companies all challenged the Commission's jurisdiction to enforce these conditions, the Commission's jurisdiction was upheld. *See id.* at 1201, 1223.

With the repeal of PUHCA and any resulting increase of activities by affiliates or parent holding companies of the California public utilities, the Commission's responsibility to protect the ratepayers remains paramount. For example, without the constraints under PUHCA, the holding companies may be exploring other business opportunities or possible mergers with or the acquisition of other companies. To do

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[1] *See* D.96-11-017, 69 CPUC2d 167 (Nov. 6, 1996) (PG&E I); D.99-04-068, 194 P.U.R.4th 1 (April 22, 1999) (PG&E II).

[2] *See* D.88-01-063, 27 CPUC2d 347 (Jan. 28, 1988) (Edison/EIX).

[3] *See* D.95-05-021, 59 CPUC2d 697 (May 10, 1995) (SDG&E I); D.95-12-018, 62 CPUC2d 626 (Dec. 6, 1995) (SDG&E II); and

[4] *See* D.98-03-073, 79 CPUC2d 343 (March 26, 1998) (Sempra Merger).

so, they may rely upon the capital they receive from the California public utilities without fully taking into account the present or future capital needs of the utilities. This could substantially undermine the present attempts by the Commission to ensure resource adequacy.

The Commission has the power and the obligation under Article XII, section 6 of the California Constitution and sections 451, 701, and 761 of the California Public Utilities Code to actively supervise and regulate natural gas and electric public utilities in California and to do all things which are necessary to ensure adequate and reliable public utility service to California. ratepayers at just and reasonable rates. *See Camp Meeker Water System, Inc. v. Pub. Util. Comm'n* (1990) 51 Cal. 3d 850, 861-862; *Sale v. Railroad Comm'n* (1940) 15 Cal.2d 607, 617. Pursuant to this authority, as well as the First Priority Condition in the holding company and merger decisions[5], the Commission will review the 2006-2010 capital budget plans of Utility Respondents and the Parent Holding Companies to see how these plans may meet California's energy needs.

After completing this review, additional rules and regulations may be proposed to address the potential conflict of interests between the utilities' public service obligations to their customers and their obligations to their common shareholders of their parent holding company and affiliates.

III. UTILITY AND PARENT HOLDING COMPANY REPORTS

Each of the Utility Respondents and the Parent Holding Companies shall file reports with the following information:

1) Estimates of capital to be invested each year from 2006-2010 by the utility;
2) Estimates of capital to be invested by the parent holding company through an affiliate for each year from 2006-2010;

[5] *See* PG&E I, Ordering paragraph 17, 69 CPUC2d at 201; Edison/EIX, Ordering paragraph 12, 27 CPUC2d at 376; SDG&E II, Ordering paragraph 6, 62 CPUC2d at 651; *see also* Sempra Merger, Ordering paragraph 2c & Attachment B(IV)(A)(5), 79 CPUC2d at 431, 447.

3) Financial statements for each affiliate that is developing, financing, constructing, operating, managing or owning energy infrastructure which meets part of California's energy needs;
4) Dividend policies and policies regarding retention of capital;
5) Names of the utility and parent holding company officers responsible for deciding corporate policy regarding capital budgets, dividends and capital retention;
6) A description of the process by which corporate policy is implemented and how capital is allocated among or between a utility and its affiliates by the parent holding company.

IV. PRELIMINARY SCOPING MEMO

Rule 6(c)(2) of our Rules of Practice and Procedure[6] provides that an OIR "shall preliminarily determine the category and need for hearing, and shall attach a preliminary scoping memo." This OIR is preliminarily determined to be quasi-legislative, as that term is defined in Rule 5(d). It is contemplated that this proceeding will be conducted through a written record, with no evidentiary hearing for this phase, and that an order will issue based on the comments timely filed in this docket.

The scope of this OIR is to adopt rules which will supplement, but not supplant, the existing rules and other requirements or conditions involving the above-mentioned utilities and their holding companies or affiliates. Any proposed rules should help ensure that the utilities will have sufficient capital budgets to meet their customers' needs and to mitigate potential conflicts of interest in the holding company structure that could undermine their fulfillment of their public service obligations to provide the lowest cost service to their customers. In addition, any proposed rules should preclude the utilities from anti-competitive conduct in favor of their holding companies or affiliates to the detriment of the competitors of their holding companies or affiliates.

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[6] Title 20 California Code of Regulations.

In accordance with Rule 6.3 and 6(c)(2) we provide a preliminary schedule.

V. PRELIMINARY SCHEDULE

We adopt the following preliminary schedule, which may be changed, if necessary, by an Assigned Commissioner Ruling or an ALJ Ruling:.

OIR issued	October 27, 2005
Reports filed	November 30, 2005
Proposed Rules Issued	January , 2006
Comments on Proposed Rules filed	February , 2006
Decision issued	March , 2006

VI. EX PARTE COMMUNICATIONS

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

VII. SERVICE LIST

We direct the Commission's Executive Director to serve this OIR on respondents and on the service list from I. 01-04-002. To obtain service in future, those persons or entities, other than respondents, who wish to participate in or monitor this proceeding must follow the steps set forth in Ordering Paragraph 4.

Any party interested in participating in this OIR who is unfamiliar with the Commission's procedures should contact the Public Advisor's Office in Los Angeles (213) 649-4782, public.advisor.la@cpuc.ca.gov, or in San Francisco (415) 703-2074, public.advisor@cpuc.ca.gov.

VIII. SERVICE BY ELECTRONIC MAIL

Pursuant to Rule 2.3(a) and Rule 2.3.1 of the Commission's Rules of Practice and Procedure, service of all documents is to be made by electronic means and will be used in lieu of paper mail where an electronic address has been provided. The assigned Administrative Law Judge and Commissioner are to be served electronically at xjv@cpuc.ca.gov and ___@cpuc.ca.gov. Any party on the service list who has not provided an electronic mail address shall serve and take service by way of paper mail. Service by mail is described in Rule 2.3(a).

Therefore, **IT IS ORDERED** that:

1. A rulemaking is initiated on the Commission's own motion to consider whether new, additional rules and regulations should be adopted to ensure that the California energy utilities retain sufficient capital and the ability to access such capital in order to meet their customers' needs, and to address the potential conflicts between the utilities' ratepayers' interests and the parent holding companies' and affiliates' interests in order to ensure that these conflicts do not undermine the utilities' ability to meet their public service obligations at the lowest possible cost.

2. California's largest natural gas and electric utilities, Southern California Gas Company, San Diego Gas & Electric Company, Pacific Gas and Electric Company, and Southern California Edison Company and each of their parent holding companies, Sempra Energy, PG&E Corporation and Edison International are made respondents to this proceeding.

3. The Executive Director shall cause this Order Instituting Rulemaking (OIR) to be served on respondents and on the service list for Investigation (I.) 01-04-002.

4. An initial service list for this proceeding shall be created by the Process Office and posted on the Commission's website (www.cpuc.ca.gov) as soon as it is practicable. We direct the Process Office to add all respondents to the service list as appearances. Other persons or entities who wish to be placed on the new service list shall follow the directions below.

(a) Appearance category. Those, other than respondents, who wish to participate in this proceeding as a party must contact the assigned administrative law judge in writing, by email (xjv@cpuc.ca.gov) or at CPUC, 505 Van Ness Ave., San Francisco, CA 94102 and describe their interest in the proceeding, indicate how the person or entity intends to participate, and list all relevant contact information (name; person or entity represented; mailing address; telephone number; email address).

(b) Information only category or state service category. Those who intend only to monitor this proceeding, must contact the Commission's Process Office in writing, by email at (Process_Office@cpuc.ca.gov) or at CPUC, Process Office, 505 Van Ness Ave., San Francisco, CA, 94102), specify the service category desired and list the same contact information detailed in Ordering Paragraph 4(a).

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

6. Respondents shall file reports including 2006-2010 projected capital budgets by November 30, 2005 with the Chief Administrative Law Judge (three copies), the General Counsel (two copies), the Director of the Energy Division and the Director of the Office of Ratepayer Advocates. Respondents may request that these reports shall be considered confidential information submitted under Public Utilities Code Section 583.

7. This filing deadline and the schedule under section V are preliminarily approved and adopted, but may be changed, if necessary, by an Assigned Commissioner Ruling or an ALJ Ruling.

This order is effective today.

Dated _____ 2005, at San Francisco, California.