Decision **ALTERNATE PAGES OF COMMISSIONER CONLON** **(Mailed 11/25/97)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates.	Rulemaking 97-04-011 (Filed April 9, 1997)
Order Instituting Investigation to Establish Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates.	Investigation 97-04-012 (Filed April 9, 1997)

OPINION ADOPTING STANDARDS OF CONDUCT GOVERNING RELATIONSHIPS BETWEEN UTILITIES AND THEIR AFFILIATES

1. On page 2 of the draft decision, after the heading "**Summary**," the following should be added after the first sentence of this section:

"In order to address market power problems and to promote competition, this order adopts limitations on transactions between an electric utility and any affiliate offering direct access within a utility's service territory. An electric utility shall limit its transactions with any affiliate offering direct access within a utility's service territory so that the utility's affiliates do not have greater than 20% market share for each class of customers (based on volume) among those customers choosing direct access.[1] This 20% market share will be calculated separately for residential, commercial, and industrial customers. To promote the development of renewable power, the provision of renewable power to residential customers by an affiliate of the utility shall not be counted toward calculation of the 20% market share Appropriate reporting requirements are adopted."

2. On page 62 of the draft decision, replace the last paragraph that begins "We also adopt…" and continues until just before the next section entitled "Transfer of Employees" with the following:

"We also adopt Petitioners' recommendation, as modified, prohibiting joint utility/affiliate board members and also extend it to joint corporate officers. Our concern with information sharing underlies this area as well. Although both officers and board members would undoubtedly do their professional best to abide by any nondisclosure rules and nondisclosure agreements, it is difficult to monitor against

[1] We are also interested in receiving comments on whether there should be a connection between the limits for industrial, commercial, and residential customers. For example, a utility affiliate would only be allowed to achieve a 20% market share in the industrial class, if it had a minimum of 5%, (or 10%) market share of the residential class.

inadvertent information sharing. We will allow a board member or corporate officer to serve on the holding company and with either the utility or the affiliate (but not both). This exemption is needed to allow for the holding company board and its officers to ensure adequate governance and oversight."

3. Replace the portion of the draft decision that begins with the last paragraph on page 16 and continues until just before section "D. Motions for Exemptions to the Adopted Rules" and replace it with the following:

"We find merit in TURN's and ORA's motion, although we are concerned that a complete prohibition may be too draconian of a measure. The Joint Utilities' Respondents proposal for no restrictions or limitations is equally draconian in the other direction. Therefore we wish to craft a solution that resolves TURN's and ORA's concerns over market power and anti-competitive problems, yet at the same time does not entirely foreclose a utility's affiliates from participating in the marketplace. Allowing the utility's affiliates to participate in the direct access market within the utility's service territories will allow these affiliates to compete for national and state-wide accounts. A complete prohibition may limit this ability, although since the affiliates can compete in the other 49-½ states for national accounts the extent of this disadvantage may be relatively minor.

"In the electric generation market, we attempted to resolve the market power problem by (1) ensuring that no one competitor held too large of a market share and (2) requiring on-going monitoring to ensure that market power abuses were not occurring. We believe that a similar solution is appropriate in this case. Therefore, we will allow an electric utility to enter into transactions with its affiliates that are offering direct access within a utility's service territory but the electric utility shall limit its transactions so that the utility's affiliates do not have greater than 20% market share for each class (based on volume) among those customers choosing direct access. This 20% market share will be calculated separately for residential, commercial, and industrial customers. For example, if 50% of the industrial customers choose to remain with the utility as the default energy provider, the utility's affiliates will be limited to providing

energy services to 10% (by volume) of the direct access market (20% of the 50% of the market choosing direct access.) Requiring that the 20% limitation be applied separately to each market (residential, commercial, industrial) ensures that the utility's affiliates do not gain an overwhelming share of any one market segment. Consistent with the recommendation of TURN and ORA, we will keep these limitations in place for two years, at which time we will examine whether the limitation needs to be eliminated or modified to continue until the end of the transition period for transition cost recovery (no later than March 31, 2002).

"In comments, several parties have stated that keeping the utilities' affiliates out of the direct access market may limit the number of energy service providers offering a renewable energy portfolio to residential customers. To address this concern, the provision of renewable power to residential customers by an affiliate of the utility shall not be counted toward calculation of the 20% market share for the residential class. For example, if 20% of the residential customers sign up for direct access, and 5% of the residential customers sign up for renewable energy from an utility affiliate, than the utility's affiliate may sign up an additional 3% of the residential customers by volume (20% of the 15%.)

"One way in which to look at this 20% limitation is that it is consistent with the guidelines for a competitive marketplace of having five firms of roughly-equal size. An equally compelling reason is that it recognizes the validity of TURN's and ORA's concerns. If soon after restructuring begins, the utilities' affiliates quickly gain their full 20% share of the market and it appears that this percentage would have gone significantly higher absent the limitation, then we will have a better sense of the importance of utility affiliation in marketing to direct access customers. Conversely, if the utility's affiliates fail to gain a 20% market share, then we will have a better sense that either our adopted safeguards are effective or that the advantage of utility affiliation is not as great a concern as we thought. Setting the initial limit at a relatively low level also prevents us from having to take extensive remedial action should the affiliates have an unfair advantage. We therefore believe that these limitations

represent a valid compromise that recognizes the concerns of ORA and TURN as well as the Joint Utilities Respondents.

"We agree with TURN and ORA that we have the jurisdiction to take this action. The investor-owned utilities have an exclusive franchise over their service territory. Except for the case of a municipal utility, we have plenary authority to regulate the utilities in the public interest. PU Code § 701 provides that we may "supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction." We also believe this these limitation are consistent with our obligation to review market power and antitrust issues (see *Northern California Power Agency v PUC,* 5 Cal.3d 370 (1971).

"Here, we believe that this 20% limitation is a practical and effective means to ensure effective competition in the direct access market within each utility's service territory. Our market power concerns are heightened with respect to electric utility affiliates offering direct access services within the service territory of the electric utility. Entities offering direct access service to customers must acquire access to essential facilities over which the utility has monopoly or near monopoly control. For example, every energy service provider (ESP) must have its Direct Access Service Requests (DASRs) processed by the utility, and the utility's distribution system is used to deliver electricity to direct access customers. This control of bottleneck facilities by the UDC heightens market power concerns unrelated to the generation market and market power concerns that go beyond the concerns raised by the actions of affiliates in other markets. We are concerned that the control of essential facilities by the utility could allow it to favor its own affiliate at the expense of the others competitors. We do not apply these limitations for natural gas only companies competing in the direct access market. These companies do not have control of the essential services needed to complete a direct access transaction.

"We are also concerned that in the case of electric utility affiliates offering direct access, the unregulated affiliate would be competing against the regulated utility. We are concerned that this would enable a utility to transfer customers, business and

profits from a regulated firm to a unregulated firm and could impede the ability of this Commission to set reasonable rates. To put this in the proper context, we note that we have yet to allow affiliates of Pacific Bell or GTEC to offer local exchange service within the service territories of the local telephone utility.

"Ideally, all of the potential abuses mentioned above will be precluded or eliminated by the totality of the affiliate rules that we adopt in this decision. To provide a further safeguard, and to protect against inadvertent omissions in our affiliate rules, we believe that the limitations on a utility's affiliate's involvement in direct access are appropriate.

"We believe that these limitations are consistent with D.91-02-022, 39 CPUC2d 321, 324-325, and that we have jurisdiction to impose these limitations. In this decision, we modified an earlier prohibition on new utility marketing affiliates, finding that we lacked jurisdiction. However, here we are adopting a temporary limitation on the volume and amount of transactions between a utility and an affiliate offering direct access within the service territory of the utility, not a ban on the formation of utility affiliates. Under, inter alia, § 701, we have the authority to prohibit all transactions between regulated utilities and their unregulated affiliates within the utility's service territory. Our adopted rule does not prohibit these transactions, but it does set appropriate limits during the movement to competition."

4. Finding of Fact 12 should be deleted and replaced with the following:

"12. Allowing an electric utility to enter into transactions with its affiliates that are offering direct access within a utility's service territory but limiting the electric utility's transactions so that the utility's affiliates do not have greater than 20% market share (based on volume) by class among those customers choosing direct access adequately addresses the issues raised by TURN and ORA in their motion, promotes competition, and sets a low enough limit that the Commission can take remedial action should there be additional market power problems. This 20% market share should be calculated separately for residential, commercial, and industrial customers except that to promote renewable energy usage, the provision of renewable power to residential

customers by an affiliate of the utility shall not be counted toward calculation of the 20% market share for the residential class."

5. Conclusion of Law 5 is deleted and the following Conclusion of Law 5 should be added:

"5. Imposing a limitation that a utility shall not have transactions with an affiliate such that the affiliate serves more than 20% of the market for direct access customers (calculated by volume separately for the residential, commercial, and industrial class, and excluding renewable energy for residential customers, fairly and reasonably addresses the concerns raised by TURN's June 2, 1997 motion requesting a provisional prohibition on marketing by the affiliate of gas or electric distribution company within the utility's service territory and ORA's June 2, 1997 motion proposing that customers of the natural gas local distribution companies and electric utility distribution companies shall not receive products or services from unregulated affiliates of the gas and electric utilities from which they receive distribution services. TURN's and ORA's motion are therefore denied in part, and granted in part as more specifically discussed in this decision."

6. Ordering Paragraph 5 is deleted and the following Ordering Paragraph 5 is added:

"5. Each electric utility shall limit its transactions with its affiliates that are offering direct access within a utility's service territory so that the utility's affiliates do not have greater than 20% market share (based on volume) among those customers choosing direct access. This 20% market share will be calculated separately for residential, commercial, and industrial customers as outlined in this decision. The provision of renewable power to residential customers by an affiliate of the utility shall not be counted toward calculation of the 20% market share for the residential class as outlined in this decision. Each electric utility shall submit quarterly reports to the Energy Division addressing the calculation and determination of their relevant market share and their compliance with these limitations.

"The Utility Reform Network's June 2, 1997 motion requesting a provisional prohibition on marketing by the affiliate of gas or electric distribution company within the utility's service territory and the Office of Ratepayer Advocate's (ORA) June 2, 1997 motion proposing that customers of the natural gas local distribution companies and electric utility distribution companies shall not receive products or services from unregulated affiliates of the gas and electric utilities from which they receive distribution services is denied in part, and granted in part, as more specifically discussed in this decision."

7. The following text, labeled **"VIII. Limitations on Direct Access Transactions"** should be added to Appendix A:

"Each electric utility shall limit its transactions with its affiliates that are offering direct access within a utility's service territory so that the utility's affiliates do not have greater than 20% market share (based on volume) among those customers choosing direct access. This 20% market share will be calculated separately for residential, commercial, and industrial customers. The provision of renewable power to residential customers through direct access by an affiliate of the utility shall not be counted toward calculation of the 20% market share for the residential class. Each electric utility shall submit quarterly reports to the Energy Division, commencing March 31, 1998, addressing the calculation and determination of their relevant market share and their compliance with these limitations."

8. Part G.1. of Existing Section V of Appendix A (page 12), should be deleted and replaced with the following:

"Except as permitted in Section V E (corporate support), a utility and its affiliates shall not jointly employ the same employees. This rule prohibiting joint employees also applies to Board Directors and corporate officers except that a Board Director or corporate officer may serve on the holding company and either the utility or an affiliate but not both.