

Decision 08-09-013 September 4, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company
and PG&E Corporation for Limited Exemption
from Rule V.E of the Commission's Affiliate
Transaction Rules (U39M).

Application 08-07-014
(Filed July 9, 2008)

**DECISION GRANTING MOTION FOR
TEMPORARY WAIVER OF AFFILIATE TRANSACTION RULE V.E**

Summary

By this decision, we grant the motion of Pacific Gas and Electric Company and PG&E Corporation (Applicants)¹ for an interim ruling granting Applicants a temporary waiver of Rule V.E of the Commission's Affiliate Transaction Rules, subject to the necessary conditions as explained below.

Background

On July 8, 2008, PG&E's President and Chief Executive Officer (CEO), William Morrow, announced plans to leave his positions with PG&E, effective August 31, 2008. The Board of Directors of PG&E has passed a resolution expressing its intent to have Peter A. Darbee, the President and CEO of PG&E

¹ Pacific Gas and Electric Company (PG&E) is an operating public utility organized under the laws of the State of California, and is engaged principally in the business of furnishing gas and electric service in California. PG&E Corporation is a holding company organized under the laws of the State of California, whose principal business is the ownership of the common stock of PG&E.

Corporation, serve concurrently as the President and CEO of PG&E as well, subject to the approval of this Commission.

Applicants recognize that a dual-hatted President and CEO is contrary to the express provisions of the Commission's Affiliate Transaction Rule V.E, as modified by Decision (D.) 06-12-029. On July 9, 2008, Applicants filed an application for a limited exemption from Rule V.E of the Commission's Affiliate Transaction Rules to allow Darbee, PG&E Corporation's President and CEO, to serve also as PG&E's President and CEO, while Applicants continue to share regulatory affairs, lobbying and legal services. Applicants seek authority to continue the exemption as long as PG&E Corporation does not have significant non-Commission-regulated subsidiaries. Because Applicants could not otherwise obtain final Commission action on this proposal before Morrow's departure, Applicants concurrently filed a motion, pursuant to Rule 11.1 of the Commission's Rules of Practice and Procedure, for an interim ruling granting Applicants a temporary waiver of Rule V.E. A temporary waiver would allow Darbee to assume the duties of the President and CEO of PG&E from September 1, 2008, the day after Morrow's announced departure date, until the Commission rules on the Application.

Applicants claim that the temporary waiver will avoid PG&E having a period without any President or CEO. Under Applicants' proposed schedule, after the Commission issues its interim ruling, parties will have an opportunity to comment on the proposed interim decision, and to request evidentiary hearings on the application, if they deem hearings necessary.

In this Decision, we only address Applicants' motion seeking a temporary waiver of the Affiliate Transaction Rules by September 1, 2008, pending final disposition of Applicants' underlying proposal to extend the waiver indefinitely.

We defer to a separate decision the disposition of Applicants' underlying proposal for an ongoing limited exemption of Rule V.E of the Affiliate Transaction Rules.

The Affiliate Transaction Rules, as initially adopted in D.97-12-088, serve as standards of conduct governing relationships between California natural gas or electric utilities and their affiliates. The Commission found these rules necessary because "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."² The adopted rules "generally require more separation between a utility and its affiliate, rather than rules that rely almost exclusively on tracking costs. The fewer the transactions between the utility and its affiliate, the greater confidence we have that the affiliate lacks market power."³

In October, 2005, the Commission issued its *Order Instituting Rulemaking Concerning Relationship Between California Energy Utilities and Their Holding Companies and Non-Regulated Affiliates*. (R.05-10-030.) The OIR stemmed from the repeal of the Public Utility Holding Company Act, and the fact that, since the utility holding companies were formed, "these companies have made significant investments in distribution and transmission lines, natural gas pipelines and terminals, powerplants, trading companies, marketing companies and other

² D.97-12-088 (December 16, 1997), 77 CPUC2d 422, 449, as amended by D.98-08-035 (August 6, 1998) 81 CPUC2d 607 and D.98-12-075 (December 17, 1998), 84 CPUC2d 155.

³ *Id.*, 77 CPUC2d at 450.

energy service companies ('energy infrastructure') both overseas and within the United States." (*Id.* at 1.) The OIR stated:

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. (*Id.* at 2.)

The Commission amended its OIR in D.06-06-062, again emphasizing that its goal was "to ensure that the utilities meet their public service obligations at the lowest reasonable cost" and "to ensure that the utilities do not favor or otherwise engage in preferential treatment of their affiliates." (*Id.*, mimeo. at 2.)

In D.06-12-069, the Commission adopted further revisions in the Affiliate Transaction Rules. Among these changes, Rule V.E provided the utility and its holding company with an election: either to (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.

Rule V.E created exceptions to allow utilities to share corporate support services with affiliates, provided such sharing did not give any affiliate an unfair competitive advantage. Thus, in order to share corporate support services with

affiliates under Rule V.E, the utilities had to elect one of the following options, either: (1) eliminate shared “key officers” or (2) eliminate the sharing of regulatory affairs, lobbying and legal services. As a basis to qualify for the exception under Rule V.E, PG&E elected not to share “key officers.”

By its motion, PG&E thus, seeks a temporary waiver from Rule V.E, precluding a sharing of “key officers” in order to allow Darbee to serve as President and CEO of both companies from September 1, 2008, until the date of a final Commission decision on the application.

Applicants argue that in PG&E’s case, the rationale for the modified rule (“the likelihood for preferential treatment, unfair competitive advantage, or the sharing of competitively sensitive information within the party regulated, mostly unregulated corporate family and the consequences such competitive abuse poses for energy markets and captive ratepayers,” D.06-12-029, mimeo. at 10) applied weakly, and was made applicable to Applicants because of the expectation that “in the future, PG&E will have unregulated affiliates again.” (D.06-06-062, mimeo. at 9.) In the 18 months since Rule V.E was modified, PG&E has remained PG&E Corporation’s only major subsidiary. As of March 31, 2008, PG&E accounted for 100% of PG&E Corporation’s consolidated operating revenue, 99.1% of the total assets and 99.99% of the total physical assets. (See PG&E Corporation Form 10-Q, filed May 6, 2008 for the period ending March 31, 2008.)

Applicants claim that, given the limited nature of PG&E Corporation’s non-utility business, the dangers Rule V.E was intended to protect against do not exist, and that strict application of the Rule to PG&E and PG&E Corporation does not serve its intended purpose.

PG&E currently has six Rule II.B affiliates, two of which are subsidiaries of PG&E (and thus not relevant to its motion), and four of which have no current operations (their entire business currently relates to the proposed Pacific Connector natural gas pipeline in Oregon).⁴ These affiliates generate no operating revenue, constitute less than 1% of PG&E Corporation's total assets and less than one hundredth of 1% of PG&E Corporation's physical assets.

Applicants argue that since PG&E remains PG&E Corporation's only significant subsidiary and PG&E Corporation does not have any significant unregulated business, allowing PG&E and PG&E Corporation to share a President and CEO would not undermine the purpose of the 2006 modification to Rule V.E. The Application therefore requests a temporary waiver of Rule V.E so that they may share a President and CEO, and continue to share regulatory affairs, lobbying and legal services, until such time as the Commission rules on the underlying application.

Positions of Responding Parties

Responses to the motion were filed on July 22, 2008, by the Commission's Division of Ratepayer Advocates (DRA), The Utility Reform Network (TURN), Greenlining Institute (Greenlining), jointly by the California Farm Bureau Federation and California Large Energy Consumers Association (CFBF/CLECA) and separately by Independent Energy Producers (IEP), and L. Jan Reid. DRA, TURN, CFBF/CLECA and Reid all categorically oppose granting the motion for an interim waiver of Rule V.E.

⁴ A description of PG&E's Rule II.B affiliates is attached to its motion.

TURN argues that the motion should be denied because the stated urgency of the request is entirely of PG&E's own making, and because the existence of a "dual-hatted" President and CEO would create undue risk to ratepayer interests. TURN argues that even though PG&E Corporation does not currently have any subsidiaries active in the energy business, the holding company is continuously on the look-out for such opportunities and has very recently considered investing a development project for which PG&E, the utility company, was a potential customer. In this regard, TURN refers to PG&E's application (A.07-12-021) for authority to enter into a long-term natural gas transportation agreement with the Ruby Pipeline Company. TURN argues that even though PG&E Corporation decided against making an investment in Ruby, the events surrounding that project demonstrate that even the current Affiliate rules are inadequate to meet the challenge of a holding company investing in projects that offer service to its regulated utility. TURN contends that allowing even a temporary waiver of Rule V.E would create the potential environment for conflicts of interest between the holding company and its utility.

Greenlining expresses limited opposition to the motion based on the concern that by combining the offices of President and CEO on a shared basis, a single CEO may be spread too thin, without sufficient time to ensure the good corporate citizenship that Greenlining believes is embodied in Morrow. Greenlining, therefore, requests that PG&E demonstrate whether the duties of Morrow, including those relating to corporate responsibility and community involvement, can be effectively carried out by Darbee. Greenlining states that it may withdraw its opposition pending such a demonstration as it has requested.

IEP has no objections to Applicants being granted the temporary waiver, but does object to the automatic triggering mechanism for termination of the

waiver as proposed by Applicants. Under Applicants' proposed triggering mechanism, the waiver would remain in effect until such time as PG&E's Rule II.B affiliates constitute 5% of PG&E Corporation's consolidated assets or generate 5% of PG&E Corporation's consolidated operating revenue. IEP proposes instead that if any waiver is granted by the Commission, it should be reevaluated whenever a new compliance plan is filed under Rule VI.A, whenever a new affiliate is created under Rule V.B, or as part of PG&E's regularly scheduled biennial affiliate audit under Rule VI.C.

Applicants were granted leave to file a third-round reply to parties' responses on January 28, 2008. PG&E argues in its reply that no party has demonstrated that the public interest will be harmed by granting the motion for a temporary waiver of Rule V.E. PG&E notes that IEP suggests an alternate approach to Applicants' proposed triggering mechanism for revisiting or withdrawing the limited exemption from Rule V.E. PG&E believes that issue raised by IEP can be addressed in the second phase of the proceeding, but that IEP does not present any reason to defer granting the temporary waiver requested in its motion.

In response to Greenlining's request for assurances of PG&E's continuing commitment to good corporate citizenship, diversity and community involvement, Applicants do not offer any specific commitments, except to express "confidence that their allegiance to [those commitments] will only strengthen under Darbee's leadership of PG&E." (Reply at 3.)

Applicants disagree with CFBF and CLECA who argue that granting the temporary waiver would set a bad precedent by upsetting the balance struck in D.06-12-029. Applicants claim that CFBF and CLECA identify no specific harm

that would result from granting the motion, and argue that the Commission expressly contemplated that future exemptions might be appropriate.

Applicants argue that the objections raised by TURN and Reid based upon claims of a potential future conflict of interest created by PG&E Corporation's consideration of an equity interest in the Ruby Pipeline project are issues that can and should be decided in A.07-12-021. Applicants do not believe that disposition of those issues, however, have any bearing on the Commission's ruling on the instant motion for a temporary waiver of Rule V.E.

Applicants maintain that although PG&E's current President and CEO, Morrow, had expressed a willingness to remain at PG&E through February of 2009, that it would not be in the public interest for California's largest utility to be led by a President and CEO who everyone knows will be phasing out and hence will not have lasting authority to enforce his decisions. Likewise, Applicants argue that filling his position with a temporary caretaker would be no better at providing the leadership required in view of the challenges that PG&E faces.

Discussion

Based on the limited record that is available under the expedited schedule requested in Applicants' motion, we conclude that the circumstances surrounding the pending departure of PG&E's current President and CEO warrant an interim waiver of Rule V.E to permit Darbee serve in a dual capacity subject to certain necessary conditions set forth below.

We have considered Applicants' argument that either temporarily extending Morrow's tenure or appointing an interim replacement would not be in the public interest, because such a temporary appointee would not have lasting authority to enforce his decisions. We shall accordingly grant the motion

for a temporary waiver of Rule V.E subject to Applicants' compliance with the specific conditions as set forth below. We have reviewed opposing parties' concerns as to why the temporary waiver should not be granted. We agree with parties that the limited exemption sought in the application raises important questions that require careful consideration in the next phase of this proceeding. As part of our review of the request for a limited exemption of Rule V.E in the next phase of this proceeding, we intend to review the existing reporting relationships among employees and officers between the holding company and the utility. However, we are not persuaded that parties' objections preclude us from granting a limited temporary waiver of Rule V.E, as long as appropriate protective conditions are in place, as outlined below. With these conditions in place, we conclude that the limited temporary waiver of Rule V.E, as granted herein, will not pose an adverse risk to ratepayers.

In granting Applicants' motion for a temporary waiver, we make no prejudgment concerning the underlying merits of Applicants' request for a limited exemption from Rule V.E beyond the period covered by the temporary waiver granted herein. This temporary waiver does not constitute a precedent, and shall not be referenced as support in this proceeding or any other proceeding, relating in any way to the substantive merits, applicability, or enforcement of the Commission's Affiliate Transaction Rules.

By granting the temporary waiver, Applicants can proceed to have Darbee serve concurrently as President and CEO of both PG&E and PG&E Corporation on an interim basis while the underlying merits of this Application are being addressed. We accordingly conclude that granting the temporary waiver is acceptable, as long as the conditions outlined herein are met, as discussed below.

The temporary waiver of Rule V.E shall be effective for a limited period not to exceed 120 days from the effective date of this decision, or upon the adoption of a final decision on this application, whichever occurs sooner. This period takes into account the proposed schedule that Applicants have presented for addressing the underlying application, but ensures that this temporary waiver will remain in effect only for a short finite period. During this period, we will undertake a substantive review of the merits of the Application, and develop a full record as a basis to decide whether, or subject to what conditions to grant the limited exemption of Rule V.E as proposed by Applicants.

We grant the temporary waiver based upon the recognition that PG&E's Rule II.B affiliates are currently inactive with no operating revenue. As an additional condition of granting the temporary waiver, we shall require that PG&E's Rule II.B affiliates not expand their existing activities or enter into new commitments throughout the duration of the temporary waiver, and that no new holding company capital investment commitments be undertaken and no new holding company subsidiaries shall be formed during the waiver period.

As a further condition for granting the temporary waiver for Darbee to serve in this dual capacity, we shall require Applicants to affirmatively commit to have Darbee function on a substantially full-time basis as the President and CEO of PG&E, with the responsibility to the utility and its operations constituting his primary duty. In imposing this requirement, we recognize that under California law, officers and directors of every California corporation owe that corporation the same high standard of care and loyalty as a fiduciary responsibility. By conditioning approval on this commitment, we will provide additional protection to ratepayers while Darbee functions in a dual capacity during the period of the limited temporary waiver.

We shall address Applicants' proposal for a waiver of Rule V.E as part of its underlying application in subsequent decision, after a record is developed.

Comments on Proposed Decision

The proposed decision of Administrative Law Judge (ALJ) Thomas R. Pulsifer in this matter was mailed to 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 22, 2008 and reply comments were filed on August 28, 2008, we have taken the comments into account in finalizing this decision.

Assignment of Proceeding

John A. Bohn is the assigned Commissioner and Thomas R. Pulsifer is the assigned ALJ in this proceeding.

Findings of Fact

1. The Commission has adopted Affiliate Transactions Rules to serve as standards of conduct governing relationships between California natural gas or electric utilities and their affiliates.
2. Affiliate Transactions Rules have been found necessary because 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.
3. PG&E seeks authorization to allow PG&E Corporation's President and Chief Executive Officer to assume the duties of the President and CEO of PG&E Company as of September 1, 2008, such that he would simultaneously serve in both offices in a dual capacity.

4. Because the authorization sought by PG&E would be inconsistent with Rule V.E of the Commission's Affiliate Transactions Rules, Applicants are seeking a waiver of Rule V.E.

5. In order to provide time within which a Commission waiver could occur prior to the departure of the current PG&E President and CEO, currently scheduled to occur on August 31, 2008, PG&E sought an interim waiver of Rule V.E by separate motion to remain effective until a Commission decision is issued on the merits of the underlying application.

6. PG&E currently has six Rule II.B affiliates, two of which are subsidiaries of PG&E, and four of which have no current operations since their entire business relates to the proposed Pacific Connector natural gas pipeline in Oregon. These affiliates generate no operating revenue; constitute less than 1% of PG&E Corporation's total assets, and less than one-hundredth of one percent of PG&E Corporation's physical assets.

7. Although the request for limited exemption of Rule V.E raises substantive issues that should be addressed in the next phase of this proceeding, a limited temporary waiver of Rule V.E, as long as it is made subject to the conditions set forth in the ordering paragraphs below, will not adversely impact ratepayers.

8. By granting the temporary waiver of Rule V.E subject to the conditions set forth in the ordering paragraphs below, Applicants will be able to appoint Peter Darbee to serve in the dual capacity of President and CEO of both PG&E Corporation, the holding company, and PG&E, the operating utility, for the duration of the limited waiver.

9. A President and CEO of PG&E who was merely an interim caretaker would not have lasting authority to enforce his decisions.

10. In order for a temporary waiver of Rule V.E to provide an interim remedy that does not pose an adverse risk to ratepayers, the conditions set forth in the ordering paragraph below are necessary. Without these conditions, the temporary waiver would not be appropriate.

11. Granting Applicants' motion for an interim waiver of Rule V.E will not establish a precedent that could be prejudicial to resolution of the underlying application.

12. Applicants have need for temporary waiver of Rule V.E to fill the position of President and CEO after the departure of Morrow on an interim basis at least until a further Commission decision is rendered on the underlying application.

Conclusions of Law

1. The Commission's Affiliate Transactions Rules are necessary to prevent the undermining of competitive markets which could be placed at risk if the utility were able to leverage its market power into the related markets in which their affiliates compete.

2. Applicants should be granted a temporary waiver of the Rule V.E based on conditions adopted below, to address the planned departure of the current PG&E Corporation President and CEO.

3. Granting the temporary waiver of Rule V.E, as authorized herein, is not to serve as a precedent in this or an other proceeding, shall not be used as evidence in deciding the next phase of this proceeding, shall not be referenced as support in this proceeding or any other proceeding, and shall not be used in any way to decide the substantive merits, applicability, or enforcement of the Commission's Affiliate Transaction Rules.

4. The Application for limited exemption of Rule V.E beyond the period of the temporary waiver raises a number of substantive concerns that require further deliberation in the next phase of this proceeding.

5. Applicants' motion for a temporary waiver of Rule V.E should be granted, and the merits of whether to grant a waiver of Rule V.E should be addressed in the next phase of this Application.

O R D E R

IT IS ORDERED that:

1. The motion of Applicants for a temporary waiver of Rule V.E is hereby granted subject to the following conditions:

- a. The temporary waiver does not constitute a precedent, and shall not be referenced as support in this proceeding or any other proceeding, relating in any way to the substantive merits, applicability, or enforcement of the Commission's Affiliate Transaction Rules.
- b. The temporary waiver of Rule V.E shall be effective for a limited period not to exceed 120 days from the effective date of this decision, or upon the adoption of a final decision on this application, whichever occurs sooner.
- c. Applicants shall affirmatively commit to have Peter Darbee function on a substantially full-time basis as the President and CEO of PG&E, with the responsibility to the utility and its operations as constituting his primary duty, while serving in a dual capacity.
- d. PG&E's Rule II.B affiliates must not expand their existing activities or enter into new commitments throughout the duration of the temporary waiver, and no new holding company capital investment commitments shall be undertaken and no new holding company subsidiaries shall be formed during the waiver period.

2. This proceeding shall remain open for further consideration and disposition of the underlying proposal set forth in the Application for a waiver of Rule V.E.

This order is effective today.

Dated September 4, 2008, at San Francisco, California.

MICHAEL R. PEEVEY

President

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

TIMOTHY ALAN SIMON

Commissioners