Decision **PROPOSED DECISION OF COMMISSIONER BROWN**
(Mailed 10/10/2006)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

OPINION ADOPTING REVISIONS TO (1) THE AFFILIATE TRANSACTION RULES AND (2) GENERAL ORDER 77-L, AS APPLICABLE TO CALIFORNIA'S MAJOR ENERGY UTILITIES AND THEIR HOLDING COMPANIES

1. Summary

Today's order amends the Commission's Affiliate Transaction Rules by adopting the Affiliate Transaction Rules Applicable to Large California Energy Utilities and amends General Order (GO) 77-L (which governs the reporting of compensation paid to executive officers and employees of regulated utilities), by adopting GO 77-M. The adopted amendments apply solely to Respondents, California's major energy utilities and their holding companies: Southern California Edison Company (Edison)/Edison International, Pacific Gas and Electric Company (PG&E)/PG&E Corporation, and Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E), both owned by Sempra Energy.

These amendments retain many of the proposals put forward by Commission staff but the Proposed Decision has been revised further under the

direction of the assigned Commissioner. These revisions to the Affiliate Transaction Rules have been designed to close existing loopholes in three main ways: (1) ensuring that key utility and holding company officers understand the Rules and their obligations under them; (2) providing greater security against the sharing within the corporate family, through improper conduits, of competitively-significant, confidential information; and (3) ensuring a utility's financial integrity is protected from the riskier market ventures of its unregulated affiliates and holding company parent. GO 77-M includes new provisions developed to yield a more complete and accurate picture of Respondents' compensation practices while protecting reasonable privacy interests.

The amendments to both Rules have required us to strike difficult balances between the public interest and the private interests of unregulated utility affiliates and the individuals employed within the holding company structure. Though we recognize these private interests, we have not lost sight of the reason these electric and natural gas utilities exist: to provide energy services in a safe, reliable and environmentally sustainable manner at the lowest reasonable cost.

2. Background and Procedural History

Decision (D.) 06-06-062, which amended this Order Instituting Rulemaking (OIR or Rulemaking), discusses problems with the Commission's Affiliate Transaction Rules and with GO 77-L, as well as potential solutions. Following written comment and reply comment,[1] Commission staff released draft rule

[1] At Respondents' request, the Administrative Law Judge (ALJ) extended the date for filing Comments from July 27 to August 8; she authorized the filing of Reply Comments on August 18. The following parties filed Comments: Consumer Federation of

Footnote continued on next page

revisions on September 12, 2006[2] for further discussion at a public workshop held September 21, 2006. We have received additional written comment in the form of Pre-workshop and Post-workshop Statements.[3]

The Proposed Decision mailed on October 10, 2006. At the request of the assigned Commissioner, Oral Argument was held on October 18. Comments on the Proposed Decision were due on October 30, 2006 and Reply Comments were due on November 6.[4] By ruling on November 11, 2006, parties were asked to provide additional written comment by November 17, 2006.[5]

California (CFC), Division of Ratepayer Advocates (DRA), Respondents (jointly), Richard Robinson & Associates, Inc. (Robinson Associates), and the Greenlining Institute (Greenlining). The following parties filed Reply Comments: CFC, DRA, Greenlining, and Respondents (jointly). Greenlining requested and received leave from the ALJ to file a further Reply on August 23, 2006. Independent Energy Producers Association's (IEP) Comments were attached to its September 29, 2006 motion requesting party status. Because IEP was granted party status earlier in this Rulemaking, its motion is moot.

[2] See *Administrative Law Judge's Ruling Proposing Draft Rules for Workshop Discussion*, September 12, 2006 (September 12 ALJ Ruling).

[3] The following parties filed Pre-workshop Statements: CFC and Respondents (jointly). The following parties filed Post-workshop Statements: CFC, DRA, Greenlining, IEP, Respondents (jointly), Robinson Associates, and The Utility Reform Network (TURN).

[4] The following parties filed timely Comments: CFC, DRA, Greenlining, Respondents (jointly), and The Utility Reform Network (TURN). CFC, DRA, and Respondents (jointly) also filed timely Reply Comments.

[5] See *Joint Ruling of Assigned Commissioner and Administrative Law Judge Inviting Comment on Further Proposal for Revisions to the Rules IV, V and VI of the Affiliate Transaction Rules Applicable to Large California Energy Utilities and Correcting Omission in Draft Revisions to GO 77 Attached to the Proposed Decision*, November 7, 2006 (November 7 AC/ALJ Ruling). DRA and Respondents (jointly) filed timely Comments.

3. Revised Affiliate Transaction Rules

3.1. Overview – Major Amendments

Appendices A-1 and A-2 to this decision show, in redlined format, the complete text of the Affiliate Transaction Rules Applicable to Large California Energy Utilities (Revised Affiliate Transaction Rules or Revised Rules) which we adopt today. Appendix A-3 is a "clean" version of the Revised Rules. These appendices replace the Proposed Decision's Appendix A. The Revised Rules, applicable only to Respondents, are based on the Affiliate Transaction Rules (Original Rules) adopted nearly ten years ago by D.97-12-088, as subsequently amended.[6] The Original Rules will continue to apply to all California energy utilities, other than Respondents, except those which have been expressly exempted by prior Commission decisions. To avoid confusion about applicability in the future, we will soon open a rulemaking for the sole purpose of amending the Original Rules to exempt the large energy utilities from them and to include a cross-reference to the Revised Rules.

The Revised Rules are not identical to either the staff proposals released with the September 12 ALJ Ruling, the Proposed Decision's Appendix A, or the proposals released with the November 7 AC/ALJ Ruling. We have refined these working drafts (to clarify, remove ambiguity, or reduce burden, etc.) and we have discarded several proposals altogether. The Comments on the Amended OIR, the workshop discussion, the written workshop statements and the Comments on the Proposed Decision and November 7 AC/ALJ Ruling have all

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

been helpful. Where Respondents have suggested changes to reporting or compliance deadlines so as to allow more lead time for compliance, improve efficiency, or minimize duplication of effort, we have incorporated all reasonable suggestions.

The amendments include the following changes, as well as other, minor revisions intended, for example, to improve internal consistency or delete outdated provisions concerning initial compliance with the Original Rules:[7]

- Add Table of Contents
- I Definitions
  - Clarify ban on circumvention of Revised Rules by prohibiting use of a utility consultant or contractor as a conduit.
- II Applicability
  - Clarify applicability of the Revised Rules to utility's holding company.
  - Expressly provide that utility holding company shall not be used to circumvent the Revised Rules.
  - Expressly exempt transactions involving broadband over power lines from the Revised Rules (recognizing D.06-04-070).
  - Delete outdated provisions concerning initial compliance with the Original Rules.
- III Nondiscrimination
  - Clarify scope of permitted utility-affiliate transactions.
  - Prohibit utility resource procurement from affiliates without prior Commission approval.
- IV Disclosure and Information

[7] Parties' Comments have not objected to these minor changes.

- Delete provision requiring utility to compile, update and provide to customers a list of service providers that compete with its affiliate in offering gas- or electric-related goods or services, since there has been no customer demand for such lists.

- V Separation
  - Expressly provide that utility, its affiliates, and its holding company shall be separate corporate entities and keep separate books and records.
  - Reiterate that Commission may review books and records of utility holding company.
  - Provide utility and its holding company with an election: (1) retain authorization to engage in sharing of all services permitted under Original Rules but eliminate any duplication of personnel among key corporate officers at utility and holding company, or (2) retain ability to name individuals to multiple key offices at utility and holding company but prohibit sharing of regulatory affairs, lobbying, and all legal services except those necessary to the provision of shared services that remain authorized. Key corporate officers consist of the Chair of the entire corporate enterprise, the President at the utility and at the holding company, the chief executive officer at each, the chief financial officer at each, the chief regulatory officer at each – or the functional equivalent, where other titles are used.
  - Delete outdated provisions concerning initial compliance with the Original Rules.
- VI Regulatory Oversight
  - Require utility compliance plans by June 30, 2007.
  - Require utility to file advice letter with Commission upon formation of a new affiliate.
  - Require Commission staff, rather than utility, to direct compliance audits and perform audits on a biennial, rather than annual, basis.
  - Reiterate witness availability must be provided pursuant to existing law.

  - Require key corporate officers (as defined above) at utility and its holding company to annually certify to personal compliance with the Revised Rules.
- Add VIII Complaint Procedures and Remedies (adopted by D.98-12-075).
- Add new IX Protecting the Utility's Financial Health
  - Require annual utility reports on capital budgets and policies (i.e., annual updates on the six categories of information requested by the OIR).
  - Reiterate that utility shall retain the capital structure authorized by the Commission and request a waiver whenever equity falls by 1% or more.
  - Require utility to provide a non-consolidation opinion that demonstrates that the "ring-fencing" around the utility is sufficient to prevent it from being pulled into the bankruptcy of its holding company; require utility to notify Commission if ring-fencing measures are changed.

Respondents' initial Comments and Workshop Statements oppose much of the content of the earlier versions of the Revised Rules. DRA and CFC support most of the earlier versions and in some instances urge us to go further, if the Commission is to exercise adequate utility oversight short of holding company divestiture. Though IEP and TURN each focus on single (and different) issues, they both strongly recommend action -- IEP, to prevent utility favoritism toward generation affiliates and TURN, to insulate utilities from any financial problems at the holding company level.

Respondents' recent Comments on the November 7, 2006 AC/ALJ Ruling are comparatively muted. Respondents acknowledge the efforts the November 7 Ruling has made to address their concerns about the Proposed Decision's perceived compliance burden and impact upon corporate governance. Respondents indicate that they support the changes the Ruling proposes to Rule

VI (officer certification) and "are reluctantly willing to accept" the proposals to revise Rule V E to provide an election (shared services versus officer duplication). (Respondents' November 17, 2006 Comments, pp. 5, 8.)

Several rule revisions have been uncontroversial. These include two revisions to Rule VI, Regulatory Oversight. Respondents appear to recognize that the Commission, rather than a utility, should determine whether a new utility affiliate is covered by the Revised Affiliate Transaction Rules (Rule VI A and B) and that it is reasonable for the Commission to take a lead role in selecting the auditor hired to perform the required utility audits (Rule VI C). Neither have Respondents contested the revisions to Rule IV, Disclosure and Information, which remove the requirement to compile, for dissemination to customers, lists of the service providers that compete with utility affiliates in offering gas- or electric-related goods or services. Commission staff have been advised that because customers have not asked for the lists, the ongoing effort to update the lists is unnecessarily time consuming.

Below, we discuss the major issues that Respondents and the other parties raise.

3.2. Discussion

The impetus for our examination of the Affiliate Transaction Rules now is the recent repeal of the Public Utilities Holding Company Act (PUHCA)[8] coupled with potentially serious flaws in Respondents' interpretation of and compliance with the Original Rules.

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[8] The Energy Policy Act of 2005 (EPAct 2005), Public Law 109-58, among other things repealed the Public Utility Holding Company Act of 1935, 12 USC §§ 79 – 79z-6.

Respondents contend that the repeal of PUHCA does not necessitate further review of the Original Rules, because each of the holding companies was exempt from PUHCA. However, Respondents miss the point. Until PUHCA was repealed, a state commission could always petition the Securities and Exchange Commission (SEC) to remove the exemption if the holding company structure thwarted effective state regulation of a utility. For example, in 1973, the SEC considered but rejected its staff's recommendation to remove the exemption for Pacific Lighting Corporation (PLC), the parent holding company of Southern California Gas Company at that time. The SEC found, among other things, that notwithstanding PLC's expanding diversification, the California Commission could still effectively regulate the utility and protect its ratepayers.[9] Because one of the main purposes of PUHCA was to facilitate effective state regulation of the utilities, the SEC gave considerable weight to state commissions' views concerning an exemption.[10] Therefore, if a holding company's acquisitions or operations ever threatened effective state regulation of the utility, the state commission had the remedy of petitioning the SEC to remove the holding company's exemption. With the repeal of PUHCA, that remedy no longer exists.[11]

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[9] See *In the Matter of Pacific Lighting Corporation* (1973) 173 SEC LEXIS 2231.

[10] See *Sempra Energy* (1998) 1998 SEC LEXIS 1310 at *84; see also *KU Energy Corporation* (1991) 1991 SEC LEXIS 2568 at *20-21.

[11] CFC's Comments and Workshop Statements contain an extensive review of the serious abuses that led to enactment of PUHCA. CFC reminds us that similar problems could arise in the future. We share CFC's concern.

D.06-06-062, which amended this Rulemaking, discusses a number of interpretation and compliance problems (selective applicability to utility holding companies and unregulated affiliates, overly narrow interpretations of the scope of covered transactions, overbroad interpretations of express exceptions, conflicts of interest, etc.). These problems give rise to two main concerns. One is the likelihood for preferential treatment, unfair competitive advantage, or the sharing of competitively sensitive confidential information within the partly regulated, mostly unregulated corporate family and the consequences such competitive abuse poses for energy markets and captive ratepayers. The second concern is the potential threat to a utility's financial health and ability to meet its public service obligations unless it is adequately insulated from the financial risks and debts of its unregulated parent and affiliates. D.06-06-062 observes that given the "substantial profits or risks at stake, there are strong incentives within the holding company structure to take advantage of confidential utility information or use ratepayer-subsidized utility facilities, whether to help affiliates maximize their profits or bail them out from risks." (D.06-06-062, p.11, slip op.)

The Revised Affiliate Transaction Rules have been designed to close existing loopholes, primarily by ensuring that key utility and holding company officers understand the Rules and their obligations under them, by providing greater security against the sharing within the corporate family, through improper conduits, of competitively-significant, confidential information, and by ensuring a utility's financial integrity is protected from the riskier market ventures of its unregulated affiliates and holding company parent.

In their Comments and Workshop Statements, Respondents argue that our concerns are largely speculative, that the electric energy crisis is now behind us,

and that recent audits of utility compliance with the Affiliate Transaction Rules have reported few, relatively minor violations. Respondents challenge what they characterize as the failure of Commission staff to lay out adequate evidentiary support for the need for revisions to the Original Rules. The September 12 ALJ Ruling notes this controversy and the reliance of Commission staff on D.06-06-062, which states: "We are not interested in conducting additional discovery in this rulemaking or litigating, here, what happened in the past." (D.06-06-062, *mimeo*, p. 10.)

However, because Respondents have pointed to past audits as proof that no problems exist with their Affiliate Transaction Rules compliance, we feel compelled to take official notice of the auditors' findings and recommendations. All of the compliance audits are public documents. Where the Commission has not reviewed an audit in a formal proceeding and made its own findings, we take official notice merely to highlight the disparity between Respondents' characterizations and the findings in the audits themselves, but make no assessment of the merits.

The most recent and most serious problems appear in several audits for the Sempra companies.[12] We also are well aware that in other Commission

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[12] We refer here to three audits. An Affiliate Transaction Rules compliance audit of SDG&E and SoCalGas in 2004 by auditors hired and managed by Sempra Energy identified violations or partial compliance with eight Rules, including Rule V E, Corporate Support. The auditors reported:

> SDG&E's joint utilization of Energy Risk Management as a corporate shared service has resulted in the means and transfer of confidential information from the utility to the affiliate, created the potential for unfair competitive advantage, and provided a conduit for the transfer of confidential utility information to a covered affiliate. Furthermore,

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> Energy Risk Management had conducted hedging related activities specifically forbidden by Rule V.E. NorthStar further concludes that Sempra Energy has not complied with CPUC Decision 02-09-048 related to the receipt and use of time-sensitive non-public information from SoCalGas Acquisition and SDG&E Fuel and Power Supply. (*2004 Affiliate Transactions Audit of Southern California Gas Company, May 1, 2005,* and *2004 Affiliate Transactions Audit of San Diego Gas & Electric Company, May 1, 2005,* by NorthStar Consulting Group, p. 62.)

The auditors recommended that: "Energy Risk Management should not be performed as a shared corporate service." (Recommendation #9); "SoCalGas should stop the transmittal of market related information to Sempra Energy Risk Management." (Recommendation #10.) The SDG&E audit contained a similar recommendation.

An audit four years earlier had identified the same problem. (See *Management Audit and Market Power Mitigation Analysis of the Merged Gas System Operation for Pacific Enterprises and Enova Corporation*, Vol. 1-3, July 2000, by Larkin & Associates, pp. 1-10.) The audit was ordered by D.98-03-073, which approved the merger of SoCalGas and SDG&E. In D.02-09-048, which issued after review of the audit, the Commission determined that the auditors had identified a serious problem (the transfer of confidential information to the unregulated affiliate, Sempra Energy Trading, through the shared risk management services allowed under Rule V E). The Commission attempted to impose a remedy (a delay in the transmittal of confidential information from the utility to the holding company), but the 2004 audit found this requirement often was ignored. (See 2004 Affiliate Transactions Audit…, p. 59.)

In Investigation (I.) 03-02-033, the Commission required a staff-managed audit of the Sempra companies to identify any Affiliate Transaction Rules violations since 1997. Auditors found that the shared risk management function "acted as a conduit for proprietary information between the utility and its affiliates in violation of Rule V E." (*Confidential Report to the CPUC for the Affiliate Transactions Compliance Audits of Sempra Energy's Southern California Gas Company/San Diego Gas and Electric Company*, by GDS and Associates, pp. 5 and 51.) The auditors concluded that the parent was a covered affiliate under the applicability provisions of Rule II B since it provides financial credit derivative services to its unregulated trading affiliate. The auditors recommended that the Commission prohibit risk management as a shared service and that Sempra Energy agree to comply with the affiliate rules as a covered affiliate (*Id*., p. 5). While the report is marked "confidential" it is not. The report was filed in I.03-02-033 by the Commission's Energy Division and served on the service list on February 28, 2006.

proceedings (I.02-11-040 and I.03-02-033), Edison has contended that certain conduct by Sempra Energy and its affiliates, including SDG&E and SoCalGas, violated the Original Rules. Recently, these parties have reached an agreement to settle their differences, and in Application 06-08-026 and in motions to withdraw claims in both investigations, they have requested that the Commission close those proceedings without adjudicating Edison's claims or the claims of the auditors. Having sought dismissal on that basis, Respondents may not refer to the past audits as evidence that their past practices have not resulted in violations of the Original Rules. Respondents cannot have it both ways. [13]

Respondents also challenge the evidentiary basis for any amendments to the Affiliate Transaction Rules. Because this Rulemaking is quasi-legislative in character, a hearing of a judicial type is not necessary. We are not required to rely upon evidence produced in this proceeding, but may draw upon evidence from past proceedings, our knowledge and experience, comments in this proceeding and our current policies.[14] Indeed, when we adopted the Original Rules in 1997, we did not conduct evidentiary hearings. Pursuant to Section 1708.5(f) of the Public Utilities Code, we may revise the Affiliate

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[13] D.06-06-062 discusses the different business approaches vis a vis the California market the three holding companies have taken in the last decade or so. Sempra has most actively engaged in business operations in California and the market affecting this state. PG&E Corporation emerged from the bankruptcy brought about by the energy crisis without any significant affiliates. Until recently, largely because of affiliate abuse problems related to its Mission Energy affiliate in the time period from 1984 to 1992, Edison International has restricted most of its affiliate operations to other geographic markets. (See D.93-03-021, 48 CPUC 2d 352.)

[14] See *City of Santa Cruz v. Local Agency Formation Commission of Santa Cruz County* (1978) 76 Cal. App. 3d 381, 388.

Transaction Rules in this proceeding through notice and comment rulemaking procedures without conducting an evidentiary hearing.[15] There is no dispute of fact concerning the inherent conflict of interest within the holding company structure. There is also no reason why, on a policy basis, we cannot revise the Original Rules to close certain loopholes in order to more effectively address this conflict of interest.

Additionally, the matters at issue in this Rulemaking are not, as Respondents appear to imply, unknown to the attorneys, lobbyists and other representatives of utilities, independent energy producers, and others who appear before the Commission. This has been a matter of substantial public and expert concern since the California energy crisis of 2000-2001. In the intervening five years, there has been no dearth of official reports and recommendations, to say nothing of accounts in the public press. As an example, the California Attorney General issued an "Energy White Paper"[16] that discussed the need for a myriad of regulatory reforms. More significantly, this Commission bears an independent obligation to look at anti-trust matters in its endeavors. In *Northern California Power Association v. Public Utilities Commission* the California Supreme Court rebuked the Commission for its failure to take into account sua sponte the anti-trust aspects of an application:

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[15] See *Southern Cal. Edison Co. v. Public Utilities Com*. (2002) 101 Cal.App.4th 982, 994.

[16] Attorney General's Energy White Paper: A Law Enforcement Perspective on the California Energy Crisis, April 2004, http://ag.ca.gov/publications/energywhitepaper.pdf. We take official notice of this report.

> [I]t is clear that the Commission must take into account the antitrust aspects of applications before it. It is equally obvious that the Commission failed to perform this essential duty in the instant case. Although the Commission heard extensive testimony and legal argument…its decision appears to ignore the antitrust issues entirely...
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> ….
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> The task of the Commission extends far beyond the passive role of a sounding board. The Commission cannot discharge its duty by merely taking "cognizance of the contracts between PG&E and its steam suppliers," without evaluating their effect upon the interests of the public. It must weigh the opposing evidence and arguments in order "to determine whether the rights and interests of the general public will be advanced by the prosecution of the enterprise which it is proposed to carry on for the service of the public." …The Commission must place the important public policy in favor of free competition in the scale along with the other rights and interests of the general public. Here, the Commission did not perform this task; it incorrectly found "no need to determine the issues raised by NCPA." (5 Cal. 3d 370, 379 (1971).)

3.2.1. Rule II – Applicability to Holding Companies

In the 1997 decision adopting the Affiliate Transaction Rules, the Commission states, "the development of competitive markets would be undermined if the utility were able to leverage its market power into the related markets in which their affiliates compete." (D.97-12-088, 77 CPUC 2d 422, 449.) The same would be true were a holding company to leverage its utility's market power or govern the utility in a way that provided unfair competitive advantages to utility affiliates over competitors. D.06-06-062 plainly recognizes the potential for holding company abuse, stating: "Unless key aspects of the Affiliate Transaction Rules govern the relationship between a utility and its

holding company, these rules and the underlying reasons for them can be totally circumvented at the top of the corporation where the significant decisions are made." (D.06-06-062, *mimeo.*, p. 13.)

Instead of showing that there are no problems with the Original Rules, Respondents' Comments highlight one of the major problems motivating us to adopt these amendments. Commission staff and some auditors have tended to perceive this problem as resulting from Respondents' overly narrow interpretation of when and how the Original Rules apply to the holding companies. Respondents insist that the holding companies are not covered by the Original Rules "unless the holding companies themselves (as opposed to their subsidiaries) directly participate in energy markets." (Respondents' Comments, p. 28.)[17]

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[17] Respondents take somewhat contradictory positions. On the one hand, relying upon the definition of "affiliate" in Rule I, Definitions and upon Rule II B, Applicability, Respondents assert the Original Rules clearly exempt holding companies not directly and actively engaged in the provision of electricity or natural gas services/products. On the other hand, Respondents suggest that we need not be concerned that holding companies might be used as a conduit to pass confidential information to utility affiliates because holding companies are covered by the prohibitions in Rule V E, Separation-Corporate Support.

Rule V E recognizes a corporate support exception to the basic requirement for separation between a utility and its affiliates, explicitly extends this exception to "the utility, its parent holding company, or a separate affiliate created solely to perform corporate support services…," and emphasizes that any shared services "shall not allow or provide a means for the transfer of confidential information from the utility to the affiliate, create the opportunity for preferential treatment or unfair competitive advantage, lead to customer confusion, or create significant opportunities for cross-subsidization of affiliates." The Rule requires mechanisms to effect utility compliance (but does not explicitly require holding company compliance).

Narrow interpretation of the Affiliate Transaction Rules creates a significant loophole and undermines their use as an adequate regulatory tool for protecting utility ratepayers and ensuring fair competition in energy markets. We examine two, simple hypothetical illustrations.

In the first, a utility provides confidential information to its corporate parent, the holding company, and unbeknownst to the utility, the holding company shares the confidential information with an affiliate or utilizes the confidential information to provide preferential treatment or an unfair competitive advantage to the affiliate.

Under Respondents' narrow interpretation, the utility may report confidential information directly to the holding company, and as long as this exchange does not utilize shared services (which may be used only if they do not create an opportunity for the transfer of confidential information), no violation of the Original Rules has occurred. The reasons? The holding company is not covered by the Rules and shared services were not utilized.

In our second hypothetical, a holding company instructs its utility to submit a particular procurement proposal to the Commission and unbeknownst to the utility, the proposal will provide preferential treatment for an affiliate. Again, if the holding company is not covered, no violation of the Rules has occurred, even though Respondents' narrow interpretation undermines the entire purpose of the Original Rules.

There are two approaches to closing this loophole. The approach we have followed is to amend specific Rules to explicitly provide that they bind the holding company. The other approach would be to interpret "affiliate" to include the holding company by virtue of its governance of the energy products/services provided by marketing affiliates. We have rejected this

approach because it creates other problems. For example, if we made the entirety of the Revised Affiliate Transaction Rules applicable to holding companies, they would be unable to keep any communications with their utilities confidential. Also, the greater structural separation required would oblige the holding company and utility to be housed in separate buildings.

The amendments to Rules II B and II C close the loophole without creating new, undesirable consequences. Specifically, Rule II B, as amended, clarifies that whenever a Rule explicitly extends its reach to a utility's holding company, that Rule is meant to apply and does apply to the holding company. The amendment rejects and prevents future use of a circular argument that, based upon the current definition of "affiliate" and the wording of Rule II. B (in the Original Rules), none of the subsequent Rules apply to a holding company which does not provide energy services, even though, the subsequent Rule, by its own terms otherwise would apply.

In Rule II C, we adopt amendments to explicitly prohibit a holding company or any other affiliate from *knowingly* directing or causing a utility to violate or circumvent the Revised Rules. This amendment revises staff's proposal by inserting the element of scienter, as Respondents' Workshop Statements argue we must. We agree that consistency with Section 2111 of California Public Utilities Code necessitates this amendment.

3.2.2. Rule III – Nondiscrimination

The amendments to Rule III B do two things. One, they strengthen the requirement that any information provided by a utility to an affiliate be limited to that made generally available to all market participants. Two, they close a significant loophole in existing resource procurement transactions by extending

the requirement for Commission pre-approval of utility-affiliate procurement to cover all types of resources.

IEP supports both of these amendments and states that they "are useful tools in a multifaceted effort to ensure fair competition among utility generation affiliates and independent power producers." (IEP Post-workshop Statement, p. 4.) IEP remarks that the other Commission tools for protecting against affiliate procurement abuse, the Independent Evaluator and Procurement Review Groups, "have not yet been shown to be effective." (*Id.*, p. 3.) IEP adds:

> [T]he Commission must ensure that no favoritism occurs in the procurement process when affiliates are involved. If utility projects or affiliate proposals are allowed to compete with independent, nonaffiliated power producers in solicitations where the utility retains the primary power to select winners, it must be beyond dispute and transparent to all participating parties that the winning projects are selected on a fair and unbiased basis. (*Ibid.*)

As we noted in D.06-06-062, while recent statutes or Commission decisions generally require some form of Commission pre-approval for utility procurement of electricity, or utility execution of liquefied natural gas (LNG) contracts and interstate pipeline contracts, at present there are no pre-approval requirements for other resources, such as natural gas supplies. Natural gas utilities file reports with the Commission which provide details of their purchases of natural gas from affiliates, but there is no way to determine if the utility is providing preferential treatment to its affiliate or to assess the reasonableness of the affiliate's after-market sales to the utility. Such omissions open the door to the appearance of favoritism and possibly, to actual market abuse. Compliance need not be overly burdensome. For short-term purchases,

for example, pre-approval need not require transaction-by-transaction assessment, but might be based on a methodology approved by the Commission.

We have revised the staff proposals to exempt blind transactions from the pre-approval requirement.

3.2.3. Rule IV – Disclosure and Information vs. Rule VI – Regulatory Compliance

The Proposed Decision included a new Rule IV C that would have required semiannual, confidential reports from a utility to the Commission disclosing when and to whom at the holding company or an affiliate the utility has provided non-public information concerning one or more of six commercially sensitive subjects: information supplied by the affiliate's competitor; negotiations with the affiliate's competitor; utility procurement plans; utility operational matters; expansion plans; and the affiliate's competition with other entities.

Respondents contend that sound governance principles and duties under state corporate law, federal securities laws and the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley),[18] require that holding company officials must have access to all material information about their subsidiaries' businesses. Such information, they argue, is necessary for a holding company to certify the company's financial statements and internal controls and thereby accurately disclose all material information to investors in a timely manner. We agree. As proposed, new Rule IV C would not have prohibited the utility from providing non-public information to its holding company.

[18] Pub. L. 107-204 (July 30, 2002).

Respondents also maintain that the obligation to report on these six subjects would be so burdensome as to interfere with or even deter the flow of information between the utility and its parent, particularly if the reporting requirements include communications involving the corporate support group of shared services under Rule V E. Respondents also maintain that the reporting obligation would fail to prevent abuse. For example, Respondents state: "Indeed, if the Commission does not trust executives to comply with the existing anti-conduit rules, then a rule that would impose a recording requirement would add nothing because there would be no basis for believing that the covered communications were properly recorded." (Respondents' Comments, p. 21.) One of Respondents' spokesmen made the same point at Oral Argument, stating: "… the key people at the holding company that have the obligation to the board and to – under Sarbanes-Oxley, if they don't intent to honor the anti-conduit rule, none of the rest of this burdensome activity works." (Tr. 39:1-5.) One Commissioner present at Oral Argument, who expressed a strong concern about the burden note taking would impose, nonetheless remarked: "One fellow I used to work for used to say, "Trust, but verify." (*Id*. at 47:14-15.) The Commissioner also observed: "… somewhere along the line there needs to be some comfort in the public that we get what we need in the process. So the point is really balance…" (*Id*. at 47:27-48:2.)

In lieu of the Proposed Decision's approach and in our continuing effort to strike the appropriate balance, we endorse the alternative approach offered for comment by the November 7, 2006 AC/ALJ Ruling. This alternative, offered in lieu of the Proposed Decision's new Rule IV C, instead amends Rule VI, Regulatory Compliance by adding a new Rule VI E entitled "Officer Certification." Rule VI E requires each key officer of a utility and its holding

company parent to execute an annual certification under penalty of perjury that the officer is familiar with the Revised Rules and either has complied with them or has listed any known violations. One of the concerns underlying this rulemaking is the potential for a utility's parent holding company to serve as a conduit, whether intentionally or inadvertently, for the kinds of information that the Original Rules prohibit the utility and its affiliate from sharing directly. The certification requirement is meant to ensure that responsibility for compliance with the Revised Rules reaches all the way to the top of the corporate enterprise and influences those individuals with the greatest ability to control utility/holding company and utility/affiliate relationships.

3.2.4. Rule V – Shared Services

Our previous adoption of holding company structures for California's major natural gas and electric utilities relied upon corporate separation of the regulated and unregulated entities. When the Commission adopted the Affiliate Transaction Rules in D.97-12-088, however, it found that the development of competitive markets required even more separation between a utility and its affiliate. Rule V, Separation was the result. Nevertheless, in Rule V E (Corporate Support), the Commission allowed an exception and authorized sharing of the corporate support group of services, provided that sharing those services did not give any affiliate an unfair competitive advantage.

As we explained in D.06-06-062, we now question the breadth of some of the exceptions, particularly the exceptions for "financial planning and analysis," "regulatory affairs," "lobbying" and "legal." These exceptions could include matters affecting marketing or operational issues, for example, where an affiliate can be given an unfair competitive advantage. Although Rule V E states that the exceptions should not provide a means to transfer confidential information

between the utility and the affiliate, provide preferential treatment or create an unfair advantage, we must question whether such separation is possible. In D.06-06-062, we asked the questions: "How can an attorney or a consultant giving advice to an affiliate, completely avoid transmitting confidential utility information that he or she also holds? Even if the attorney or consultant does not disclose the confidential information, how could it not at least influence the attorney's or consultant's advice?" (D.06-06-062, *mimeo.*, p. 16.)

Respondents contend that professionals can keep the confidential information separate, and they give as examples law firms that may have clients in competing businesses. However, when the same law firm is hired by two clients with contrary interests, those clients typically have an opportunity to decide whether or not to waive any conflict issues. Even then, there may be a firewall imposed in the law firm.

In contrast, for holding company shared services, competitors of the affiliate or groups representing ratepayers have no opportunity to decide whether or not to waive conflict issues that may arise when the same lawyer or law firm provides shared services for the utility and its affiliate. There are no mandatory firewalls within the shared services of the holding company, and firewalls are ineffective if the same person is providing the shared services.

Another problem with shared services in Rule V E (Original Rules) is timing. The shared services allow an affiliate to obtain information prior to public disclosure, if any. In addition, the individuals providing shared services may learn an enormous amount of vital, non-public information from the utility that could be very beneficial to the affiliate. Yet, under the Original Rules, even if an individual had extensive knowledge of one or more of these subjects, he or she could provide shared services for the utility, holding company and affiliate,

simply because that individual is an attorney, regulatory affairs official, lobbyist or financial planner. Similarly, under Rule V G of the Original Rules, contractors or consultants could be jointly retained by the utility, holding company and affiliate and thereby learn about a utility's confidential matters while working concurrently for the affiliate.

Respondents claim that the shared services help to ensure that holding company officials receive necessary information and that all entities in the corporate family take consistent positions with respect to material issues that bear on public disclosures. They further contend that these shared services are necessary to enable all entities in the corporate family to take a common, coordinated position before this Commission and other state and federal bodies. However, there is nothing in the Revised Rules which precludes a holding company from obtaining information from its utility without using shared services. For example, holding company officials can call utility officials or receive written or oral reports or presentations from utility officials.

Furthermore, some of the coordination that takes place through use of shared services concerns us. Respondents contend that the corporate family should be entitled to harmonize conflicting goals in order to present coordinated positions before the Commission and other agencies. They further suggest that the First Amendment protects their right to do so. This entirely depends upon what they are harmonizing.

Often it is permissible for a utility, its holding company, and affiliates to take coordinated positions before the Commission. Just like other parties which may jointly file pleadings, the utility and its holding company and affiliate do not have to share services of the same individual in order to do so. However, if a utility, its holding company and affiliates should decide to engage in anti-

competitive conduct whereby the utility provides preferential treatment for its affiliate, this harmonization is not proper or protected by the First Amendment.[19]

We provide a hypothetical example. Suppose SoCalGas and SDG&E were to coordinate with their holding company and affiliates in order to purchase regasified LNG only from Sempra LNG and avoid a fair opportunity for any other potential LNG supplier to compete and offer a better supply arrangement. A coordinated effort, subsequently, to file an application with the Commission for approval of this supply arrangement would not be justifiable or protected by the First Amendment.

Coordination problems are not merely hypothetical, however. In D.06-06-062, we cited examples of significant utility/affiliate/holding company problems in California's past (Edison and Mission Energy, PG&E and PGT, SoGalGas and PITCO). We reiterate that utilities have a public service obligation to provide services in a safe, reliable and environmentally sustainable manner at the lowest reasonable cost. Preferential treatment to affiliates is prohibited. Whether or not these legal obligations conflict with holding company or affiliate goals, it is impermissible for a utility to resolve these conflicts by abandoning its public service obligations.

Because of these concerns, the Proposed Decision recommends revision of the examples of permitted and prohibited corporate support services in Rule V E.

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[19] S*ee, e.g., Columbia Steel Casting v. Portland General Electric* (9th Cir.1996) 111 F.3d 1427, 1446 ["Applying to an administrative agency for approval of an anticompetitive contract is not lobbying activity within the meaning of the *Noerr-Pennington* doctrine (which is rooted in the First Amendment protection). In any case, PGE is not being held liable for filing the application . . . PGE is being held liable for agreeing with PP&L to replace competition with area monopolies in the Portland market."]

The Proposed Decision would exclude sharing by utility and affiliates of regulatory affairs, lobbying, risk management, and legal services (except legal services necessary to the provision of authorized shared services). However, largely based on workshop discussions in which Respondents itemized some of the specific corporate tasks which rely upon the timely sharing of information, the Proposed Decision would expand the examples of permitted sharing to include cash management, banking relations, communications with rating agencies, trust management, and corporate compliance with the Revised Rules. The Proposed Decision also would revised Rule V G (Employees) to extend the prohibition on the sharing of employees by utility and affiliates to ban the sharing of consultants and contractors (though it would expressly exempt auditors and providers of accounting services).

Respondents' Comments strongly oppose the Proposed Decision's approach to Rule V and continue to assert that its suggestions for amendment to Rule V are unwarranted, inefficient and in some cases, unworkable. After considering Respondents' concerns and reconsidering the Commission' regulatory objectives, the November 7 AC/ALJ Ruling suggests an alternative approach, which provides a utility and its holding company with an election. This election involves modifying Rule V to provide that if these corporate entities prefer to retain the provisions on shared services or shared employees, consultant, and contractors found in the Original Rules, they must eliminate any duplication of personnel among key corporate officers. If they prefer not to eliminate overlap among key officers, then they must cease sharing services in the areas of legal, regulatory affairs and lobbying. The definition of key officers for the purposes of Rule V is the same as for the new officer certification requirement in Rule IV. In lieu of the change to Rule V G, we also make a minor,

clarifying amendment to Rule I, Definitions to stress that the utility shall not use a consultant or contractor as a conduit to circumvent the Revised Rules.

We think that the election goes far to solve the matters of greatest concern to us, either by directly limiting the scope of shared services or by restricting the potential conflict of interest among top corporate decision makers. The present high degree of overlap among key corporate officers at each utility and its holding company parent means either option will take time to implement. Accordingly, we require implementation by 180 days after the effective date of today's decision.

Our adoption of these revisions strikes a different balance than the Proposed Decision would, but the objectives are the same. Today's decision offers Respondents greater flexibility to determine how to conduct their businesses efficiently, minimize duplication and enjoy any economies of scale that may be available but also requires clearer protections against preferential treatment of utility affiliates.

3.2.5. Rule IX – Protecting the Utility's Financial Health

The new Rule IX consists of four provisions, A-D, previously articulated in various Commission decisions. Rule IX A is designed to ensure that we receive, on an ongoing basis, the same information (about capital budgets, etc.) that we called for in the OIR. Rule IX B imposes on all the utilities the obligation to retain a capital structure consistent with the Commission-authorized structure. We imposed this requirement on PG&E in 1996, in D.96-11-017. Respondents would prefer that we did not add this requirement to the Revised Rules, but have not established that it is unreasonable. As Respondents' suggest, however,

we have revised the staff proposal and Proposed Decision so that the Rule tracks the language in D.96-11-017.

We have deleted the final two staff proposals and added two ring-fencing proposals which TURN advocates. One of the deleted rules would prohibit a utility from issuing dividends or repurchasing stocks when its senior, unsecured long-term debt rating falls to the lowest investment grade unless the utility first obtains Commission approval to do so. We imposed this condition in our approval of the PacifiCorp merger, D.06-02-033, where it was offered as one of the many terms of the multi-state settlement. Respondents oppose this staff proposal, partly because it inadvertently referenced the wrong debt benchmarks. Respondents also argue that the rule may have adverse consequences and offer, in support, the opinion of their consultant, Steven M. Fetter.[20] We conclude that we should not impose this condition, broadly, without further study. The other deleted rule would prohibit a utility from becoming or remaining liable for the indebtedness of its affiliates without Commission approval, also a condition of approval of the PacifiCorp merger. This condition essentially restates the prohibitions in Public Utilities Code Section 701.5, and as such, need not be restated in the Revised Rules.

Rules IX C and IX D are two of the ring-fencing measures which we approved in the context of the PacifiCorp merger. TURN urges us to adopt these two provisions which focus "on the *effect* of the intended ring-fencing, rather

[20] Fetter is President of Regulation, UnFettered, an energy advisory firm. He served as head of the utility ratings practice at Fitch Ratings (1993-2002) and Chairman of the Michigan Public Service Commission (1987-1993). By motion filed September 29, 2006, Respondents seek leave to file Fetter's Declaration. The motion is unopposed.

than the detailed provisions required to achieve such an outcome." (TURN Post-workshop Comments, p. 2.) That effect, of course, is to ensure that a utility is not pulled into the bankruptcy of its holding company, should serious financial problems develop. We have amended the Revised Rules to adopt TURN's recommendation.

Rule IX C simply requires a utility to obtain a non-consolidation opinion that demonstrates that the ring-fencing measures it has in place are adequate to keep the utility out of a bankruptcy filed by its holding company parent. Rule IX C does not mandate what types of ring-fencing measures the utility must adopt. We make no changes to this Rule. However, after further consideration, we have revised Rule IX D to require only that a utility notify the Commission if it subsequently makes changes to its ring-fencing measures.

4. GO 77-M

The new GO 77-M, appended to this decision as Appendices B-1 and B-2, consists of our amendments to GO 77-L, the prior version of the general order.[21] Appendix B-3 is a "clean" version of the general order. The amendments have been developed to yield a more complete and accurate picture of Respondent's compensation practices while protecting reasonable privacy interests. Greenlining urged us to expand the OIR to consider a number of issues related to

[21] The Appendices show corrections made to reinsert in draft GO 77-M an existing paragraph that was unintentionally dropped from the working draft. That paragraph makes the existing general order applicable to utilities having gross operating revenues of $1 billion or more. It will continue to apply to all such utilities other than Respondents, consistent with Public Utilities Code Section 1708, which requires notice and opportunity to be heard before the Commission may alter a prior decision. Because this Rulemaking applies only to Respondents, any modifications to existing law made by today's decision apply only to Respondents.

executive compensation. We did so in D.06-06-062 and stated our intent to consider revisions to GO 77-L. In response, the September 12 ALJ Ruling released the staff proposals. We have looked closely at the pre- and post-workshop statements and other comments and have refined the staff proposals by incorporating suggestions from Respondents and from Greenlining. In summary, the amendments to the general order require:

- reporting of total compensation, by category and in the aggregate, for all utility Executive Officers and employees with a base salary of $250,000. (For employees earning a base salary of more than $125,000 but less than $250,000, the current practice continues to be adequate, i.e., reporting all compensation and expenses but excluding pension and benefits.);
- reporting of total compensation, by category and in the aggregate, for all Executive Officers of the utility's holding company for whom compensation disclosures must be made in the holding company's proxy statement (already required for PG&E and Edison);
- disclosure of the proportion of utility or holding company Executive Officer compensation paid, directly or indirectly, by a utility's ratepayers;
- a statement explaining in plain-English all elements of compensation to utility Executive Officers and employees with a base salary of $250,000, including the performance metrics or criteria used to determine incentive compensation;
- an independent auditor's letter verifying that all elements of total compensation have been disclosed and described (already required for PG&E), and because of tax season workload, a two-month extension in the time for submitting the report and letter, from March 31 to May 31; and
- posting on the utility's website of internet links to all public compensation documents filed at the SEC or with this

> Commission. (SEC link already required of PG&E and Edison.)

In addition, GO 77-M incorporates a provision adopted in D.04-08-055 and D.05-04-030, which issued in Rulemaking 03-08-019, the Commission's last review of this general order but which was not made part of the general order's formal text. The provision authorizes a utility to annually report names of highly compensated individuals in conditional access reports as long as any utility that chooses this option also files a report for public inspection from which the individual names have been redacted. The public version is available for review by members of the public without qualification.

The new reporting provisions in the amendments have been drawn, in significant part, from Commission decisions in the last general rate cases (GRCs) for PG&E and Edison and from recent SEC orders that require public disclosure of the total compensation awarded a corporation's top executives and others.

The GRC decisions require several things. D.04-05-055 directs PG&E to supplement its GO 77 report with a separate list showing the total compensation awarded to all of its officers and to those top officers of its holding company for whom compensation disclosures must be made in the holding company's proxy statement. The decision also requires PG&E to include an independent auditor's letter verifying that all elements of compensation are fully disclosed, clearly described and totally comprehensive. Further, the decision requires PG&E to include an internet site-link to all documents filed with the SEC that relate to any

elements of executive compensation.[22] D.06-05-016 requires Edison's next GO 77 report to follow the PG&E model.

On July 26, 2006, the SEC voted to amend its rules governing disclosure of compensation to directors and top officers and determined to take additional comment on extending these disclosures to three other highly compensated employees. The SEC released a final version of the new disclosure rules for directors and for the principal executive officer, principal financial officer, and

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[22] Ordering paragraph 12 of D.04-05-055 states:

> PG&E shall file in its GO 77-K reports a separate tab listing the total compensation of the top executive officers of the utility's holding company whose compensation is listed in the holding company's proxy statement as well as the total compensation of all other utility officers. This additional information shall include not only compensation received in the prior year as now required by GO 77-K [the predecessor of GO 77-L] but also compensation awarded in the last year but not yet received, including but not limited to stock option grants. PG&E shall also include an independent auditor's letter verifying that all elements of compensation as required are fully disclosed, clearly described, and totally comprehensive. Disclosure shall include internet site links to all documents filed with the Securities and Exchange Commission that relate to any and all elements of executive compensation as required herein.

Though Ordering Paragraph 12 refers to "total compensation" (and a comprehensive definition of that term is discussed in D.04-05-055 at Section 10.3.1), GO 77 traditionally has sought disclosure of annual compensation only (e.g., salary, expense accounts, and contingent fees, excluding pension or benefits), and has not necessarily captured short- or long-term incentive payments. While Ordering Paragraph 12 clearly seeks disclosure of incentive payments, its intent to require disclosure of total compensation may have been less clear. Review indicates that PG&E's 2005 report continues to exclude pensions and benefits. Note also the directive in Edison's most recent GRC decision, D.06-05-016, that Edison not only follow the PG&E model for GO 77 reporting but also, in its next GRC "provide full transparent and understandable information on the present and future market value of the retirement severance benefits of its top executives." (D.06-05-015, Conclusion of Law 31.)

three other highest paid executive officers on August 11, 2006. The SEC's new rules require comprehensive tabular disclosure of total compensation for each of the past three years, including holdings of outstanding equity-related interests received as compensation that are a source of future gains, and retirement plans, deferred compensation, and other post-employment payments and benefits. The tabular format requires reporting of the value of all components of the compensation package, as well as a single figure total. The tabular disclosure must be accompanied by a narrative disclosure, in plain English.

Respondents' workshop statements observe that the GO 77 amendments on total compensation reporting will apply to a greater number of executives and employees than the SEC rule. While true, we do not think that observation exposes an infirmity in our reporting requirements, as our regulatory purposes (e.g., ratemaking) are not identical to the SEC's. Moreover, we have limited the burden of compliance by extending the total compensation reporting requirement only to those executives and employees who receive a base salary of $250,000 or more. Furthermore, though we maintain the objective of the staff proposal to obtain, for these individuals, a plain-English explanation of the elements of the compensation package and description of the basis for any incentive compensation awards, we have revised the text. We have deleted the stand-alone paragraph that staff proposed, rewritten the proposal to remove any normative judgment, and added the revised text to the paragraph that lists all other compensation-related disclosure requirements applicable to the large energy utilities.

We have added two requirements to the staff proposal, both based on suggestions made by Greenlining and both consistent with current practices. First, we require the GO 77 report to include an independent auditor's letter

verifying that all elements of total compensation have been disclosed and properly described. PG&E is already subject to this requirement, per D.04-05-055, and D.06-05-016 recently extended the requirement to Edison. Second, recognizing that PG&E and Edison already must provide an internet-link on their respective websites to public, compensation-related filings at the SEC, we require the major energy utilities to make the public version of the GO 77-M report available by that means as well. The additional burden should be minimal and will provide reasonable public access. We think Greenlining's suggestions that we do more are not warranted (e.g., requiring a summary of the report in notices mailed to ratepayers when rate increases are sought; requiring each major energy utility to provide in its own report, for comparison purposes, compensation information for the top officers of the others).

Finally, Greenlining asks that we open a generic proceeding, now, to examine the "indirect impacts" of executive compensation on compensation of middle manages and union employees, on morale and efficiency, and on ratepayers. We decline to do so at this time.

5. Motions

Because IEP is a party to this Rulemaking already, IEP's unopposed motion for party status is moot and we take no action on it. IEP's Post-workshop Statement should be filed. We grant Respondents' unopposed motion to file the Declaration of Steven M. Fetter.

6. 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 Rule 14.2(a) of the Commission's Rules of Practice and Procedure. We have amended the "Background and Procedural History" to list all Comments filed. The remainder

of the decision has been revised after further consideration of all of the Comments. As revised, this is the Proposed Decision of Commissioner Brown.

7. Assignment of Proceeding

Geoffrey F. Brown is the assigned Commissioner and Jean Vieth is the assigned ALJ in this proceeding.

Findings of Fact

1. With the repeal of PUHCA, the Commission has lost the remedy of applying to the SEC for revocation of the PUHCA-exemptions formerly held by Respondent holding companies.

2. Respondents contend that our concerns about their compliance with the Affiliate Transaction Rules are speculative and that recent compliance audits do not reveal any problems. Respondents' have not accurately characterized the audit findings. Respondents also ignore California's history, which reflects serious affiliate abuse problems in the past.

3. All audits referred to herein are public documents.

4. Respondent electric and natural gas utilities exist to provide energy services in a safe, reliable and environmentally sustainable manner at the lowest reasonable cost. This fundamental principle must guide the Commission in balancing the public interest and the private interests of unregulated utility affiliates and the individuals employed within the holding company structure.

5. The staff proposals for amendment to the Affiliate Transaction Rules have been reviewed and refined to better balance the Commission's regulatory need for information and the burden of compliance.

6. The Revised Affiliate Transaction Rules are designed to close existing loopholes, primarily by ensuring that key utility and holding company officers understand the Rules and their obligations under them, providing greater

security against the sharing within the corporate family, through improper conduits, of competitively-significant, confidential information, and ensuring a utility's financial integrity is protected from the riskier market ventures of its unregulated affiliates and holding company parent.

7. The staff proposals for amendment to GO 77-L have been reviewed and refined to better balance the Commission's regulatory need for information and the burden of compliance.

8. GO 77-M has been developed to yield a more complete and accurate picture of Respondents' compensation practices while protecting reasonable privacy interests.

9. No hearing is necessary.

Conclusions of Law

1. IEP's motion to become a party is moot; IEP's Post-Workshop Statement should be filed.

2. Respondents' unopposed motion for leave to file the declaration of Steven M. Fetter should be granted.

3. We may adopt rule changes in a quasi-legislative Rulemaking such as this one, as long as we provide notice and an opportunity for comment.

4. Where the Commission has not reviewed an audit in a formal proceeding and made its own findings, we may nonetheless take official notice merely to highlight the disparity between Respondents' characterizations and the findings in the audits themselves, but make no assessment of the merits.

5. As revised by today's order, the amendments to Affiliate Transaction Rules are reasonable and should be adopted.

6. As revised by today's order, the amendments to GO 77-L are reasonable and should be adopted.

O R D E R

IT IS ORDERED that:

1. The Affiliate Transaction Rules Applicable to Large California Energy Utilities, appended as Appendix A-3 to this decision, and General Order (GO) 77-M, appended as Appendix B-3 to this decision, are adopted. Both apply to Respondents (Southern California Edison Company/Edison International, Pacific Gas and Electric Company/PG&E Corporation, and Southern California Gas Company and San Diego Gas & Electric Company, both owned by Sempra Energy).

2. Within three months of the effective date of today's order, or as otherwise extended by the assigned Commissioner or assigned Administrative Law Judge and in order to avoid confusion, Commission staff shall place on the Commission's public meeting agenda a draft Rulemaking which proposes amendment of the Affiliate Transaction Rules adopted by Decision 97-12-088 as subsequently amended by other Commission decisions, for the sole purpose of exempting the large energy utilities from them. The amendments proposed shall include a cross-reference to today's order and The Affiliate Transaction Rules Applicable to Large California Energy Utilities Revised Rules.

3. The Motion of the Independent Energy Producers Association to Become a Party, filed September 29, 2006, is moot. The Post-workshop Statement attached to the Motion shall be filed as of September 29, 2006.

4. Respondent Utilities' and Holding Companies' Motion for Leave to File Declaration of Steven M. Fetter, filed September 29, 2006, is granted.

5. Rulemaking 05-10-030 is closed.

This order is effective today.

Dated _____, at San Francisco, California.