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September 22, 1999

Florida Public Service Commission
Clerk's Office
Ms. Blanca Bayó
Director, Division of Records & Reporting
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

RE: Docket No. 980643-EI

Dear Ms. Bayó,

Enclosed please find an original and 15 copies of Enron's comments regarding Florida Cost Allocation and Affiliate Transactions.

Should you have any questions, please do not hesitate to contact me at 713-853-9193. Thank you for your attention to this matter.

Sincerely,

Lara Leibman

Lara Leibman
Manager
State Government Affairs

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ENRON'S COMMENTS REGARDING FLORIDA COST ALLOCATION AND AFFILIATE TRANSACTION DOCKET NO. 980643-EI

September 22, 1999

I. Introduction

Enron Energy Services, Inc. ("Enron") would like to thank the Florida Public Service Commission ("Commission") for the opportunity to submit these comments regarding Staff's proposed cost allocation and affiliate transaction rules ("Proposed Rules"). Proper affiliate rules prevent the sharing of competitively sensitive information and discriminatory access to goods and services, provide sufficient separation to achieve those goals, and have adequate penalties to enforce the code. Enron believes its proposed Code of Conduct, attached hereto as "Appendix A," achieves those goals by protecting competition (and not competitors) and by ensuring that all unregulated companies operate under the same rules and with no advantages due to their affiliation. Moreover, Enron submits that rules governing cost allocation and utility-affiliate transactions can and should be consolidated into a single, comprehensive code of conduct.

A common theme among many incumbent utilities across the nation is the notion that while we need rules, we do not need them now. Commissions across the country disagree and so should Florida. The FERC saw fit to impose an affiliate code of conduct at the same time it issued Orders No. 888 and 636 which began wholesale competition in electric and gas pipeline markets, respectively. The need for affiliate rules is with us today. Florida cannot wait as the utilities are currently participating in competitive energy-related markets such as the heating, ventilation and air conditioning ("HVAC") markets. Moreover, Enron submits that Florida may forego many of the early benefits of

competition if it does not implement an affiliate code of conduct now, and the effect will be to give the incumbent utilities the retail electric and gas markets.

A. Structural Separation

In order for competition in the electric and gas industry to succeed and provide the anticipated benefits for the customer, it is important that there be a competitively neutral market for all participants in the competitive market. The most significant threat to the effective development of competition is residual market power. Residual market power is the ability of incumbent utilities to maintain market power as a result of customer inertia and the incumbents' ownership and control of essential facilities. This market power may be maintained by integrated utilities or can result from affiliate abuses. The potential for vertical market power abuse comes from a utility's ability to use its control and knowledge of generation operations and dispatch, transmission operation and capability, and distribution facilities, and the relationships developed by virtue of its monopoly franchise to the advantage of its own unregulated operations.

Enron's proposed code of conduct properly advocates the need for structural separation. A distinction needs to be drawn between functional and structural separation. Functional separation is inadequate because it is impossible for the regulatory process to police market power abuse completely. Structural separation, enforced by strong affiliate rules, will help mitigate market power and encourage the development of a competitive market that will benefit consumers. In many respects, the requirements for structural separation are drawn from FERC rules, and Enron recommends that the Commission consider the FERC guidelines when addressing this issue. For example, while the FERC requires maintenance in separate offices, it does not require those offices be in separate

buildings. Enron recommends that the Commission attribute the same interpretation to the applicable rule.

Structural separation is rooted in the belief that a regulated utility should only be allowed to engage in activities considered to be traditional utility services. Separation of regulated and unregulated activities further avoids the danger that unregulated activities may harm ratepayers or competitive markets through cross-subsidization. It reduces the opportunity for the utility to shift costs of competitive goods and services onto its utility customers.

Although Enron recognizes the need for employee separation, there are many more separation rules that this Commission should consider adopting if it means to prevent incumbents from leveraging their monopolist advantages into competitive businesses. For example, the above-mentioned Commissions' rules also include requirements pertaining to such issues as: joint marketing and advertising, information sharing, and employee migration between the utility and its affiliates. For a greater understanding of how other states have dealt with the issue of separation in an effort to ensure the mitigation of market power and consumer protection, Enron would refer the Commission to the rules adopted by the California, Nevada and Maine Commissions, attached hereto as "Appendix B."

B. Other Competitive Services

While utilities nationwide attempt to steer the focus of the code of conduct to affiliate transactions that deal only with commodity and access to distribution and/or transmission facilities, the Commission should not lose sight of the effect of these rules on other services. Utility affiliates, which provide demand side management services,

energy audits, appliance sales and repairs, etc., are all in a position to benefit from the sharing of confidential information and preferential access to utility goods and services. For that reason, the application of these rules to all affiliates, regulated and unregulated alike, is critical. Assuming the Commission adopts a rule that requires unbundling of energy services, it can be assumed that companies will want to compete to offer those unbundled services. It will be essential that strong affiliate rules be in effect to enable a competitive market to grow and prosper. In support of this, see the 1998 study performed by Spectrum Economics, Inc., on the "Impacts of Utility Entry into Air Conditioning Installation and Maintenance," attached hereto as "Appendix C."

At this time, however, it is imperative that the Commission effectively monitor and prohibit certain utility activity to ensure that unregulated activities are not being subsidized by the utility's captive ratepayers and information is not being shared improperly with the utility's competitive affiliates. Utilities must be prohibited from engaging in any competitive activities. No utility employees or resources should be devoted to forming, developing or engaging in competitive business activities, as ratepayers should not be required to subsidize the utilities' development of their unregulated businesses, and all interaction between those utilities and their affiliates must be closely monitored.[1]

[1] *E.g.*, Enron would refer the Commission to the electricity code of conduct proceeding currently underway in Missouri, where no legislation or a commission order is in place mandating electric restructuring, Docket No. EX-99-442.

Moreover, captive ratepayers should not be paying for the transfer of information and equipment from utilities to their competitive affiliates, or for advertising that promotes the name that the utility and the competitive affiliates will share. While the Commission has normally permitted ratepayers to be charged for advertising that promotes safety and reliability, these are not normal times. The Commission should monitor all such advertising, and ensure that ratepayers, including potential competitors of the utility's competitive affiliates who are ratepayers, are not forced to subsidize activities that promote name recognition for the utility's competitive affiliates.

II. Staff's Proposed Rules

Enron echoes the voices of the contractors who would like to see Staff's Proposed Rules broadened to encompass all aspects of utility transactions with their affiliates, not just cost accounting procedures. *See* Transcript, at p.10. While the underlying purpose of the Proposed Rules is "to establish cost allocation requirements to ensure proper accounting for affiliate transactions and utility nonregulated activities," Enron recommends that the purpose also address the need to establish standards of conduct for transactions between the utilities and their unregulated (*i.e.*, competitive) affiliates. *See id.* at pp.21, 23 (discussing elimination of the words "guidelines and reporting").

As previously stated, such standards would: (1) prevent the sharing of competitively sensitive information; (2) prevent discriminatory access to assets, goods and services; (3) provide sufficient separation of unregulated and regulated activities; and (4) provide adequate enforcement mechanisms to address violations of the rules. Only with the combination of strict cost allocation rules and standards of conduct requiring structural separation will the Commission truly be capable of monitoring cross-

subsidization and other anti-competitive behavior by the utilities. *See id.* at pp.67-68 (recognizing the need for structural separation).

Clearly, the potential for cross-subsidization exists today. *Id.* at p.16 (describing Florida Power's home writing insurance plan and air conditioning planned maintenance program). Enron submits that the proposed rules will not effectively protect consumers from this harmful and improper utility activity. *See id.* at pp. 55-59. Prohibiting the utility from using its employees, equipment and facilities with regard to its competitive activities or that of its unregulated affiliate, however, will better assist the Commission in policing this anti-competitive behavior. *Id.* at pp. 39-40 (discussing assets such as floor space devoted to unregulated activity). In addition, requiring utilities and their affiliates to keep separate books, accounts and records would better enable the Commission to monitor cross-subsidization. *Id.* at p.47 (recognizing the California model as an optimal solution); p. 131 (discussing current improper account practices by utilities). Thus, Enron believes that the proposed cost allocation rules, as modified by Enron below, should be incorporated into a code of conduct that requires structural separation and stringent affiliate rules.

A. Definitions – 25-6.1351 (Section 2)

1. Indirect Costs

Enron recommends that the definition of "indirect costs" be revised to also include assets. As such, the definition would read as follows: "Indirect Costs – Costs, including all overheads, that cannot be identified with a particular asset, service or product."

2. Subsidize

Subsidization does not only involve utility ratepayers paying "more than their share of costs associated with affiliate transactions and utility nonregulated activities." Enron submits that utility ratepayers should not be paying for *any* costs associated with utility ventures into unregulated markets. Subsidization occurs when the utility shifts any costs of competitive goods and services onto its utility customers. *Id.* at p.49 ("If they use any portion of the ratepayers' money, it's going to be a subsidy."). As a result, Enron respectfully requests that the definition of "subsidize" be revised to better reflect the reality of business practices.

B. Non-Tariffed Affiliate Transactions – 25-6.1351 (Section 3)

With regard to proposed Section 3(b), Staff appropriately requires a utility to charge its affiliate(s) at fully allocated cost for all non-tariffed services and products purchased by the affiliate(s) from the utility. Enron would include in Section 3(b) the word "asset" so that this provision would apply to the transfer of assets, services and products. Moreover, Enron believes that the exception is inconsistent with the rest of Section 3(b). Apparently, Staff is still considering revision to this section. *See id.* at pp. 71-72. As a result, if Staff chooses to maintain an exception at all, then Enron respectfully requests that Staff revise the exception to read as follows: "Except, a utility may charge an affiliate the greater of fully allocated costs or market value." In addition, Enron believes that the utilities certainly should have to petition the Commission for any exemption from the rules.

In addition, Enron submits that certain utilities incorrectly allege that the Securities and Exchange Commission's ("SEC") rules would exempt them from pricing transactions with their affiliates at market value or anything other than a cost basis. *See*

id. at pp.76-77 (comments by Mr. McMillan on behalf of Gulf Power Company). In fact, the novelty of such situations has caused the SEC to comment on the need for new approaches and the inadequacies of existing rules. For example, with respect to those instances where goods and services are flowing from the utility to an unregulated affiliate, the SEC has stated: "A new standard of review for transactions between utility and nonutility associate companies may also be appropriate where the utility is the seller of goods or the service provider."[2] Staff correctly surmises that the Commission's jurisdiction over retail rates would still permit it to set the appropriate transfer pricing mechanisms without being preempted by the SEC. *See* Transcript, at p.78. Moreover, Enron submits that asymmetrical pricing must be in place in order to avoid cross-subsidization by the utilities of their unregulated affiliates.

C. Cost Allocation Principles – 25-6.1351 (Section 4)

Enron requests that Staff revise proposed Section 4(a) to include the word "assets" so that the rule would read as follows: "Utility accounting records must show whether each transaction involves an asset, product or service that is regulated or nonregulated." Enron has the same request for proposed Section 4(b) so that the rule would require direct costs to be assigned to "each asset, service and product provided by the utility."

With regard to proposed Section 4(c), Enron does not understand Staff's treatment of indirect costs. Indirect costs are assigned to a regulated function or activity as there are no indirect costs associated with non-regulated components of assets, services or products in utility rates for service. All indirect costs should be assigned to the regulated

[2] *The Regulation of Public-Utility Holding Companies,* Division of Investment, Management, Securities and Exchange Commission (June 1995).

component of a balance sheet in accordance with generally accepted cost allocation methodologies for establishing regulated rates. As a result, there should not be any indirect costs left to "distribute" or allocate elsewhere. Finally, regarding the exception proposed in Section 4(c), Enron would agree to the maintenance of this exception provided any asset, service or product made available by the utility to its affiliate were made available to third parties on an equal and nondiscriminatory basis. Also, the utilities would have to petition the Commission for such an exception. However, Enron seeks clarification from Staff as to how a utility would distribute indirect costs on an incremental or market basis.

With regard to proposed Section 4(d), Enron respectfully requests that Staff revise this rule to include the word "assets" to read as follows: "Each utility must maintain a listing of revenues and expenses for all non-tariffed assets, products and services."

D. Definition of "Net Book Value" – 25-6.0436

Enron respectfully requests that Staff revise the definition of "net book value" to reflect the following:

> Net Book Value – The recorded cost of an asset or liability less accumulated depreciation and amortization plus allocated general and intangible plant and other regulated rate base elements or considerations directly or indirectly attributable to the function and recorded purpose of the asset or liability.

APPENDIX A

ENRON'S PROPOSED CODE OF CONDUCT

Section I: Definitions

For purposes of this Code of Conduct, the following definitions apply:

a. "**Affiliate**" means any affiliated interest, including any person, corporation, local distribution company, partnership, or any separate legal entity owned by or subject to control of the local distribution company or any of its subsidiaries or its parent.
b. **"Commission"** means the Public Service Commission of Florida, or any successor thereto.
c. **"Retail Electric Supplier"** means any entity or entities, including aggregators, brokers, and marketers, offering electricity and/or energy-related services to the public, by sale or otherwise.
d. **"Local Distribution Company"** means the entity controlling or operating facilities for the distribution of electricity to the public.
e. **"Retail Distribution Service Tariff"** means the tariff(s) on file with the Commission that requires the local distribution company to make retail electric service available to all retail electric consumers in the local distribution company's service area on a non-discriminatory and comparable basis.
f. **"Customer Information"** means non-public information and data specific to a local distribution company's customer which the local distribution company acquired or developed in the course of its provision of utility services.
g. **"Customer"** means any person or corporation that is the ultimate retail consumer of goods and services.
h. **"Fully loaded cost"** means the direct cost of good or service plus all applicable indirect charges and overheads.
i. "**FERC**" means the Federal Energy Regulatory Commission.

Section II. Nondiscrimination

A. No Preferential Treatment Regarding Services Provided by the Utility: Unless otherwise authorized by the Commission or the FERC, or permitted by these rules, a local distribution company shall not:

1. represent that, as a result of the affiliation with the local distribution company, its affiliate(s) or customers of its affiliate(s) will receive any different treatment by the local distribution company than the treatment the local distribution company provides to other, unaffiliated retail electric suppliers or their customers; or
2. provide its affiliate(s), or customers of its affiliate(s), any preference (including but not limited to terms and conditions, pricing, or timing) over unaffiliated retail electric suppliers or their customers in the provision of services provided by the local distribution company.

B. Affiliate Transactions

1. In its dealings with its affiliate(s), a local distribution company may not discriminate between its affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards.
2. A local distribution company shall apply any tariff provision that allows for discretion in its application in the same manner for its affiliate(s) and other market participants and their respective customers. If the local distribution company has no discretion in the application of a tariff provision, then it shall strictly enforce that tariff provision.
3. If a local distribution company offers its affiliate(s) a discount, rebate, or other waiver of any charge or fee, the local distribution company shall contemporaneously make such discount or waiver applicable to all competitors serving the same market as the local distribution company.
4. A local distribution company shall process requests for similar services provided by the local distribution company in the same manner and within the same time for its affiliate(s) and for all other market participants and their respective customers.
5. A local distribution company shall not condition or tie the provision of any services provided by the local distribution company, nor the availability of discounts, rates, other charges, fees, rebates, or waivers of terms and conditions to the taking of any goods or services from its affiliate(s).
6. A local distribution company shall not assign customers to which it currently provides services to any of its affiliates, whether by default, direct assignment, option or by any other means, unless that means is equally available to all competitors.
7. Except as otherwise provided by these rules, a local distribution company shall not:

   (a) provide leads to its affiliate(s); (b) solicit business on behalf of its affiliate(s); (c) acquire information on behalf of or to provide to its affiliate(s); (d) share market analysis reports or any other types of proprietary or non-publicly available reports, including but not limited to market, forecast, planning or strategic reports, with its affiliate(s); (e) request authorization from its customers to pass on customer information exclusively to its affiliate(s); (f) give the appearance that the local distribution company speaks on behalf of its affiliate(s) or that the customer will receive preferential treatment as a consequence of conducting business with the affiliate(s); or (g) give any appearance that the affiliate speaks on behalf of the local distribution company.

Section III. <u>Information</u>

A. Disclosure

1. A local distribution company shall provide customer information to its

affiliate(s) and unaffiliated electric suppliers on a strictly nondiscriminatory basis, and only with prior affirmative customer written consent.

2. Local distribution companies shall not disclose to their affiliates any information which a local distribution company receives from an unaffiliated customer or alternative retail electric supplier; a potential customer or retail electric supplier; or any agent or contractor of such customer or potential customer.
3. Information which is not specific to a customer, including but not limited to information about a local distribution company's goods, purchases, sales, or operations, shall be available to the local distribution company's affiliate(s) only if the local distribution company makes that information contemporaneously available to all other service providers on the same terms and conditions, and keeps the information open to public inspection.
4. Except upon request by a customer or as otherwise authorized by the Commission, a local distribution company shall not provide its customer with any list of retail electric suppliers. Such list shall include the entities' names, addresses, telephone numbers, fax numbers, and internet addresses, if any. Providers shall be listed in a manner that does not identify the affiliate relationship or emphasize affiliates in any way.
5. Except as provided in these rules, a local distribution company shall not offer or provide customers advice or assistance of any kind with regard to its affiliate(s) or other retail electric suppliers.

B. Record-keeping

1. Each local distribution company and its affiliated interests shall maintain their books and records in accordance with applicable Uniform System and Accounts (USOA) and Generally Accepted Accounting Procedures (GAAP).
2. A local distribution company shall maintain contemporaneous records documenting all tariffed and non-tariffed transactions with its affiliate(s), including but not limited to, all waivers of tariff or contract provisions, all discounts, the name of the affiliated interest involved in the transaction, a description of the transaction, the time period over which the transaction applies, and the terms and conditions involved in the transaction. A local distribution company shall maintain such records for a minimum of three years, and longer if this Commission or another government agency so requires. The local distribution company shall make such records available for third party review upon 72 hours notice, or at a time mutually agreeable to the local distribution company and third party.
3. The local distribution company shall maintain a record of all contracts and related bids for the provision of work, products or services to and from the local distribution company to its affiliate(s) for a minimum of three years.

Section IV. Separation

A. Corporate Entities: A local distribution company and its affiliate(s) shall be separate

corporate entities.

B. Books and Records: A local distribution company and its affiliated interests shall maintain separate books, accounts, and records and such records shall be kept in accordance with applicable Uniform System and Accounts (USOA) and Generally Accepted Accounting Procedures (GAAP). Transactions between the local distribution company and its affiliate(s) shall be recorded in separate sub-accounts.

C. Sharing of Plant, Facilities, Equipment, or Costs: A local distribution company shall not share office space, office equipment, services, and systems with its affiliate(s), nor shall a local distribution company access the computer or information systems of its affiliate(s) or allow its affiliate(s) to access its computer or information systems, except to the extent appropriate to perform shared corporate support functions permitted under this section.

D. Joint Purchases: The local distribution company and its affiliate(s) may not make joint purchases of goods and services associated with the traditional utility merchant function. To the extent that a local distribution company is engaged in the marketing of the commodity of electricity to customers, it is engaging in the traditional merchant function. Examples of permissible joint purchases include: joint purchases of office supplies and telephone services. Examples of joint purchases not permitted include: electric purchasing for resale, purchasing of electric transmission, systems operations, and marketing. The local distribution company must ensure that all joint purchases are priced, reported, and conducted in a manner that permits clear identification of the local distribution company and affiliate portions of such purchases, and in accordance with applicable Commission allocation and reporting rules.

E. Corporate Support: As a general principle, a local distribution company, its parent holding company, or a separate affiliate created solely to perform corporate support services may share with its affiliate(s) joint corporate oversight, governance, support systems, and personnel. Any shared support shall be priced, reported, and conducted in accordance with these rules, as well as other applicable Commission pricing and reporting requirements. As a general principle, such joint utilization shall not allow or provide a means for the transfer of confidential information from the local distribution company to the affiliate(s), create the opportunity for preferential treatment or unfair competitive advantage, lead to customer confusion, or create significant opportunities for cross-subsidization of affiliates. Examples of services that may be shared include: payroll, taxes, shareholder services, insurance, financial planning and analysis, corporate accounting, corporate security, human resources (compensation, benefits, employment policies), employee records, regulatory affairs, lobbying, legal, telecommunications, and pension management. Examples of services that may not be shared include: engineering, hedging and financial derivatives and arbitrage services, electric purchasing for resale, purchasing of electric transmission, system operations, and marketing.

F. Corporate Identification and Advertising:

1. An affiliate of a local distribution company shall not trade upon, promote, or advertise its affiliation with the local distribution company, nor use the name or logo of the local distribution company in any material circulated.

2. An affiliate of a local distribution company shall not use any space in any correspondence of the local distribution company for the purpose of advertising its services.
3. A local distribution company, through action or words, shall not represent that, as a result of the affiliate's affiliation with the local distribution company, its affiliate(s) will receive any different treatment than other service providers.
4. A local distribution company shall not participate in joint advertising or joint marketing with its affiliate(s). This prohibition means that local distribution companies may not engage in activities which include, but are not limited to the following:
    (a) A local distribution company shall not participate with its affiliate(s) in joint sales calls, through joint call centers or otherwise, or joint proposals (including responses to requests for proposals (RFPs)) to existing or potential customers. At a customer's unsolicited request, a local distribution company may participate, on a nondiscriminatory basis, in non-sales meetings with its affiliate(s) or any other market participant to discuss technical or operational subjects regarding the local distribution company's provision of transportation service to the customer.
    (b) A local distribution company shall not share or subsidize costs, fees, or payments with its affiliate(s) associated with research and development activities or investment in advanced technology research.

G. Employees: Except as permitted under "corporate support," a local distribution company and its affiliate(s) shall not jointly employ the same employees. In the case of shared directors and officers, a corporate officer from the utility and, where applicable, holding company, shall verify in the utility's compliance plan the adequacy of the specific mechanisms and procedures in place to ensure that the utility is not utilizing shared officers and directors to circumvent any of these rules.

1. A local distribution company shall track and report annually to the Commission all employee movement between the local distribution company and its affiliate(s).
2. Once an employee of a local distribution company becomes an employee of an affiliate, the employee may not return to the local distribution company for a period of one year. This rule is inapplicable if the affiliate to which the employee transfers goes out of business during the one-year period. In the event that such an employee returns to the local distribution company, such employee cannot be retransferred, reassigned, or otherwise employed by the affiliate for a period of one year.
3. Any employee of a local distribution company hired by an affiliate shall not remove or otherwise provide or use proprietary property or information gained from the local distribution company in a discriminatory or exclusive fashion, to the benefit of the affiliate or to the detriment of other unaffiliated retail electric suppliers.
4. Transferring employees must sign a statement indicating that they are aware of

and understand the restrictions set forth in the Code and the attendant consequences.

5. A local distribution company shall not make temporary or intermittent assignments or rotations of its affiliate(s).

H. Transfer of Goods and Services: In all proceedings, filings, complaints or investigations relating to this subsection, the local distribution company shall have the burden of proof in establishing the fair market value.

1. Transfers from a local distribution company to its affiliate(s) of goods and services produced, purchased or developed for sale on the open market shall be priced at fair market value.
2. Transfers from an affiliate to the local distribution company of goods or services produced, purchased or developed for sale on the open market shall be priced at the lower of cost or fair market value.
3. Goods and services produced, purchased or developed for sale on the open market by the local distribution company shall be provided to its affiliate(s) and unaffiliated companies on a nondiscriminatory basis.
4. Transfers from a local distribution company to its affiliate(s) of goods or services not generally meant for sale on the open market shall be priced at fully loaded cost.
5. Transfers from an affiliate to the local distribution company of goods or services not generally meant for sale on the open market shall be priced at the lower of fully loaded cost or fair market value.

V. Regulatory Oversight

A. Compliance Plans: Each local distribution company shall file with the Commission a compliance plan conforming to the terms and conditions set forth in this Code. Upon the creation of a new affiliate, the local distribution company shall immediately file a compliance plan for such affiliate.

B. Affiliate Audit: No later than December 31, 1998, and every year thereafter, the local distribution company shall have audits prepared by independent auditors that verify that the local distribution company is in compliance with the Code. The local distribution company shall file this audit with the Commission beginning no later than December 31, 1998, and serve it on all parties to this proceeding. The audits shall be at shareholder expense.

C. Complaint Procedure: Local distribution companies shall establish and file with the Commission a complaint procedure. All complaints, whether written or verbal, shall be referred to the general counsel of the local distribution company. The general counsel shall verbally acknowledge such complaint within five working days of receipt. The general counsel shall prepare a written statement of the complaint which shall contain the name of the complainant and a detailed factual report of the complaint, including all relevant dates, companies involved, employees involved, and the specific claim. The general counsel shall provide a copy of the statement to the complainant and shall communicate the results of the preliminary investigation to the

complainant in writing within thirty days after the complaint was received including a description of any course of action which will be taken. In the event the local distribution company and the complainant are unable to resolve the complaint, the complainant may address the complaint to the Commission. If the Commission determines that probable cause exists for the complaint, it shall order a hearing, give notice of the hearing and conduct the hearing as it would any other hearing.

D. Complaint Log: Each local distribution company shall maintain a log of all new, resolved and pending complaints. The log shall be available to the public upon request and shall be filed annually with the Commission. The log shall include, at a minimum, a written statement of the complaint and the resolution of the complaint or an explanation why the complaint is still pending.

E. Penalties: In addition to other penalties available under the Commission's rules and regulations, the Commission shall have the authority to do any of the following: (i) terminate the transaction; (ii) prospectively limit or restrict the amount, percentage, or value of transactions entered into between a local distribution company and its affiliate(s) as a remedy for a violation of these standards; (iii) assess such penalties as described in subsections (1) and (2) of this section; or (iv) apply any other remedy available to the Commission.

1. Penalties shall reflect the actual or potential injury, or both, to ratepayers and competitors, and the gravity of the violation. Repeated violations will require more severe penalties. Specifically, in addition to any other penalties, if any local distribution company found by the Commission to have violated these rules, fails to perform a duty imposed on it, or fails, neglects, or refuses to obey an order, regulation, directive, or requirement of the Commission, such local distribution company shall be subject to a penalty of no less than $5,000 nor more than $20,000 for each separate violation. The Commission may deem a violation which continues for more than one day to be separate violations for each day a violation described herein continues.
2. Any penalties assessed by the Commission will in no manner preclude a party's rights to pursue damages in a court of competent jurisdiction.
3. If the Commission, in two separate orders, finds that a local distribution company has violated these standards more than twice in a period of twelve months, such finding will trigger a prohibition for one year on the local distribution company's entry into any transactions with the affiliate(s) involved in such violations. In the event that such prohibition is not honored, the Commission may consider extension of the prohibition period as appropriate or may permanently preclude the local distribution company from dealing with the affiliate(s) in the local distribution company's service territory. The mandatory penalties set forth in subsection (1) of this section do not preclude any other penalties set forth in these rules or this state's statutes.
4. For each violation of these rules, the local distribution company will be obligated to place in one monthly billing packet a notice, written by the Commission, which informs the public of the substance of the violation and explains how similar violations can be reported by members of the public.

APPENDIX B

Affiliate Transaction Rules

I. Definitions

Unless the context otherwise requires, the following definitions govern the construction of these Rules:

A. "Affiliate" means any person, corporation, utility, partnership, or other entity 5 per cent or more of whose outstanding securities are owned, controlled, or held with power to vote, directly or indirectly either by a utility or any of its subsidiaries, or by that utility's controlling corporation and/or any of its subsidiaries as well as any company in which the utility, its controlling corporation, or any of the utility's affiliates exert substantial control over the operation of the company and/or indirectly have substantial financial interests in the company exercised through means other than ownership. For purposes of these Rules, "substantial control" includes, but is not limited to, the possession, directly or indirectly and whether acting alone or in conjunction with others, of the authority to direct or cause the direction of the management or policies of a company. A direct or indirect voting interest of 5% or more by the utility in an entity's company creates a rebuttable presumption of control.

For purposes of this Rule, "affiliate" shall include the utility's parent or holding company, or any company which directly or indirectly owns, controls, or holds the power to vote 10% or more of the outstanding voting securities of a utility (holding company), to the extent the holding company is engaged in the provision of products or services as set out in Rule II B. However, in its compliance plan filed pursuant to Rule VI, the utility shall demonstrate both the specific mechanism and procedures that the utility and holding company have in place to assure that the utility is not utilizing the holding company or any of its affiliates not covered by these Rules as a conduit to circumvent any of these Rules. Examples include but are not limited to specific mechanisms and procedures to assure the Commission that the utility will not use the holding company or another utility affiliate not covered by these Rules as a vehicle to (1) disseminate information transferred to them by the utility to an affiliate covered by these Rules in contravention of these Rules, (2) provide services to its affiliates covered by these Rules in contravention of these Rules or (3) to transfer employees to its affiliates covered by these Rules in contravention of these Rules. In the compliance plan, a corporate officer from the utility and holding company shall verify the adequacy of these specific mechanisms and procedures to ensure that the utility is not utilizing the holding company or any of its affiliates not covered by these Rules as a conduit to circumvent any of these Rules.

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

B. "Commission" means the California Public Utilities Commission or its succeeding state regulatory body.

C. "Customer" means any person or corporation, as defined in Sections 204, 205 and 206 of the California Public Utilities Code, that is the ultimate consumer of goods and services.

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

E. "FERC" means the Federal Energy Regulatory Commission.

F. "Fully Loaded Cost" means the direct cost of good or service plus all applicable indirect charges and overheads.

G. "Utility" means any public utility subject to the jurisdiction of the Commission as an Electrical Corporation or Gas Corporation, as defined in California Public Utilities Code Sections 218 and 222.

II. Applicability

A. These Rules shall apply to California public utility gas corporations and California public utility electrical corporations, subject to regulation by the California Public Utilities Commission.

B. For purposes of a combined gas and electric utility, these Rules apply to all utility transactions with affiliates engaging in the provision of a product that uses gas or electricity or the provision of services that relate to the use of gas or electricity, unless specifically exempted below. For purposes of an electric utility, these Rules apply to all utility transactions with affiliates engaging in the provision of a product that uses electricity or the provision of services that

relate to the use of electricity. For purposes of a gas utility, these Rules apply to all utility transactions with affiliates engaging in the provision of a product that uses gas or the provision of services that relate to the use of gas.

C. These Rules apply to transactions between a Commission-regulated utility and another affiliated utility, unless specifically modified by the Commission in addressing a separate application to merge or otherwise conduct joint ventures related to regulated services.

D. These rules do not apply to the exchange of operating information, including the disclosure of customer information to its FERC-regulated affiliate to the extent such information is required by the affiliate to schedule and confirm nominations for the interstate transportation of natural gas, between a utility and its FERC-regulated affiliate, to the extent that the affiliate operates an interstate natural gas pipeline.

E. **Existing Rules**: Existing Commission rules for each utility and its parent holding company shall continue to apply except to the extent they conflict with these Rules. In such cases, these Rules shall supersede prior rules and guidelines, provided that nothing herein shall preclude (1) the Commission from adopting other utility-specific guidelines; or (2) a utility or its parent holding company from adopting other utility-specific guidelines, with advance Commission approval.

F. **Civil Relief**: These Rules shall not preclude or stay any form of civil relief, or rights or defenses thereto, that may be available under state or federal law.

G. **Exemption (Advice Letter)**: A Commission-jurisdictional utility may be exempted from these Rules if it files an advice letter with the Commission requesting exemption. The utility shall file the advice letter within 30 days after the effective date of this decision adopting these Rules and shall serve it on all parties to this proceeding. In the advice letter filing, the utility shall:

1. Attest that no affiliate of the utility provides services as defined by Rule II B above; and

2. Attest that if an affiliate is subsequently created which provides services as defined by Rule II B above, then the utility shall:

   a. Notify the Commission, at least 30 days before the affiliate begins to provide services as defined by Rule II B above, that such an affiliate has been created; notification shall be accomplished by means of a

letter to the Executive Director, served on all parties to this proceeding; and

b. Agree in this notice to comply with the Rules in their entirety.

H. **Limited Exemption (Application):** A California utility which is also a multi-state utility and subject to the jurisdiction of other state regulatory commissions, may file an application, served on all parties to this proceeding, requesting a limited exemption from these Rules or a part thereof, for transactions between the utility solely in its capacity serving its jurisdictional areas wholly outside of California, and its affiliates. The applicant has the burden of proof.

I. These Rules should be interpreted broadly, to effectuate our stated objectives of fostering competition and protecting consumer interests. If any provision of these Rules, or the application thereof to any person, company, or circumstance, is held invalid, the remainder of the Rules, or the application of such provision to other persons, companies, or circumstances, shall not be affected thereby.

III. Nondiscrimination

A. **No Preferential Treatment Regarding Services Provided by the Utility:** Unless otherwise authorized by the Commission or the FERC, or permitted by these Rules, a utility shall not:

1. represent that, as a result of the affiliation with the utility, its affiliates or customers of its affiliates will receive any different treatment by the utility than the treatment the utility provides to other, unaffiliated companies or their customers; or

2. provide its affiliates, or customers of its affiliates, any preference (including but not limited to terms and conditions, pricing, or timing) over non-affiliated suppliers or their customers in the provision of services provided by the utility.

B. **Affiliate Transactions:** Transactions between a utility and its affiliates shall be limited to tariffed products and services, the sale or purchase of goods, property, products or services made generally available by the utility or affiliate to all market participants through an open, competitive bidding process, or as provided for in Sections V D and V E (joint purchases and corporate support) and Section VII (new products and services) below, provided the transactions provided for in Section VII comply with all of the other adopted Rules.

1. **Provision of Supply, Capacity, Services or Information:** Except as provided for in Sections V D, V E, and VII, provided the transactions provided for in Section VII comply with all of the other adopted Rules, a utility shall provide access to utility information, services, and unused capacity or supply on the same terms for all similarly situated market participants. If a utility provides supply, capacity, services, or information to its affiliate(s), it shall contemporaneously make the offering available to all similarly situated market participants, which include all competitors serving the same market as the utility's affiliates.

2. **Offering of Discounts:** Except when made generally available by the utility through an open, competitive bidding process, if a utility offers a discount or waives all or any part of any other charge or fee to its affiliates, or offers a discount or waiver for a transaction in which its affiliates are involved, the utility shall contemporaneously make such discount or waiver available to all similarly situated market participants. The utilities should not use the "similarly situated" qualification to create such a unique discount arrangement with their affiliates such that no competitor could be considered similarly situated. All competitors serving the same market as the utility's affiliates should be offered the same discount as the discount received by the affiliates. A utility shall document the cost differential underlying the discount to its affiliates in the affiliate discount report described in Rule III F 7 below.

3. **Tariff Discretion:** If a tariff provision allows for discretion in its application, a utility shall apply that tariff provision in the same manner to its affiliates and other market participants and their respective customers.

4. **No Tariff Discretion:** If a utility has no discretion in the application of a tariff provision, the utility shall strictly enforce that tariff provision.

5. **Processing Requests for Services Provided by the Utility:** A utility shall process requests for similar services provided by the utility in the same manner and within the same time for its affiliates and for all other market participants and their respective customers.

C. **Tying of Services Provided by a Utility Prohibited:** A utility shall not condition or otherwise tie the provision of any services provided by the utility, nor the availability of discounts of rates or other charges or fees, rebates, or waivers of terms and conditions of any services provided by the utility, to the taking of any goods or services from its affiliates.

D. **No Assignment of Customers:** A utility shall not assign customers to which it currently provides services to any of its affiliates, whether by default, direct assignment, option or by any other means, unless that means is equally available to all competitors.

E. **Business Development and Customer Relations:** Except as otherwise provided by these Rules, a utility shall not:

1. provide leads to its affiliates;

2. solicit business on behalf of its affiliates;

3. acquire information on behalf of or to provide to its affiliates;

4. share market analysis reports or any other types of proprietary or non-publicly available reports, including but not limited to market, forecast, planning or strategic reports, with its affiliates;

5. request authorization from its customers to pass on customer information exclusively to its affiliates;

6. give the appearance that the utility speaks on behalf of its affiliates or that the customer will receive preferential treatment as a consequence of conducting business with the affiliates; or

7. give any appearance that the affiliate speaks on behalf of the utility.

F. **Affiliate Discount Reports:** If a utility provides its affiliates a discount, rebate, or other waiver of any charge or fee associated with services provided by the utility, the utility shall, within 24 hours of the time at which the service provided by the utility is so provided, post a notice on its electronic bulletin board providing the following information:

1. the name of the affiliate involved in the transaction;

2. the rate charged;

3. the maximum rate;

4. the time period for which the discount or waiver applies;

5. the quantities involved in the transaction;

6. the delivery points involved in the transaction;

7. any conditions or requirements applicable to the discount or waiver, and a documentation of the cost differential underlying the discount as required in Rule III B 2 above; and

8. procedures by which a nonaffiliated entity may request a comparable offer.

A utility that provides an affiliate a discounted rate, rebate, or other waiver of a charge or fee associated with services provided by the utility shall maintain, for each billing period, the following information:

9. the name of the entity being provided services provided by the utility in the transaction;

10. the affiliate's role in the transaction (i.e., shipper, marketer, supplier, seller);

11. the duration of the discount or waiver;

12. the maximum rate;

13. the rate or fee actually charged during the billing period; and

14. the quantity of products or services scheduled at the discounted rate during the billing period for each delivery point.

All records maintained pursuant to this provision shall also conform to FERC rules where applicable.

IV. Disclosure and Information

A. **Customer Information:** A utility shall provide customer information to its affiliates and unaffiliated entities on a strictly non-discriminatory basis, and only with prior affirmative customer written consent.

B. **Non-Customer Specific Non-Public Information:** A utility shall make non-customer specific non-public information, including but not limited to information about a utility's natural gas or electricity purchases, sales, or

operations or about the utility's gas-related goods or services, electricity-related goods or services, available to the utility's affiliates only if the utility makes that information contemporaneously available to all other service providers on the same terms and conditions, and keeps the information open to public inspection. Unless otherwise provided by these Rules, a utility continues to be bound by all Commission-adopted pricing and reporting guidelines for such transactions. Utilities are also permitted to exchange proprietary information on an exclusive basis with their affiliates, provided the utility follows all Commission-adopted pricing and reporting guidelines for such transactions, and it is necessary to exchange this information in the provision of the corporate support services permitted by Rule V E below. The affiliate's use of such proprietary information is limited to use in conjunction with the permitted corporate support services, and is not permitted for any other use. Nothing in this Rule precludes the exchange of information pursuant to D.97-10-031.

C. **Service Provider Information:**

1. Except upon request by a customer or as otherwise authorized by the Commission, or approved by another governmental body, a utility shall not provide its customers with any list of service providers, which includes or identifies the utility's affiliates, regardless of whether such list also includes or identifies the names of unaffiliated entities. A utility shall submit lists approved by other governmental bodies in the first semi-annual advice letter filing referenced in Rule IV.C.2 following such approval, but may provide customers with such lists pending action on the advice letter.

2. If a customer requests information about any affiliated service provider, the utility shall provide a list of all providers of gas-related, electricity-related, or other utility-related goods and services operating in its service territory, including its affiliates. The Commission shall authorize, by semi-annual utility advice letter filing, and either the utility, the Commission, or a Commission-authorized third party provider shall maintain on file with the Commission a copy of the most updated lists of service providers which have been created to disseminate to a customer upon a customer's request. Any service provider may request that it be included on such list, and, barring Commission direction, the utility shall honor such request. Where maintenance of such list would be unduly burdensome due to the number of service providers, subject to Commission approval by advice letter filing, the utility shall direct the customer to a generally available listing of service providers (e.g., the Yellow Pages). In such cases, no list shall be provided. If there is no

Commission-authorized list available, utilities may refer customers to a generally available listing of service providers (e.g., the Yellow Pages.) The list of service providers should make clear that the Commission does not guarantee the financial stability or service quality of the service providers listed by the act of approving this list.

D. **Supplier Information**: A utility may provide non-public information and data which has been received from unaffiliated suppliers to its affiliates or non-affiliated entities only if the utility first obtains written affirmative authorization to do so from the supplier. A utility shall not actively solicit the release of such information exclusively to its own affiliate in an effort to keep such information from other unaffiliated entities.

E. **Affiliate-Related Advice or Assistance**: Except as otherwise provided in these Rules, a utility shall not offer or provide customers advice or assistance with regard to its affiliates or other service providers.

F. **Record-Keeping**: A utility shall maintain contemporaneous records documenting all tariffed and nontariffed transactions with its affiliates, including but not limited to, all waivers of tariff or contract provisions and all discounts. A utility shall maintain such records for a minimum of three years and longer if this Commission or another government agency so requires. The utility shall make such records available for third party review upon 72 hours' notice, or at a time mutually agreeable to the utility and third party.

If D.97-06-110 is applicable to the information the utility seeks to protect, the utility should follow the procedure set forth in D.97-06-110, except that the utility should serve the third party making the request in a manner that the third party receives the utility's D.97-06-110 request for confidentiality within 24 hours of service.

G. **Maintenance of Affiliate Contracts and Related Bids**: A utility shall maintain a record of all contracts and related bids for the provision of work, products or services to and from the utility to its affiliates for no less than a period of three years, and longer if this Commission or another government agency so requires.

H. **FERC Reporting Requirements:** To the extent that reporting rules imposed by the FERC require more detailed information or more expeditious reporting, nothing in these Rules shall be construed as modifying the FERC rules.

V. Separation

A. **Corporate Entities:** A utility and its affiliates shall be separate corporate entities.

B. **Books and Records:** A utility and its affiliates shall keep separate books and records.

1. Utility books and records shall be kept in accordance with applicable Uniform System of Accounts (USOA) and Generally Accepted Accounting Procedures (GAAP).

2. The books and records of affiliates shall be open for examination by the Commission and its staff consistent with the provisions of Public Utilities Code Section 314.

C. **Sharing of Plant, Facilities, Equipment or Costs:** A utility shall not share office space, office equipment, services, and systems with its affiliates, nor shall a utility access the computer or information systems of its affiliates or allow its affiliates to access its computer or information systems, except to the extent appropriate to perform shared corporate support functions permitted under Section V E of these Rules. Physical separation required by this rule shall be accomplished preferably by having office space in a separate building, or, in the alternative, through the use of separate elevator banks and/or security-controlled access. This provision does not preclude a utility from offering a joint service provided this service is authorized by the Commission and is available to all non-affiliated service providers on the same terms and conditions (e.g., joint billing services pursuant to D.97-05-039).

D. **Joint Purchases:** To the extent not precluded by any other Rule, the utilities and their affiliates may make joint purchases of good and services, but not those associated with the traditional utility merchant function. For purpose of these Rules, to the extent that a utility is engaged in the marketing of the commodity of electricity or natural gas to customers, as opposed to the marketing of transmission and distribution services, it is engaging in merchant functions. Examples of permissible joint purchases include joint

purchases of office supplies and telephone services. Examples of joint purchases not permitted include gas and electric purchasing for resale, purchasing of gas transportation and storage capacity, purchasing of electric transmission, systems operations, and marketing. The utility must insure that all joint purchases are priced, reported, and conducted in a manner that permits clear identification of the utility and affiliate portions of such purchases, and in accordance with applicable Commission allocation and reporting rules.

E. **Corporate Support**: As a general principle, a utility, its parent holding company, or a separate affiliate created solely to perform corporate support services may share with its affiliates joint corporate oversight, governance, support systems and personnel. Any shared support shall be priced, reported and conducted in accordance with the Separation and Information Standards set forth herein, as well as other applicable Commission pricing and reporting requirements.

As a general principle, such joint utilization 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. In the compliance plan, a corporate officer from the utility and holding company shall verify the adequacy of the specific mechanisms and procedures in place to ensure the utility follows the mandates of this paragraph, and to ensure the utility is not utilizing joint corporate support services as a conduit to circumvent these Rules.

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

Examples of services that may not be shared include: employee recruiting, engineering, hedging and financial derivatives and arbitrage services, gas and electric purchasing for resale, purchasing of gas transportation and storage capacity, purchasing of electric transmission, system operations, and marketing.

F. **Corporate Identification and Advertising:**

1. A utility shall not trade upon, promote, or advertise its affiliate's affiliation with the utility, nor allow the utility name or logo to be used by the affiliate or in any material circulated by the affiliate, unless it discloses in plain legible or audible language, on the first page or at the first point where the utility name or logo appears that:

   a. the affiliate "is not the same company as [i.e. PG&E, Edison, the Gas Company, etc.], the utility,";

   b. the affiliate is not regulated by the California Public Utilities Commission; and

   c. "you do not have to buy [the affiliate's] products in order to continue to receive quality regulated services from the utility."

   The application of the name/logo disclaimer is limited to the use of the name or logo in California.

2. A utility, through action or words, shall not represent that, as a result of the affiliate's affiliation with the utility, its affiliates will receive any different treatment than other service providers.

3. A utility shall not offer or provide to its affiliates advertising space in utility billing envelopes or any other form of utility customer written communication unless it provides access to all other unaffiliated service providers on the same terms and conditions.

4. A utility shall not participate in joint advertising or joint marketing with its affiliates. This prohibition means that utilities may not engage in activities which include, but are not limited to the following:

   a. A utility shall not participate with its affiliates in joint sales calls, through joint call centers or otherwise, or joint proposals (including responses to requests for proposals (RFPs)) to existing or potential customers. At a customer's unsolicited request, a utility may participate, on a nondiscriminatory basis, in non-sales meetings with its affiliates or any other market participant to discuss technical or operational subjects regarding the utility's provision of transportation service to the customer;

b. Except as otherwise provided for by these Rules, a utility shall not participate in any joint activity with its affiliates. The term "joint activities" includes, but is not limited to, advertising, sales, marketing, communications and correspondence with any existing or potential customer;

c. A utility shall not participate with its affiliates in trade shows, conferences, or other information or marketing events held in California.

5. A utility shall not share or subsidize costs, fees, or payments with its affiliates associated with research and development activities or investment in advanced technology research.

G. **Employees:**

1. 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 for the following circumstances: In instances when this Rule is applicable to holding companies, any board member or corporate officer may serve on the holding company and with either the utility or affiliate (but not both). Where the utility is a multi-state utility, is not a member of a holding company structure, and assumes the corporate governance functions for the affiliates, the prohibition against any board member or corporate officer of the utility also serving as a board member or corporate officer of an affiliate shall only apply to affiliates that operate within California. In the case of shared directors and officers, a corporate officer from the utility and holding company shall verify in the utility's compliance plan the adequacy of the specific mechanisms and procedures in place to ensure that the utility is not utilizing shared officers and directors as a conduit to circumvent any of these Rules. In its compliance plan required in Rule VI, the utility shall list all shared directors and officers between the utility and affiliates. No later than 30 days following a change to this list, the utility shall notify the Commission's Energy Division and the parties on the service list of R.97-04-011/I.97-04-012 of any change to this list.

2. All employee movement between a utility and its affiliates shall be consistent with the following provisions:

a. A utility shall track and report to the Commission all employee movement between the utility and affiliates. The utility shall report

this information annually pursuant to our Affiliate Transaction Reporting Decision, D.93-02-016, 48 CPUC2d 163, 171-172 and 180 (Appendix A, Section I and Section II H.).

b. Once an employee of a utility becomes an employee of an affiliate, the employee may not return to the utility for a period of one year. This Rule is inapplicable if the affiliate to which the employee transfers goes out of business during the one-year period. In the event that such an employee returns to the utility, such employee cannot be retransferred, reassigned, or otherwise employed by the affiliate for a period of two years. Employees transferring from the utility to the affiliate are expressly prohibited from using information gained from the utility in a discriminatory or exclusive fashion, to the benefit of the affiliate or to the detriment of other unaffiliated service providers.

c. When an employee of a utility is transferred, assigned, or otherwise employed by the affiliate, the affiliate shall make a one-time payment to the utility in an amount equivalent to 25% of the employee's base annual compensation, unless the utility can demonstrate that some lesser percentage (equal to at least 15%) is appropriate for the class of employee included. In the limited case where a rank-and-file (non-executive) employee's position is eliminated as a result of electric industry restructuring, a utility may demonstrate that no fee or a lesser percentage than 15% is appropriate. The Board of Directors must vote to classify these employees as "impacted" by electric restructuring- and these employees must be transferred no later than December 31, 1998, except for the transfer of employees working at divested plants. In that instance, the Board of Directors must vote to classify these employees as "impacted" by electric restructuring and these employees must be transferred no later than within 60 days after the end of the O&M contract with the new plant owners. All such fees paid to the utility shall be accounted for in a separate memorandum account to track them for future ratemaking treatment (i.e. credited to the Electric Revenue Adjustment Account or the Core and Non-core Gas Fixed Cost Accounts, or other ratemaking treatment, as appropriate), on an annual basis, or as otherwise necessary to ensure that the utility's ratepayers receive the fees. This transfer payment provision will not apply to clerical workers. Nor will it apply to the initial transfer of employees to the utility's holding company to perform corporate support functions or to a separate affiliate performing corporate support functions, provided that that transfer

is made during the initial implementation period of these rules or pursuant to a § 851 application or other Commission proceeding. However, the rule will apply to any subsequent transfers or assignments between a utility and its affiliates of all covered employees at a later time.

d. Any utility employee hired by an affiliate shall not remove or otherwise provide information to the affiliate which the affiliate would otherwise be precluded from having pursuant to these Rules.

e. A utility shall not make temporary or intermittent assignments, or rotations to its energy marketing affiliates. Utility employees not involved in marketing may be used on a temporary basis (less than 30% of an employee's chargeable time in any calendar year) by affiliates not engaged in energy marketing only if:

i. All such use is documented, priced and reported in accordance with these Rules and existing Commission reporting requirements, except that when the affiliate obtains the services of a non-executive employee, compensation to the utility should be priced at a minimum of the greater of fully loaded cost plus 10% of direct labor cost, or fair market value. When the affiliate obtains the services of an executive employee, compensation to the utility should be priced at a minimum of the greater of fully loaded cost plus 15% of direct labor cost, or fair market value.

ii. Utility needs for utility employees always take priority over any affiliate requests;

iii. No more than 5% of full time equivalent utility employees may be on loan at a given time;

iv. Utility employees agree, in writing, that they will abide by these Affiliate Transaction Rules; and

v. Affiliate use of utility employees must be conducted pursuant to a written agreement approved by appropriate utility and affiliate officers.

H. **Transfer of Goods and Services:** To the extent that these Rules do not prohibit transfers of goods and services between a utility and its affiliates, and except for as provided by Rule V.G.2.e, all such transfers shall be subject

to the following pricing provisions:

1. Transfers from the utility to its affiliates of goods and services produced, purchased or developed for sale on the open market by the utility will be priced at fair market value.

2. Transfers from an affiliate to the utility of goods and services produced, purchased or developed for sale on the open market by the affiliate shall be priced at no more than fair market value.

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

4. Goods and services produced, purchased or developed for sale on the open market by the utility will be provided to its affiliates and unaffiliated companies on a nondiscriminatory basis, except as otherwise required or permitted by these Rules or applicable law.

5. Transfers from the utility to its affiliates of goods and services not produced, purchased or developed for sale by the utility will be priced at fully loaded cost plus 5% of direct labor cost.

6. Transfers from an affiliate to the utility of goods and services not produced, purchased or developed for sale by the affiliate will be priced at the lower of fully loaded cost or fair market value.

VI. Regulatory Oversight

A. **Compliance Plans**: No later than December 31, 1997, each utility shall file a compliance plan demonstrating to the Commission that there are adequate procedures in place that will preclude the sharing of information with its affiliates that is prohibited by these Rules. The utility should file its compliance plan as an advice letter with the Commission's Energy Division and serve it on the parties to this proceeding. The utility's compliance plan shall be in effect between the filing and a Commission determination of the advice letter. A utility shall file a compliance plan annually thereafter by advice letter served on all parties to this proceeding where there is some change in the compliance plan (i.e., when a new affiliate has been created, or the utility has changed the compliance plan for any other reason).

B. **New Affiliate Compliance Plans:** Upon the creation of a new affiliate which is addressed by these Rules, the utility shall immediately notify the Commission of the creation of the new affiliate, as well as posting notice on its electronic bulletin board. No later than 60 days after the creation of this affiliate, the utility shall file an advice letter with the Energy Division of the Commission, served on the parties to this proceeding. The advice letter shall demonstrate how the utility will implement these Rules with respect to the new affiliate.

C. **Affiliate Audit:** No later than December 31, 1998, and every year thereafter, the utility shall have audits ~~prepared~~ performed by independent auditors that cover the calendar year which ends on December 31, and that verify that the utility is in compliance with the Rules set forth herein. The utilities shall file~~this audit~~ the independent auditor's report with the Commission's Energy Division beginning no later than ~~December 31, 1998,~~ May 1, 1999, and serve it on all parties to this proceeding. The audits shall be at shareholder expense.

D. **Witness Availability:** Affiliate officers and employees shall be made available to testify before the Commission as necessary or required, without subpoena, consistent with the provisions of Public Utilities Code Section 314.

VII. Utility Products and Services

A. **General Rule:** Except as provided for in these Rules, new products and services shall be offered through affiliates.

B. **Definitions:** The following definitions apply for the purposes of this section (Section VII) of these Rules:

1. "Category" refers to a factually similar group of products and services that use the same type of utility assets or capacity. For example, "leases of land under utility transmission lines" or "use of a utility repair shop for third party equipment repair" would each constitute a separate product or service category.

2. "Existing" products and services are those which a utility is offering on the effective date of these Rules.

3. "Products" include use of property, both real and intellectual, other than those uses authorized under General Order 69-C.

4. "Tariff" or "tariffed" refers to rates, terms and conditions of services as approved by this Commission or the Federal Energy Regulatory Commission (FERC), whether by traditional tariff, approved contract or other such approval process as the Commission or the FERC may deem appropriate.

C. **Utility Products and Services:** Except as provided in these Rules, a utility shall not offer nontariffed products and services. In no event shall a utility offer natural gas or electricity commodity service on a nontariffed basis. A utility may only offer for sale the following products and services:

1. Existing products and services offered by the utility pursuant to tariff;

2. Unbundled versions of existing utility products and services, with the unbundled versions being offered on a tariffed basis;

3. New products and services that are offered on a tariffed basis; and

4. Products and services which are offered on a nontariffed basis and which meet the following conditions:

   a. The nontariffed product or service utilizes a portion of a utility asset or capacity;

   b. such asset or capacity has been acquired for the purpose of and is necessary and useful in providing tariffed utility services;

   c. the involved portion of such asset or capacity may be used to offer the product or service on a nontariffed basis without adversely affecting the cost, quality or reliability of tariffed utility products and services;

   d. the products and services can be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk being incurred by ~~the~~ utility ratepayers, and ~~minimal or~~ no ~~direct~~ undue diversion of utility ~~-~~management attention; ~~control;~~ and

   e. ~~the utility offering is restricted to less than 1% of the number of customers in its customer base.~~ The utility's offering of such nontariffed product or service does not violate any law, regulation, or Commission policy regarding anticompetitive practices.

D. **Conditions Precedent to Offering New Products and Services:** This Rule does not represent an endorsement by the Commission of any particular nontariffed utility product or service. A utility may offer new nontariffed products and services only if the Commission has adopted and the utility has established:

1. A mechanism or accounting standard for allocating costs to each new product or service to prevent cross-subsidization between services a utility would continue to provide on a tariffed basis and those it would provide on a nontariffed basis;

2. A reasonable mechanism for treatment of benefits and revenues derived from offering such products and services, except that in the event the Commission has already approved a performance-based ratemaking mechanism for the utility and the utility seeks a different sharing mechanism, the utility should petition to modify the performance-based ratemaking decision if it wishes to alter the sharing mechanism, or clearly justify why this procedure is inappropriate, rather than doing so by application or other vehicle.

3. Periodic reporting requirements regarding pertinent information related to nontariffed products and services; and

4. Periodic auditing of the costs allocated to and the revenues derived from nontariffed products and services.

E. **Requirement to File an Advice Letter:** Prior to offering a new category of nontariffed products or services as set forth in Section VII C above, a utility shall file an advice letter in compliance with the following provisions of this paragraph.

1. The advice letter shall:

   a. demonstrate compliance with these rules;

   b. address the amount of utility assets dedicated to the non-utility venture, in order to ensure that a given product or service does not threaten the provision of utility service, and show that the new product or service will not result in a degradation of cost, quality, or reliability of tariffed goods and services;

   c. demonstrate that the utility has not received competition transition charge (CTC) recovery in the Transition Cost Proceeding, A.96-08-001, or other ~~applicable~~ related CTC Commission

proceeding, for the portion of the utility asset dedicated to the non-utility venture; and

d. address the potential impact of the new product or service on competition in the relevant market~~.~~, including but not limited to the degree in which the relevant market is already competitive in nature and the degree to which the new category of products or services is projected to affect that market.
e. be served on the service list of Rulemaking 97-04-011/Investigation 97-04-012, as well as on any other party appropriately designated by the rules governing the Commission's advice letter process.

2. For categories of nontariffed products or services targeted and offered to less than 1% of the number of customers in the utility's customer base, ~~I~~in the absence of a protest alleging non-compliance with these Rules or any law, regulation, decision, or Commission policy, or allegations of harm, the utility may commence offering the product or service 30 days after submission of the advice letter. For categories of nontariffed products or services targeted and offered to 1% or more of the number of customers in the utility's customer base, the utility may commence offering the product or service after the Commission approves the advice letter through the normal advice letter process.

3. A protest of an advice letter filed in accordance with this paragraph shall include:

   a. An explanation of the specific Rules, or any law, regulation, decision, or Commission policy the utility will allegedly violate by offering the proposed product or service, with reasonable factual detail; or

   b. An explanation of the specific harm the protestant will allegedly suffer.

4. If such a protest is filed, the utility may file a motion to dismiss the protest within 5 working days if it believes the protestant has failed to provide the minimum grounds for protest required above. The protestant has 5 working days to respond to the motion.

5. The intention of the Commission is to make its best reasonable efforts to rule on such a motion to dismiss promptly. Absent a ruling granting a motion to dismiss, the utility shall begin offering that category of

products and services only after Commission approval through the normal advice letter process.

F. **Existing Offerings:** Unless and until further Commission order to the contrary as a result of the advice letter filing or otherwise, a utility that is offering tariffed or nontariffed products and services, as of the effective date of this decision, may continue to offer such products and services, provided that the utility complies with the cost allocation and reporting requirements in this rule. No later than January 30, 1998, each utility shall submit an advice letter describing the existing products and services (both tariffed and nontariffed) currently being offered by the utility and the number of the Commission decision or advice letter approving this offering, if any, and requesting authorization or continuing authorization for the utility's continued provision of this product or service in compliance with the criteria set forth in Rule VII. This requirement applies to both existing products and services explicitly approved and not explicitly approved by the Commission.

G. **Section 851 Application:** A utility must continue to comply fully with the provisions of Public Utilities Code Section 851 when necessary or useful utility property is sold, leased, assigned, mortgaged, disposed of, or otherwise encumbered as part of a nontariffed product or service offering by the utility. If an application pursuant to Section 851 is submitted, the utility need not file a separate advice letter, but shall include in the application those items which would otherwise appear in the advice letter as required in this Rule.

H. **Periodic Reporting of Nontariffed Products and Services:** Any utility offering nontariffed products and services shall file periodic reports with the Commission's Energy Division twice annually for the first two years following the effective date of these Rules, then annually thereafter unless otherwise directed by the Commission. The utility shall serve periodic reports on the service list of this proceeding. The periodic reports shall contain the following information:

1. A description of each existing or new category of nontariffed products and services and the authority under which it is offered;

2. A description of the types and quantities of products and services contained within each category (so that, for example, "leases for agricultural nurseries at 15 sites" might be listed under the category "leases of land under utility transmission lines," although the utility would not be required to provide the details regarding each individual lease);

3. The costs allocated to and revenues derived from each category; and

4. Current information on the proportion of relevant utility assets used to offer each category of product and service.

I. **Offering of Nontariffed Products and Services to Affiliates:** Nontariffed products and services which are allowed by this Rule may be offered to utility affiliates only in compliance with all other provisions of these Affiliate Rules. Similarly, this Rule does not prohibit affiliate transactions which are otherwise allowed by all other provisions of these Affiliate Rules.

(END OF APPENDIX A)

COMPARISON OF APPENDIX A, ABOVE, TO THE ORIGINALLY PROPOSED DECISION

~~Proposed as an e~~Extension of the rules adopted by the Commission in D.97-12-088:

VIII. Complaint Procedures and Remedies

A. The Commission shall strictly enforce these rules. Each ~~transaction~~act or failure to act by a utility in violation of these rules ~~shall~~may be considered a separate occurrence.

B. Standing:

1. Any person or corporation as defined in Sections 204, 205 and 206 of the California Public Utilities Code may complain to the Commission or to a utility in writing, setting forth any act or thing done or omitted to be done by any utility or affiliate in violation or claimed violation of any rule set forth in this document.

2. "Whistleblower complaints" will be accepted and the confidentiality of complainant will be maintained until conclusion of an investigation or indefinitely, if so requested by the whistleblower. When~~re the latter is invoked, the Commission has~~ a whistleblower requests anonymity, the ~~authority to convert an anonymous complain~~Commission will continue to pursue the complaint only where it has elected to convert it into a Commission-initiated investigation. Regardless of the complainant's status, the defendant shall file a timely answer to the complaint.

~~3. The Consumer Services Division may file a Request for Investigation in reaction to audit results or other information that suggests that a violation may have occurred.~~

C. *Procedure:*

1. All complaints shall be filed as formal complaints with the Commission and complainants shall provide a copy to the utility's designated officer (as described below) on the same day that the complaint is filed.

2. Each utility shall designate an ~~officer~~Affiliate Compliance Manager who is responsible for compliance with these affiliate rules and the utility's compliance plan adopted pursuant to these rules. Such officer shall also be responsible for receiving, investigating and attempting to resolve complaints. The Affiliate Compliance Manager may, however, delegate responsibilities to other officers and employees.

a. The utility shall ~~have three weeks from the date the complaint is filed to~~ *investigate and attempt to resolve the complaint.* The resolution process shall include a meet-and-confer session with the complainant. A Commission staff member may, upon request by the utility or the complainant, ~~be present at~~participate in such meet-and-confer sessions and shall participate in the case of a whistleblower complaint.

A party filing a complaint may seek a temporary restraining order at the time the formal complaint is filed. The defendant utility and other interested parties may file responses to a request for a temporary restraining order within 10 days of the filing of the request. An assigned commissioner or administrative law judge may shorten the period for responses, where appropriate. An assigned commissioner or administrative law judge, or the Commission shall act on the request for a temporary restraining order within 30 days. The request may be granted when: (1) the moving party is reasonably likely to prevail on the merits, and (2) temporary restraining order relief is

necessary to avoid irreparable injury, will not substantially harm other parties, and is consistent with the public interest.

A notice of temporary restraining order issued by an assigned commissioner or administrative law judge will only stay in effect until the end of the day of the next regularly-scheduled Commission meeting at which the Commission can issue a temporary restraining order or a preliminary injunction. If the Commission declines to issue a temporary restraining order or a preliminary injunction, the notice of temporary restraining order will be immediately lifted. Whether or not a temporary restraining order or a preliminary injunction is issued, the underlying complaint may still move forward.

b. The utility shall prepare and preserve a report on each complaint, ~~including but not limited to the specific allegations contained in the complaint;~~ all relevant dates, companies, customers, and employees involved, and; if applicable, the resolution reached, the date of the resolution; and any actions taken to prevent further violations from occurring. The report shall be provided to the Commission and all parties within four weeks of the date the complaint was filed. In addition, to providing hard copies, the utility shall also provide electronic copies to the Commission and to any party providing an e-mail address.

c. Each ~~U~~utility shall file annually with the Commission a report detailing the nature and status of all complaints ~~and requests for investigation filed in the previous year~~.

d. The Commission may, notwithstanding any resolution reached by the utility and the complainant, convert a complaint to an

investigation and ~~seek a finding that~~determine whether the utility violated these rules, and ~~in that event~~ impose any appropriate penalties under Section VIII.D. or any other remedies provided by the Commission's rules or the Public Utilities Code.

3. The utility will inform the Commission's Energy Division and Consumer Services Division of the results of this dispute resolution process. If ~~it was~~the dispute is resolved, the utility shall inform the Commission staff of the actions taken to resolve the complaint and the date the complaint was resolved.

4. If the utility and the complainant cannot reach a resolution of the complaint, ~~it~~the utility will so inform the Commission's Energy Division. It will also file an answer to the complaint within ~~thirty~~30 days of the issuance by the Commission's Docket Office of instructions to answer the original complaint. Within ~~ten~~10 business days of notice of failure to resolve the complaint, Energy Division staff will meet and confer with the utility and the complainant and propose actions to resolve the complaint. Under the circumstances where the complainant and the utility cannot resolve the complaint, the Commission shall strive to resolve the complaint within 180 days of the date the ~~complaint was first filed with the utility or the Commission~~instructions to answer are served on the utility.

5. The Commission shall maintain on its web page a public log of all new, pending, and resolved complaints. The Commission shall update the log ~~once every week at a minimum~~at least once every week. The log shall specify, at a minimum, the date the complaint was received, the specific allegations contained in the complaint, the date the complaint was resolved and

the manner in which it was resolved, and a description of any similar complaints, including the resolution of such similar complaints.

6. Preliminary Discussions

a. Prior to filing a formal complaint, a potential complainant may contact the responsible utility officer and/or the Energy Division to inform them of the possible violation of the affiliate rules. If the potential complainant seeks an informal meeting with the utility to discuss the complaint, the utility shall make reasonable efforts to arrange such a meeting. Upon mutual agreement, Energy Division staff and interested parties may attend any such meeting.

~~6. The Consumer Services Division may initiate a formal inquiry by filing with the Commission, and serving on the subject utility a Request for Investigation, setting forth~~b. If a potential complainant makes an informal contact with a utility regarding an alleged violation of the affiliate transaction rules~~. The Commission shall~~, the utility officer in charge of affiliate compliance shall respond in writing to the potential complainant within 15 ~~provide notice of any such filing in the Daily Calendar. The utility shall file a response to the Request for Investigation and undertake informal dispute resolution efforts using the procedures and adhering to the time frame set out above for resolving complaints. If the utility and the Consumer Service Division are unable to informally resolve the concern that prompted the filing of the Request for Investigation, the Commission shall consider both the request and the response and determine whether or not to issue an Order Instituting Investigation.~~

~~D. Penalties.~~business days. The response would state whether or not the issues raised by the potential complainant require further investigation. (The potential complainant does not have to rely on the responses in deciding whether to file a formal complaint.)

D. Remedies

1. When enforcing these rules or any order of the Commission regarding these rules, the Commission may do any or all of the following:

a. ~~Terminate any transaction that is the subject of the complaint~~Order a utility to stop doing something that violates these rules;

b. Prospectively limit or restrict the amount, percentage, or value of transactions entered into between ~~a utility and its affiliate(s) as a remedy for a violation of these rules~~the utility and its affiliate(s);

~~c. Assess such damages and penalties as described in Paragraphs 2 and 3 below;~~

~~d. Enjoin conduct in alleged violation of these Rules if the conduct indicates a potential pattern of abuse or if the conduct could significantly affect market decisions;~~

c. ~~e. Apply any other remedy available to the Commission.~~Assess fines or other penalties;

d. ~~f.~~ Prohibit the utility from allowing its affiliate(s) to utilize the name and logo of the utility, either on a temporary or ~~permanent basis.~~ a permanent basis;

APPENDIX B
Page 7

~~2. Penalties shall reflect the actual and/or potential injury to ratepayers and competitors and the gravity of the violation and shall be significant enough to provide incentives to utilities to prevent violations of these rules. Repeated violations will require proportionately more severe penalties. A separate violation shall be deemed for each day on which a violation occurred and for each day on which a violation described herein continues. Alternatively, if the penalty is imposed on an incident by incident basis, the Commission shall impose penalties up to $10,000,000. In addition, the Commission may issue penalties pursuant to § 798 of the Public Utilities Code.~~

~~3. Fines and penalties collected under the Rules shall be paid to the General Fund of the State of California.~~

~~4. Each violation of any provision of Sections III, IV, or V of these Rules shall count as a point against the utility. In the event that a utility accumulates three or more points, the Commission shall impose a one (1) year prohibition, to go into effect immediately, on the utility entering into any transactions (including sales of any tariffed or non-tariffed services) with any of the affiliate(s) involved in such violations. After the one-year ban is concluded, the utility shall file a formal application with the Commission before resuming transactions with any of the involved affiliates. The application shall demonstrate the utility's compliance with all of the provisions of these rules, and shall specify what measures the utility has taken to prevent further violations of these rules from occurring.~~

~~In the event that a utility violates a temporary affiliate transaction ban imposed by the Commission, the Commission shall impose additional penalties, including but not limited to: (i) extensions of the prohibition period as appropriate, including permanently precluding the Utility from dealing with the affiliate(s) in the utility's service area; (ii) levying fines of up to $20,000 per day for unlawful affiliate operation in restricted areas to be paid within ten (10) days of the Commission's action, in addition to any other applicable penalty or fine; or (iii) requiring divestiture of the involved affiliate(s).~~

~~5. Each violation of any provision of Section VII of these rules shall count as a point against the utility. In the event that a utility accumulates three or more points, the Commission shall impose a ban on the offering of any non-tariffed products and services for a period of one year. After the one-year prohibition is over, the utility shall file a formal application with the Commission before resuming offering non-tariffed products and services. The application shall specify what measures the utility has taken to prevent further violations of these rules from occurring.~~

~~6. If Sections VIII.D.4 and 5 do not apply, the Commission shall use its discretion to determine the amount of any additional penalty or fine to be paid by the utility and the restrictions it wishes to impose on utility and affiliate transactions.~~

e. Apply any other remedy available to the Commission.

2. Any public utility which violates a provision of these rules is subject to a fine of not less than five hundred dollars ($500), nor more than $20,000 for each offense. The remainder of this subsection distills the principles that the Commission has historically relied upon in assessing fines and restates them in a manner that will form the analytical foundation for future decisions in which fines are assessed. Before discussing those principles, reparations are distinguished.

a. Reparations

Reparations are not fines and conceptually should not be included in setting the amount of a fine. Reparations are refunds of excessive or discriminatory amounts collected by a public utility. PU Code § 734. The purpose is to return funds to the victim which were unlawfully collected by the public utility. Accordingly, the statute requires that all reparation amounts are paid to the victims. Unclaimed reparations generally escheat to the state, Code of Civil Procedure § 1519.5, unless equitable or other authority directs otherwise, e.g., Public Utilities Code § 394.9.

b. Fines

The purpose of a fine is to go beyond restitution to the victim and to effectively deter further violations by this perpetrator or others. For this reason, fines are paid to the State of California, rather than to victims.

Effective deterrence creates an incentive for public utilities to avoid violations. Deterrence is particularly important against violations which could result in public harm, and particularly against those where severe consequences could result. To capture these ideas, the two general

factors used by the Commission in setting fines are: (1) severity of the offense and (2) conduct of the utility. These help guide the Commission in setting fines which are proportionate to the violation.

i. Severity of the Offense

The severity of the offense includes several considerations. Economic harm reflects the amount of expense which was imposed upon the victims, as well as any unlawful benefits gained by the public utility. Generally, the greater of these two amounts will be used in establishing the fine. In comparison, violations which caused actual physical harm to people or property are generally considered the most severe, with violations that threatened such harm closely following.

The fact that the economic harm may be difficult to quantify does not itself diminish the severity or the need for sanctions. For example, the Commission has recognized that deprivation of choice of service providers, while not necessarily imposing quantifiable economic harm, diminishes the competitive marketplace such that some form of sanction is warranted.

Many potential penalty cases before the Commission do not involve any harm to consumers but are instead violations of reporting or compliance requirements. In these cases, the harm may not be to consumers but rather to the integrity of the regulatory processes. For example, compliance with Commission directives is required of all California public utilities:

"Every public utility shall obey and comply with every order, decision, direction, or rule made or prescribed by the Commission in the matters specified in this part, or any other matter in any way relating to or affecting its business as a public utility; and shall do everything necessary or proper to secure

compliance therewith by all of its officers, agents, and employees." Public Utilities Code § 702.

Such compliance is absolutely necessary to the proper functioning of the regulatory process. For this reason, disregarding a statutory or Commission directive, regardless of the effects on the public, will be accorded a high level of severity.

The number of the violations is a factor in determining the severity. A series of temporally distinct violations can suggest an on-going compliance deficiency which the public utility should have addressed after the first instance. Similarly, a widespread violation which affects a large number of consumers is a more severe offense than one which is limited in scope. For a "continuing offense," PU Code § 2108 counts each day as a separate offense.

ii. Conduct of the Utility

This factor recognizes the important role of the public utility's conduct in (1) preventing the violation, (2) detecting the violation, and (3) disclosing and rectifying the violation. The public utility is responsible for the acts of all its officers, agents, and employees:

> "In construing and enforcing the provisions of this part relating to penalties, the act, omission, or failure of any officer, agent, or employee of any public utility, acting within the scope of his [or her] official duties or employment, shall in every case be the act, omission, or failure of such public utility." Public Utilities Code § 2109.

(1) The Utility's Actions to Prevent a Violation

Prior to a violation occurring, prudent practice requires that all public utilities take reasonable steps to ensure compliance with

Commission directives. This includes becoming familiar with applicable laws and regulations, and most critically, the utility regularly reviewing its own operations to ensure full compliance. In evaluating the utility's advance efforts to ensure compliance, the Commission will consider the utility's past record of compliance with Commission directives.

(2) The Utility's Actions to Detect a Violation

The Commission expects public utilities to monitor diligently their activities. Where utilities have for whatever reason failed to meet this standard, the Commission will continue to hold the utility responsible for its actions. Deliberate as opposed to inadvertent wrong-doing will be considered an aggravating factor. The Commission will also look at the management's conduct during the period in which the violation occurred to ascertain particularly the level and extent of involvement in or tolerance of the offense by management personnel. The Commission will closely scrutinize any attempts by management to attribute wrong-doing to rogue employees. Managers will be considered, absent clear evidence to the contrary, to have condoned day-to-day actions by employees and agents under their supervision.

(3) The Utility's Actions to Disclose and Rectify a Violation

When a public utility is aware that a violation has occurred, the Commission expects the public utility to promptly bring it to the attention of the Commission. The precise timetable that constitutes "prompt" will vary based on the nature of the violation. Violations which physically endanger the public must be immediately corrected and thereafter reported to the Commission staff. Reporting violations should be remedied at the earliest administratively feasible time.

Prompt reporting of violations furthers the public interest by allowing for expeditious correction. For this reason, steps taken by a public utility to promptly and cooperatively report and correct violations may be considered in assessing any penalty.

iii. Financial Resources of the Utility

Effective deterrence also requires that the Commission recognize the financial resources of the public utility in setting a fine which balances the need for deterrence with the constitutional limitations on excessive fines. Some California utilities are among the largest corporations in the United States and others are extremely modest, one-person operations. What is accounting rounding error to one company is annual revenue to another. The Commission intends to adjust fine levels to achieve the objective of deterrence, without becoming excessive, based on each utility's financial resources.

iv. Totality of the Circumstances in Furtherance of the Public Interest

Setting a fine at a level which effectively deters further unlawful conduct by the subject utility and others requires that the Commission specifically tailor the package of sanctions, including any fine, to the unique facts of the case. The Commission will review facts which tend to mitigate the degree of wrongdoing as well as any facts which exacerbate the wrongdoing. In all cases, the harm will be evaluated from the perspective of the public interest.

v. The Role of Precedent

The Commission adjudicates a wide range of cases which involve sanctions, many of which are cases of first impression. As such, the outcomes of cases are not usually directly comparable. In future decisions which impose

sanctions the parties and, in turn, the Commission will be expected to explicitly address those previously issued decisions which involve the most reasonably comparable factual circumstances and explain any substantial differences in outcome.

(END OF APPENDIX B)

BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Docket No. 97-8001
In Re Investigation of issues to be considered as a result of restructuring of the electric industry (pursuant to NRS 704.965 to 704.990, inclusive).

PROCEDURAL ORDER NO. 13

The Public Utilities Commission of Nevada ("Commission") makes the following findings:

1. On April 16, 1999, the Commission issued a notice in this docket of its intent to adopt a regulation which concerns the treatment of past costs, pursuant to NRS 704.983. Pursuant to this notice, this hearing commenced on June 1, 1999.

2. Senate Bill 438 ("S.B. 438") (Chapter 600, Statutes of Nevada, 1999) amends NRS 704.983 and other sections of Chapters 703 and 704 of NRS.

3. At the hearing on June 1, 1999, the issue of the potential impact of S.B. 438 on not only the proposed past cost regulation, but on all regulations proposed or adopted to date by the Commission in this docket, was raised.

4. The following regulations which may be affected by S.B. 438 have been adopted to date:

Date Adopted	Description of Regulation
08/20/98	Application process to have a service declared potentially competitive.
10/29/1998	PCS/NCS affiliations (per 704.980, application process for provider of noncompetitive service to obtain authority to provide a potentially competitive service).
11/13/98	(1) Contents of distribution tariffs. (2) Requirements for consumer protection.
12/18/98	(In Docket No. 97-5034) Affiliate rule.
12/31/98	Licensing requirements for alternative sellers of electric services.
02/11/99	Compliance Filing per NRS 704.986.
05/06/99	Licensing fee for alternative sellers of electric services.

5. In addition to the regulation concerning past costs which was to be the subject of the hearing on June 1, 1999, the Commission has also proposed a regulation concerning providers of last resort (NRS 704.982). A hearing on this latter proposed regulation was held on April 26, 1999.

6. The purpose of this Procedural Order is to solicit comments on the impacts that S.B. 438 may have on any of these regulations, i.e., whether any amendments should be made.

7. The Regulatory Operations Staff has organized a meeting of all interested persons in order to determine the intent of S.B. 438. Following this meeting, Staff should submit a comprehensive list of the issues

which need to be addressed by the Commission in this docket, whether via rulemaking or otherwise. The Commission anticipates that this list will reflect consensus to the extent that consensus can be reached. However, all interested persons should be afforded the opportunity to submit supplemental or alternative lists for the Commission's consideration.

8. Staff should submit the list described above (and any interested persons should submit any supplemental or alternative lists which may be necessary) no later than July 16, 1999.

Therefore, based on the foregoing, it is hereby ORDERED that:

1. Staff shall hold a meeting as described above.

2. Staff shall file a list of the issues to be addressed by the Commission as a result of S.B. 438 no later than July 16, 1999. Any other interested person shall file a supplement to this list or an alternative list no later than July 16, 1999.

3. The Commission shall issue a notice to convene a workshop on July 23, 1999.

4. The Commission retains jurisdiction for the purpose of correcting any errors which may have occurred in the drafting or issuance of this Order.

By the Commission,
JUDY M. SHELDREW, Chairman and Presiding Officer

Attest: JEANNE REYNOLDS, Commission Secretary
Dated: 6/21/99 Carson City, Nevada

BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Docket No. 97-5034

In re proposed rulemaking to establish

standards of conduct and related requirements

for distribution companies and affiliates.

At a general session of the Public Utilities Commission of Nevada, held at its offices on December 18, 1998.

PRESENT:

Chairman Judy M. Sheldrew

Commissioner Timothy Hay

Commissioner Lucy A. Stewart

Commission Secretary Jeanne Reynolds

ORDER

The Public Utilities Commission of Nevada ("Commission") makes the following findings of fact and conclusions of law:

1. In March 1998, the Commission first issued a proposed regulation for comment and hearing in Docket No. 97-5034. The proposed regulation consists of standards of conduct and related requirements for distribution companies (electric distribution utilities and natural gas local distribution companies) and their affiliates. The regulation was necessitated by the enactment of NRS 704.965 to 704.999, inclusive. On March 30 and April 2, 1998, the Commission held a workshop, the Commission made substantive changes to the proposed regulation and re-issued it for further comment and hearing. Further revisions to the proposed regulation were made; subsequent hearings were held on June 30 (and continued on July 20, 1998); September 29, 1998; November 6, 1998; and December 4, 1998.

2. The Legislative Counsel Bureau has reviewed this regulation and has returned it in a format suitable for codification in the Nevada Administrative Code.

3. At a duly-noticed agenda meeting on December 18, 1998, the Commission voted to adopt the amendments to Chapter 704 of the NAC, which are attached to this Order, as permanent regulations.

Therefore, based upon the foregoing findings and conclusions, it is hereby ORDERED that:

1. The Commission hereby adopts the amendments to Chapter 704, which are attached to this order and incorporated herein by reference, as permanent regulations in accordance with the provisions of NRS 233B.

2. The attached permanent regulations shall be forwarded to the legislative counsel for incorporation into the Nevada Administrative Code.

3. The Commission retains jurisdiction for the purpose of correcting any errors which may have occurred in the drafting or issuance of this Order.

By the Commission,

JUDY M. SHELDREW, Chairman

TIMOTHY HAY, Commissioner

LUCY A. STEWART, Commissioner

Attest: JEANNE REYNOLDS, Commission Secretary

Dated: 12/30/98 Carson City, Nevada

ADOPTED REGULATION OF THE

PUBLIC UTILITIES COMMISSION OF NEVADA

(Adopted December 18, 1998)

LCB File No. R087-98

December 11, 1998

Explanation - matter in *italics* is new; matter in brackets [ ] is material to be omitted.

AUTHORITY: §§ 2-31, NRS 703.025, 704.980, 704.981 and 704.998.

Section 1. Chapter 704 of the NAC is hereby amended by adding thereto the provisions set forth as

sections 2 to 31, inclusive, of this regulation.

Sec. 2. *As used in Section 2 to 31, inclusive, of this regulation, unless the context otherwise requires, the words and terms defined in sections 3 to 7, inclusive, of this regulation have the meanings ascribed to them in those sections.*

Sec. 3. *"Affiliate" means a company that is a branch, division or subsidiary of a distribution company that:*

1. Provides a potentially competitive or discretionary electric or natural gas service; or

2. Is a provider of last resort as described in NRS 704.982.

Sec. 4. *"Customer" means the retail purchaser of electric or natural gas service.*

Sec. 5. *"Distribution company" includes:*

1. An electric distribution utility as defined in NRS 704.970; and

2. A seller of any noncompetitive component of natural gas service.

Sec. 6. *"Noncompetitive service" means any electric or natural gas service determined by statute or by the commission to be unsuitable for purchase by customers from alternative sellers.*

Sec. 7. *"Potentially competitive service" means a component of electric or natural gas service determined by the commission to be suitable for purchase by customers from alternative sellers. The term includes any potentially competitive electric service that is deemed to be effectively competitive pursuant to NRS 704.976.*

Sec. 8. *1. Sections 2 to 31, inclusive, of this regulation:*

(a) Apply to the provision of services as set forth in NRS 704.961 to 704.999, inclusive.

(b) Do not apply to a public utility that supplies natural gas which is not regulated under an alternative plan established pursuant to NRS 704.997.

2. The provisions of sections 2 to 31, inclusive, of this regulation are not in any way restricted by the provisions of NAC 704.270 to 704.2725, inclusive.

Sec. 9. *1. A distribution company may not provide any potentially competitive or discretionary electric natural gas service.*

2. An affiliate of a distribution company may provide a potentially competitive or discretionary electric or natural gas service upon approval by the commission and in accordance with sections 2 to 31, inclusive, of this regulation.

Sec. 10. *A distribution company shall designate an officer to evaluate and certify compliance* with sections 2 to 31, inclusive, of this regulation.

Sec. 11. *1. An affiliate shall:*

(a) Be a separate corporate entity from the distribution company;

(b) Operate independently from the distribution company;

(c) Maintain books, records and accounts in the manner prescribed by the commission;

(d) Keep its books, records and accounts separate from the books, records and accounts kept by the distribution company;

(e) Not have officers, directors or employee in common with the distribution company, except that the chairman of the distribution company or of the holding company of the distribution company may serve on the board of directors of the affiliate;

(f) Not have any member on its board of directors who is also an employee or officer of the distribution company, except as otherwise provided in paragraph (e);

(g) Not obtain credit pursuant to an arrangement that would allow a creditor, upon default, to have recourse to the assets of the distribution company; and

(h) Not use office space, office equipment or office services provided by the distribution company, unless the affiliate executes with the distribution company a contract that is approved by the commission. The affiliate and the distribution company must:

(1) File the contract with the commission as a joint application not later than 6 months before the effective date of the contract; and

(2) Demonstrate to the commission that the contract:

(I) Does not circumvent the provisions of sections 2 to 31, inclusive, of this regulation;

(II) Preserves an arm's length business relationship between an affiliate and the distribution company;

(III) Does not interfere with the development of effective competition;

(IV) Will result in minimal risk of anticompetitive behavior by the affiliate or distribution company and;

(V) Will result in minimal regulatory expenses to prevent anticompetitive behavior.

The contract must not become effective until the commission approves the contract. Unless the commission determines otherwise, all office space, office equipment and office services provided by the distribution company pursuant to the contract are subject to the provisions of section 12 of this regulation.

2. A distribution company shall document and report quarterly to the commission each occasion that:

(a) An employee of the distribution company becomes an employee of an affiliate; or

(b) An employee of an affiliate becomes an employee of the distribution company.

3. An employee of a distribution company who is hired by an affiliate:

(a) Shall not remove proprietary property or information from the distribution company;

(b) Shall not provide the affiliate with proprietary property or information of the distribution company;

(c) Shall not use proprietary property or information of the distribution company on behalf of the affiliate; and

(d) Shall, before he becomes an employee of the affiliate, sign a statement indicating that the employee has read and will abide by the restrictions set forth in this section and understands that a violation of a provision of this section could subject him to the penalties set forth in section 30 of this regulation.

Sec. 12. *When dealing with an affiliate, a distribution company:*

1. Shall not discriminate between the affiliate and another entity that competes with the affiliate in the provision or procurement of goods, services, facilities and information, or in the establishment of standards.

2. Shall not refuse to provide an entity that is in competition with an affiliate with goods, services, facilities or information which the commission determines the distribution company is reasonably capable of providing to its affiliate, regardless of whether the distribution company currently offers such goods, services, facilities or information to an affiliate.

3. Shall not, when providing or procuring, or declining to provide or procure, goods, services, facilities or information, or when establishing standards, provide, attempt to provide or conspire with another person, including, without limitation, an affiliate, to provide:

(a) A competitive advantage to an affiliate; or

(b) A competitive disadvantage to a competitor of an affiliate.

4. Shall account for all transaction with each affiliate in accordance with accounting principles designated or approved by the commission.

5. Shall, if it offers to an affiliate a good or service other than a good or service provided by a contract pursuant to paragraph (h) of subsection 1 of section 11 of this regulation, offer the same service to all similarly situated nonaffiliated entities.

6. Shall, at the same time it offers to an affiliate a good or service other than a good or service provided by contract pursuant to paragraph (h) of subsection 1 of section 11 of this regulation, offer the same service to nonaffiliated entities by using the mechanism described in subsection 7.

7. Shall provide a mechanism that is accessible to the public, such as an electronic bulletin board, for all interested entities to receive promptly pertinent information concerning:

(a) Services which the distribution company provides;

(b) Any discounted services which the distribution company offers to an affiliate; and

(c) Any transaction between the distribution company and an affiliate.

8. Shall not represent that it will provide an affiliate or a customer of an affiliate with different treatment regarding the provision of services as a result of affiliation with the distribution company than the treatment the distribution company provides a nonaffiliated provider of service and its customers.

9. Shall not provide an affiliate or a customer of an affiliate with preferences over a nonaffiliated supplier or its customers, including, without limitation, preferences in terms and conditions of service or pricing, or in timing of service.

10. Shall apply a tariff provision that allows for discretion in its application in the same manner for an affiliate and customers of the affiliate as it does for another market participant and its customers.

11. Shall strictly enforce mandatory tariff provisions.

12. Shall not condition or otherwise tie the provision of a utility service or the availability of discounts, rates, other charges, fees, rebates or waivers of terms and conditions to the taking of any goods or services from an affiliate.

12. Shall not:

(a) Refer a potential customer to an affiliate;

(b) Provide information to an affiliate regarding a potential business arrangement between a potential customer and the affiliate;

(c) Except as otherwise prescribed by the commission, acquire information on behalf of or to provide to an affiliate;

(d) Share with an affiliate a market analysis report, survey, research or any other type of report that is proprietary or not available to the public, including, without limitation, a forecast, planning or strategic report;

(e) Give an appearance that the distribution company speaks on behalf of an affiliate or that a customer will receive preferential treatment as a consequence of conducting business with an affiliate; or

(f) Give an appearance to a third party that an affiliate speaks on behalf of the distribution company.

Nothing in this subsection prohibits an affiliate from billing for distribution services in a manner consistent with sections 2 to 31, inclusive, of this regulation.

14. Shall make any discount or waiver of all or of part of a charge or fee available to all market participants.

15. Shall not share the office space, equipment or services of an affiliate or access the computer information systems of an affiliate, unless the affiliate executes a contract with the distribution company that has been approved by the commission pursuant to the procedures set forth in paragraph (h) of subsection 1 of section 11 of this regulation.

Sec. 13. *A distribution company shall provide information about specific customers to its affiliates and to nonaffiliated entities:*

1. On a strictly nondiscriminatory basis;

2. Only with the consent of a customer; and

3. In accordance with the rules or standards required by the commission.

Sec. 14. *Information that is not specific to a customer, including, without limitation, information concerning the goods, services, purchases, sales or operations of the distribution company, may be made available to an affiliate only if the distribution company:*

1. Makes such information contemporaneously available to all alternative sellers at the same price, terms and conditions; and

2. Keeps the information open to public inspection.

Sec. 15. *Except as otherwise authorized by the commission, a distribution company shall not provide a person with a list of alternative sellers.*

Sec. 16. *Except as otherwise provided in sections 2 to 31, inclusive, of this regulation, a distribution company shall not offer or provide a customer with advice or assistance of any kind regarding an affiliate or another service provider.*

Sec. 17. *A distribution company shall:*

1. Keep for at least 3 years a record documenting a transaction with an affiliate, including, without limitation, a record documenting:

(a) A waiver of a tariff;

(b) A waiver of a contract provision;

(c) A discount given by the distribution company to the affiliate;

(d) Contracts or related bids for the provision of work, products or services for or from an affiliate.

2. Make the records that the distribution company is required to maintain pursuant to subsection 1 available for review by third parties upon notice of at least 72 hours, unless the distribution company makes a different agreement with a third party concerning the review of the record.

Sec. 18. *1. If a distribution company provides an affiliate with a discount, rebate or other waiver of a charge or fee, the distribution company shall, at the time the service for which the distribution company is giving the discount, rebate or other waiver of a charge or fee is first provided, post on the electronic bulletin board of the distribution company a notice which included, without limitation:*

(a) The name of the affiliate involved in the transaction;

(b) The actual rate charged by the distribution company;

(c) The maximum rate that the distribution company may charge pursuant to its tariff;

(d) The period during which the discount or waiver applies;

(e) The quantities involved in the transaction;

(f) The delivery points involved in the transaction;

(g) Any conditions or requirements applicable to the discount or waiver; and

(h) The procedures through which a nonaffiliated entity may request and receive a comparable discount, rebate or other waiver of a charge or fee.

2. This section does not provide a distribution company with any authority not otherwise existing to grant a discount, rebate or other waiver of a charger or fee.

Sec. 19. *1. A distribution company that provides an affiliate with a discounted rate, rebate or other waiver of a charge or fee for a service shall, for each billing period, maintain in its records:*

(a) The name of the affiliate to which the distribution company is providing services pursuant to the transaction;

(b) A description of the role of the affiliate in the transaction, including, without limitation, whether the affiliate will act as a transporter, marketer, supplier or seller;

(c) The duration of the discount or waiver;

(d) The maximum rate that the distribution company may charge pursuant to its tariff;

(e) The rate or fee that the distribution company charges during the billing period; and

(f) The quantity of products or services scheduled at the discounted rate during the billing period for each delivery point.

2. All records maintained pursuant to this section must also conform to rules of the Federal Energy Regulatory Commission, where applicable.

3. This section does not provide the distribution company with any authority not otherwise existing to grant such discount, rebate or other waiver of a charge or fee.

Sec. 20. *1. Unless the commission specifies otherwise, a distribution company with an affiliate shall obtain and pay for an audit 6 months after the affiliate first provides service to customers and once every year thereafter.*

2. The audit required pursuant to subsection 1 must be conducted by an independent auditor selected by the commission.

3. The auditor shall determine whether a distribution company has complied with all pertinent regulations, including, without limitation, whether the distribution company has:

(a) Complied with the separate accounting requirements set forth in section 11 of this regulation; and

(b) Provided information or services to affiliated and nonaffiliated entities on a nondiscriminatory basis.

4. The auditor shall submit the results of the audit to the commission.

5. The commission will make the results of the audit available for public inspection.

6. Any person may submit comments on the final audit report.

Sec. 21. *For purposes of conducting an audit pursuant to section 20 of this regulation, the distribution company and its affiliate shall provide the independent auditor, the commission staff, the bureau of consumer protection in the office of the attorney general and the commission access to:*

1. Financial accounts and records which:

(a) Verify that the transactions conducted between the distribution company and its affiliates are authorized by and conducted in accordance with the provisions of NRS 704.961 to 704.999, inclusive, and sections 2 to 31, inclusive, of this regulation; and

(b) Relate to the regulation of rates;

2. All records in any form relating to the provision of information or services to affiliated or nonaffiliated entities; and

3. The working papers and supporting materials of any auditor who performed an audit pursuant to section 20 of this regulation.

Sec. 22. *Except as otherwise stated in its approved tariff, a distribution company:*

1. Shall fulfill a request from a nonaffiliated entity for service within a period no longer than the period in which it fulfills such a request for itself or for an affiliate;

2. Shall charge each affiliate an amount for service that is no less than the amount charged to any nonaffiliated entity for the same service;

3. May, in accordance with the provisions of paragraph (h) of subsection 1 of section 11 of this regulation, provide an affiliate with facilities, services and information if the distribution company makes such facilities, services and information available to all nonaffiliated entities at the same rates and on the same terms and conditions and the costs are allocated in a manner acceptable to the commission;

4. May not market or sell services that are provided by an affiliate; and

5. May not state that it is an affiliate of a potentially competitive or discretionary service unless the statement complies with the requirements set forth in subsection 6 of section 24 of this regulation.

Sec. 23. *1. If a distribution company transfers goods or services to an affiliate, the distribution company must price the goods or services at fair market value or fully loaded cost, whichever is higher.*

2. If an affiliate transfers goods or services to the distribution company, the affiliate shall price the goods or services at fair market value or fully loaded cost, whichever is less.

3. As used in this section, "fully loaded cost" means the direct costs of goods and services plus all applicable indirect charges and overhead costs, including, without limitation, a reasonable rate of return.

Sec. 24. *An affiliate:*

1. Shall not market or otherwise sell services jointly with the distribution company;

2. Shall not have a name, logo, trademark, service mark or trade name that is deceptively similar to that of the distribution company, except that an affiliate which has been designated by the commission as a provider of last resort service pursuant to NRS 704.982 may have a name, logo, trademark, service mark or trade name that is similar or identical to that of the distribution company if the affiliate has been specifically authorized to do so by the commission, subject to any conditions that commission deems necessary;

3. Shall not have the logo, trademark or other corporate identification of the distribution company appear on documents of the affiliate or on goods or merchandise sold by the affiliate, unless the commission:

(a) Designates the affiliate to be the provider of last resort service pursuant to NRS 704.982; and

(b) Specifically authorizes, subject to any conditions that the commission deems necessary, the affiliate to use the name, logo, trademark, service mark or trade name;

4. Shall not use the name of the distribution company in any material that the affiliate circulates, unless the affiliate provides with the material the information described in subsection 6;

5. Shall not us space in the correspondence of the distribution company or any other form of information about the distribution company for the purpose of advertising the services of the affiliate; and

6. Shall not advertise its affiliation with the distribution company, unless the affiliate includes each of the following statements in a manner no less prominent that the statement of affiliation:

(a) (Name of the affiliate) is not the same corporation as (name of distribution company). (Name of affiliate) has separate management and separate employees.

(b) (Name of affiliate)'s affiliation with (name of distribution company) does not entitle (name of affiliate) to any special endorsement of the public utilities commission of Nevada.

(c) The safety, reliability and cost of distribution service received by customers of (name of affiliate) will be equivalent to that received by customers of nonaffiliated companies.

Sec. 25. *An affiliate of a distribution company shall not offer goods or services until the affiliate satisfies any applicable requirements set forth in section 2 to 31, inclusive, of this regulation, except the appointment of an auditor pursuant to section 20 of this regulation.*

Sec. 26. *Each transaction that violates the provisions of sections 2 to 31, inclusive, of this regulation, will be considered a separate violation.*

Sec. 27. *1. A person or business may complain to the commission or distribution company in writing, setting forth any act or thing allegedly done or not done by a distribution company or affiliate in violation*

of sections 2 to 31, inclusive, of this regulation.

2. Upon request of a complainant who is a current or former employee of a distribution company or an affiliate, the commission will maintain the confidentiality of the complainant until the end of any resulting investigation or longer if the commission deems it necessary.

3. The distribution company shall refer all complaints, whether written or oral, to a designated representative of the distribution company, who shall:

(a) Acknowledge receipt of the complaint in writing to the complainant within 5 working days after receiving the complaint;

(b) Prepare a written summary of the complaint which must include, without limitation:

(1) The name of the complainant; and

(2) A detailed factual report of the complaint, including, without limitation:

(I) The relevant dates;

(II) The names of the companies involved;

(III) The names of the employees involved; and

(IV) The details of the claim;

(c) Conduct a preliminary investigation; and

(d) Communication the results of the preliminary investigation, including, without limitation, a description of any course of action that was taken as a result of the investigation, in writing to the complainant not more than 20 business days after the designated representative received the complaint.

4. The distribution company shall:

(a) Maintain a public log of all new, pending and resolved complaints; and

(b) Make the public log available to the commission and the bureau of consumer protection in the office of the attorney general not more than 10 business days after the end of each month, which must include, without limitation:

(1) A written summary of each complaint; and

(2) A written summary of the manner in which each complaint was resolved or, if applicable, an explanation of the reason why a complaint is still pending.

Sec. 28. *1. The division of consumer complaint resolution shall investigate any complaint concerning a violation of the provisions of NRS 703.290 and sections 2 to 31, inclusive, of this regulation.*

2. If the division transmits a complaint to the commission and the commission determines that probable cause exists for the complaint, the commission will:

(a) Order that a hearing be held;

(b) Provide notice of the hearing to the parties; and

(c) Conduct the hearing as it would any other hearing.

Sec. 29. *After a hearing has been held pursuant to section 28 of this regulation, the commission, when enforcing the provisions of sections 2 to 31, inclusive, of this regulation or an order of the commission that relates to sections 2 to 31, inclusive, of this regulation, may, without limitation:*

1. Terminate a transaction if the violation caused material harm to the competitive market;

2. Prospectively limit or restrict the amount, percentage or value of transactions entered into between a distribution company and its affiliates;

3. Assess a penalty pursuant to the provisions of section 30 of this regulation; or

4. Apply any other remedy which is available to the commission.

Sec. 30. *1. A penalty assessed by the commission must reflect the actual or potential injury, or both, to ratepayers and competitors, and the gravity of the violation.*

2. Repeated violations will require more sever penalties.

3. In addition to any other penalties, the commission may subject a distribution company to a penalty of not more than $20,000 for each time the distribution company:

(a) Violates a provision of sections 2 to 31, inclusive, of this regulation;

(b) Fails to perform a contractual duty; or

(c) Fails, neglects or refuses to obey an order, regulation, directive or requirement of the commission.

4. Penalties for a supplier of a noncompetitive natural gas distribution service are limited pursuant to the provisions of NRS 703.380.

5. The commission may deem a violation that continues for more than 1 day to be a separate violation for each day the violation continues.

6. A penalty or other remedy imposed by the commission will in no manner preclude the right of a party to pursue a private action in a court of competent jurisdiction.

7. A fine or penalty collected pursuant to the provisions of section 2 to 31, inclusive, of this regulation, must be deposited in the state treasury pursuant to NRS 703.147 for the purposes identified therein.

8. For each violation of the provisions of sections 2 to 31, inclusive, of this regulation, the affiliate shall include in one monthly billing packet a notice, written by the commission, that informs the public of the substance of the violation and explains how members of the public can report similar violations in the future.

9. The penalties set forth in this section do not preclude any other penalty from being imposed pursuant to sections 2 to 31, inclusive, of this regulation or any other provision of law.

Sec. 31. *1. If the commission finds in two separate orders that a distribution company has materially violated the provisions of sections 2 to 31, inclusive, of this regulation more than twice in a period of 12 months, the distribution company may not, for 1 year after the date of the findings by the commission, enter into a transaction with an affiliate that was involved in the violations.*

2. If a distribution company violates the provisions of subsection 1 by entering into a prohibited transaction with an affiliate, the commission may:

(a) Extend the period in which the distribution company is prohibited from entering into a transaction with the affiliate; or

(b) Permanently prohibit the distribution company from entering into a transaction with the affiliate.

3. The penalties set forth in this section do not preclude any other penalty from being imposed pursuant to sections 2 to 31, inclusive, of this regulation or any other provision of law.

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 98-457

June 29, 1999

PUBLIC UTILITIES COMMISSION
Standards of Conduct
for Transmission and Distribution
Utilities and Affiliated
Competitive Electricity Providers
(Chapter 304)

ORDER FINALLY
ADOPTING RULE AND
STATEMENT OF
POLICY BASIS

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

In this Order, we finally adopt a rule implementing standards of conduct for transmission and distribution utilities and affiliated competitive electricity providers.

On December 7, 1998, the Commission provisionally adopted a rule governing standards of conduct between utilities and their affiliated electricity providers. Because the rule was denominated as a "major substantive" rule by 35-A M.R.S.A. §§ 3205(4) and 3206(2), it required legislative approval under 5 M.R.S.A. §§ 8071-8074. In compliance with those provisions, the Commission submitted the rule to the Legislature for its approval. On May 18, 1999, Governor King signed into law Resolves 1999, ch. 36, which authorizes final adoption of the standards of conduct rule.

Although Chapter 36, which became effective on May 18, 1999,[1] authorizes the final adoption of the standards of conduct rule, it also requires that the following three changes be made to the language of the rule when finally adopted:

1. Deletion of section 2, paragraph F (proprietary customer information definition);

2. Deletion of section 3, paragraph I (proprietary customer information requirement);

3. Addition of a provision that clarifies that nothing in the rule prevents a distribution utility from entering into a special contract offering a special rate to a customer or group of customers pursuant to a rate flexibility program approved by the Commission under 35-A M.R.S.A. § 3195(6).

These changes have been made to the final rule.

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[1] Section 8072(8) of Title 5 requires agencies to finally adopt major substantive rules within 60 days of the effective date of the legislation approving the rule

In addition, Public Law 1999, ch. 398, Part G, directs that the following two modifications be made to Chapter 304:

1. Addition of a provision providing that an investor-owned electric utility may not subsidize the business of its affiliated competitive provider at ratepayer expense in a manner not specifically authorized by 35-A M.R.S.A. § 3205; and

2. Modification of the penalty provisions to increase the administrative penalties from a maximum of $10,000 to a maximum of $100,000 and provide for disgorgement of profits in addition to the administrative penalty for violations of the standards of conduct.

Chapter 398, however, will not take effect until September 18, 1999. After that date, we will issue a supplemental order finally adopting rule that make the changes required by Chapter 398.

Accordingly, we

ORDER

1. That the attached Chapter 304, Standards of Conduct for Transmission and Distribution Utilities and Affiliated Competitive Electricity Providers is hereby finally adopted;

2. That the Administrative Director shall file the finally adopted rule and related materials with the Secretary of State; and

3. That the Administrative Director shall send copies of this Order and attached rule to:

A. All electric utilities in the State;

B. All persons who have filed with the Commission within the past year a written request for notices of rulemakings;

C. All persons on the Commission's list of persons who wish to receive notice of all electric restructuring proceedings;

D. All persons who have filed comments in Docket No. 98-457; and

E. The Executive Director of the Legislative Council (20 copies).

Dated at Augusta, Maine, this 29th day of June, 1999.

BY ORDER OF THE COMMISSION

Raymond J. Robichaud
Assistant Administrative Director

COMMISSIONERS VOTING FOR: Nugent
Diamond

COMMISSIONER ABSENT: Welch

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73, et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.

65 - INDEPENDENT AGENCIES - REGULATORY

407 - PUBLIC UTILITIES COMMISSION

CHAPTER 304 - STANDARDS OF CONDUCT FOR TRANSMISSION AND DISTRIBUTION UTILITIES AND AFFILIATED COMPETITIVE ELECTRICITY PROVIDERS

SUMMARY - This Chapter establishes standards of conduct applicable to both large and small investor-owned distribution utilities and affiliated competitive providers, a method of tracking the retail sales made by an affiliated competitive provider within the service territory of its affiliated distribution utility and a requirement that consumer-owned utilities notify the Commission of any wholesale generation sales.

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§ 1 PURPOSE OF RULE; APPLICATION

This Chapter establishes standards of conduct governing the relationship and interactions between a distribution utility and an affiliated competitive provider to promote the development of a fair and efficient competitive retail electricity market.

A distribution utility or an affiliated competitive provider may not use its corporate structure, or any other means, to circumvent the requirements or intent of this Chapter.

§ 2 DEFINITIONS

A. Advertising or Marketing. Advertising or Marketing is:

1) Any communication or activity designed or intended to increase the profitability of an entity or to increase the recipient's likelihood of purchasing service from the entity; or

2) Any communication or activity that could reasonably be viewed by the recipient of the communication or activity as an attempt to increase the recipient's likelihood of purchasing a service or product.

B. Affiliated Competitive Provider. Affiliated competitive provider means a competitive electricity provider whose relationship with an investor-owned transmission and distribution utility qualifies it as an affiliated interest under 35-A M.R.S.A. § 707.

C. Distribution Utility. Distribution utility means an investor-owned transmission and distribution utility that has an affiliated competitive provider.

D. Joint Advertising or Marketing. Joint advertising or marketing is any advertising or marketing that includes, directly or indirectly, references to both the distribution utility and its affiliated competitive provider. It also includes the use by the affiliated competitive provider of the same or substantially similar name or logo as the distribution utility in a way that would require a payment for good will under Chapter 820.

E. Large Investor-owned Distribution Utility. Large investor-owned distribution utility means an investor-owned transmission and distribution utility serving more than 50,000 retail customers.

F. Regulated Product or Services. A regulated product or service means the transmission or distribution of electricity, services necessary to perform those functions, services for which the utility is the provider of last resort or services the Commission requires the utility to provide, except that any service that a utility provides outside its service territory is not a regulated product or service.

G. Small Investor-owned Distribution Utility. Small investor-owned distribution utility means an investor-owned transmission and distribution utility serving 50,000 or fewer retail customers.

§ 3 STANDARDS OF CONDUCT

A. No Preference. A distribution utility may not, through a tariff provision or otherwise, give its affiliated competitive provider or customers of its affiliated competitive provider preference over nonaffiliated competitive electricity providers or customers of nonaffiliated competitive electricity providers in matters relating to any regulated product or service.

B. Service Provided Without Discrimination. All regulated products and services offered by a distribution utility, including any discount, rebate or fee waiver, must be available to all customers and competitive electricity providers simultaneously to the extent technically possible and without undue or unreasonable discrimination. Nothing in this Chapter prevents a distribution utility from entering into a special contract offering a special rate to a customer or group of customers pursuant to a rate flexibility program approved by the Public Utilities Commission under the Maine 35-A M.R.S.A. § 3195(6).

C. Posting. A distribution utility may not sell or otherwise provide regulated products or services to its affiliated competitive provider without either simultaneously posting the offering electronically on the distribution utility's Internet web site or otherwise making a sufficient offering to the market for that product or service. Provision of the product or service under the terms of a filed tariff constitutes a sufficient offering. Otherwise, a sufficient offering to the market must be approved by the Commission before the distribution utility sells or provides the product or service to its affiliated competitive provider.

D. Requests for Regulated Products. A distribution utility shall process all similar requests for a regulated product or service in the same manner and within the same period of time.

E. No Tying. A distribution utility may not condition or tie the provision of any regulated product, service or rate agreement by the distribution utility to the provision of any product or service in which an affiliated competitive provider is involved.

F. Requests for Information. A distribution utility shall process all similar requests for information in the same manner and within the same period of time. A distribution utility may not provide information to an affiliated competitive provider without a request when information is made available to nonaffiliated competitive electricity providers only upon request. A distribution utility may not allow an affiliated competitive provider preferential access to any nonpublic information regarding the

distribution system, customers taking service from the distribution utility, or any other nonpublic information that the utility has obtained as a result of its status as a provider of core utility services that is not made available to nonaffiliated competitive electricity providers upon request. A distribution utility shall instruct all of its employees not to provide any competitive electricity provider preferential access to nonpublic information.

G. Employees. Employees of a distribution utility may not share with any competitive electricity provider:

1. Any market information acquired from any other competitive electricity provider, other than information that is generally publicly available, without the permission of the competitive electricity provider from which the information was acquired; or

2. Any market information developed by the distribution utility in the course of responding to requests for distribution service, other than information that is generally publicly available.

H. Log of Information Requests. A distribution utility shall keep a log of all requests made by a competitive electricity provider for commercial information that it has obtained by virtue of providing electricity service.. The log is subject to Commission review. The log must:

1. Contain all requests for commercial information from competitive electricity providers, including the nature and date of the request;

2. Identify, for each request, the name of the entity making the request; and

3. Describe the date and nature of the distribution utility's response to each request. The distribution utility shall protect the information contained in the log from being disclosed to any entity (except the Commission) unless, or until, the Commission determines such protection is unnecessary. Absent such a finding by the Commission, any entity (other than the distribution utility that maintains the log or the Commission) that seeks access to the information contained in the log, must file a request for such access with the Commission. At that time, the Commission will determine the appropriate level of protection for the information pursuant to its statutory authority to grant protective orders. 35-A M.R.S.A. § 1311-A.

I. Promotion of Affiliate; Joint Marketing.

1. Neither a distribution utility nor its affiliated competitive provider may give any appearance of speaking on behalf of the other.

2. Neither a distribution utility nor an affiliated competitive provider may in any way represent that any advantage accrues to customers or others in the use of the distribution utility's services as a result of that customer's or others' dealing with the affiliated competitive provider.

3. A distribution utility and its affiliated competitive provider may not engage in joint advertising or marketing.

4. The distribution utility may not in any manner promote its affiliated competitive provider or any product or service offered by its affiliated competitive provider nor may the affiliated competitive provider promote any product or service offered by the distribution utility.

5. The Commission shall maintain a current list of all competitive providers available to customers in each distribution utility's service territory. The Commission shall update the list and rearrange the names on the list in a random sequence at least every 60 days. If a customer requests information about competitive electricity providers or where the customer may obtain generation services, the distribution utility shall provide a copy of the most recent list of competitive electricity providers issued by the Commission.

6. Unless the distribution utility or affiliated competitive provider is specifically asked what the relationship is between the two entities or whether the distribution utility or affiliated competitive provider has an affiliation or association with a competitive provider or distribution utility, respectively, employees of those entities may not disclose the affiliation. If they are specifically asked, employees may disclose the affiliation but must inform the questioner that:

a. The affiliated competitive provider is not regulated by the Public Utilities Commission;

b. No advantage will accrue to any customer of the affiliated competitive provider due to the affiliate's relationship with the distribution utility; and

c. Customers may select another competitive electricity provider.

The distribution utility shall submit as part of its implementation plan under Section 5 a script containing the information specified above that distribution utility and affiliated competitive provider employees shall use in responding to inquiries regarding affiliated status.

J. No Recommendation. Employees of a distribution utility may not state or provide to any customer or potential customer any opinion regarding the reliability, experience, qualifications, financial capability, managerial capability, operations capability, customer service record, consumer practices or market share of any affiliated competitive provider or nonaffiliated competitive electricity provider.

K. Sharing of Employee Prohibition. Employees of a distribution utility must be located in a separate building from the employees of the affiliated competitive provider. Employees may not be shared between a distribution utility and its affiliated competitive provider. An employee is considered to be shared if the employee performs work for both entities. The employees of a distribution utility and the employees of an affiliated competitive provider must be served by separate telecommunications and computer systems. An employee who is transferred from an affiliated competitive provider to the distribution utility cannot return to the affiliated competitive provider for at least one year.

1. Exemption.

The Commission may approve an exemption from this subsection upon a finding that:

a. Sharing employees or facilities would be in the best interest of the public;

b. Sharing employees or facilities would have no anticompetitive effect; and

c. The costs of any shared employees or facilities can be fully and accurately allocated between the distribution utility and the affiliated competitive provider.

Any request for an exemption must be accompanied by a full and transparent allocation of costs for any shared facilities or general and administrative support services. The Commission shall allow a reasonable opportunity for parties to submit comments regarding any request for an exemption. An exemption is valid until the Commission determines that modification or removal of the exemption is necessary.

L. Books. A distribution utility and its affiliated competitive provider shall keep separate books of account and records, which are subject to Commission review.

M. Dispute Resolution. A distribution utility shall establish and file with the Commission, as part of its implementation plan under Section 5, a dispute resolution procedure to address complaints alleging violations of 35-A M.R.S.A. §§ 3205 & 3206; applicable Chapter 820 provisions governing the actions of the distribution utility and its affiliated competitive provider; the distribution utility's implementation plan; and this

Chapter. A dispute resolution procedure must, at a minimum, designate a person to conduct an investigation of the complaint and communicate the results of the investigation to the claimant in writing within 30 days after the complaint was received, including a description of any action taken and the complainant's right to file a complaint with the Commission if not satisfied with the results of the investigation.

1. Complaints log. The distribution utility shall maintain a log of all resolved and pending complaints. This log is subject to Commission review. The log must include, at a minimum:

a. The name of the person or entity that filed the complaint;

b. The date the complaint was filed;

c. The written statement of the complaint, if any; and

d. The date the complaint was resolved and the resolution or the reason why the complaint is still pending.

N. Separate Records. A distribution utility shall maintain its books of account and records of its transmission and distribution operations separately from those of its affiliated competitive provider. These books of account and records are subject to Commission review.

O. Implementation Plan. A distribution utility shall maintain in a public place and file with the Commission current written procedures implementing the standards of conduct established by 35-A M.R.S.A. §§ 3205 & 3206 and this Chapter. A copy of this Chapter must be posted in the distribution utility's offices in the same manner as required for minimum wage information under 26 M.R.S.A. § 668. The distribution utility and its affiliated competitive provider shall provide every employee with a copy of the implementation plan and any amendments to the plan. The implementation plan must include procedures to train employees of the distribution utility and its affiliated competitive provider in procedures necessary to ensure compliance with 35-A M.R.S.A. §§ 3205 & 3206 and this Chapter. The implementation plan must be in detail sufficient to enable customers and the Commission to determine that the company is in compliance with 35-A M.R.S.A. §§ 3205 & 3206 and this Chapter.

P. Notice of Stock Acquisition. A distribution utility must immediately notify the Commission if another entity acquires 10% or more of the distribution utility's stock or achieves 10% ownership of the distribution utility's stock after June 26, 1997.

Q. A distribution utility may not subsidize the business of its affiliated competitive provider at ratepayer expense in any manner not specifically authorized under this section.

R. Compliance with Chapter 820. A distribution utility and its affiliated competitive provider must comply with all applicable provisions of Chapter 820.

§ 4 MARKET SHARE LIMITATIONS

No competitive electricity provider affiliated with a large investor-owned distribution utility may sell or contract to sell more than 33% of the total kilowatt-hours sold at retail within its affiliated distribution utility's service territory over a calendar year. Any standard offer service provided within the distribution utility's service territory by an affiliated competitive provider under Chapter 302 is included within the 33% limitation. No competitive electricity provider affiliated with a large investor-owned distribution utility may bid to provide more than 20% of the total standard-offer service kilowatt-hours in its affiliated distribution utility's service territory.

If a distribution utility has more than one affiliated competitive provider, all limits and sanctions will be determined based on the total kilowatt-hours sold, contracted for sale or bid for sale, respectively, by all of its affiliated competitive providers in the aggregate.

A. Reports. By May 1st of each year, each affiliated competitive provider shall report to the Commission:

1) The total kilowatt-hours it sold at retail between January 1 and December 31 of the previous year within its affiliated distribution utility's service territory; and,

2) The total kilowatt-hours it contracted to sell at retail between January 1 and December 31 of the previous year within its affiliated distribution utility's service territory.

By May 1st of each year, each distribution utility shall report to the Commission the total kilowatt-hours sold at retail between January 1 and December 31 of the previous year within its service territory.

B. Sanctions. A competitive provider affiliated with a large investor-owned distribution utility that sells or contracts to sell more than 33% of the total kilowatt-hours sold at retail in its affiliated distribution utility's service territory or bids to sell more than 20% of the standard-offer kilowatt-hours in its affiliated distribution utility's service territory is subject to the sanctions provided in Section 7.

§ 5 IMPLEMENTATION PLAN

Before an affiliated competitive provider is authorized, or if an affiliated competitive provider has already been authorized, within 30 days after the effective

date of this Chapter, the distribution utility must have filed with the Commission an implementation plan in compliance with Section 3(P).

A. Effective Date. An implementation plan takes effect 30 days after it is filed with the Commission unless the Commission suspends the effectiveness of all or part of the plan, in which case the suspended portion takes effect upon Commission approval.

B. Changes. A distribution utility shall file with the Commission any change to an implementation plan. A change to an implementation plan takes effect 30 days after the change is filed with the Commission unless the Commission suspends the effectiveness of all or part of the change, in which case the suspended portion takes effect upon Commission approval.

C. Commission Investigation. The Commission may open an investigation into a distribution utility's implementation plan or a distribution utility's compliance with its plan at any time and may order changes to be made in an implementation plan as a result of the investigation.

§ 6 AUDITS

The Commission shall audit the records of each distribution utility and affiliated competitive provider subject to this Chapter to ensure compliance with 35-A M.R.S.A. §§ 3205 and 3206, applicable Chapter 820 provisions, the distribution utility's implementation plan, and this Chapter.

A. Audit Schedule. For the first three years following adoption of this Chapter, the Commission shall annually audit each distribution utility and affiliated competitive provider. Thereafter, the Commission shall audit investor-owned distribution utilities and affiliated competitive providers at least once every three years but may audit them more frequently at the Commission's discretion.

§ 7 SANCTIONS

This section governs sanctions applicable to violations of 35-A M.R.S.A. § 3205 and this Chapter. For purposes of imposing a sanction under this Section, the provisions of a distribution utility's implementation plan and Chapter 820 are incorporated into this Chapter. Penalties collected pursuant to this section must be deposited in the Public Utilities Commission Reimbursement Fund.

A. General Administrative Penalties. The Commission may, in an adjudicatory proceeding, impose an administrative penalty of up to $10,000 for a violation of 35-A M.R.S.A. § 3205 or this Chapter. Each day a violation continues constitutes a separate offense.

B. Violations of the 33% Market Share Limitation. If an affiliated competitive provider exceeds the 33% market share limitation imposed by Section 4, the penalty is determined according to the following:

1. If in the calendar year reported pursuant to Section 4(A) (current calendar year), the actual retail sales (measured in kilowatt-hours) of an affiliated competitive provider plus its contracted retail sales (measured in kilowatt-hours) exceed 33% but not 35% of the total retail sales in its affiliated distribution utility's service territory in the year previous to the year reported pursuant to Section 4(A) (prior calendar year), the penalty equals the difference between the average revenue per kilowatt-hour the affiliated competitive provider received for sales in the service territory of its affiliated distribution utility during the current calendar year and the New England independent system operator average market clearing prices for capacity and energy for the current calendar year, multiplied by the kilowatt-hours in excess of 33% of the total retail kilowatt-hours sold within the affiliated distribution utility's service territory in the prior year, up to a maximum penalty of $10,000 per day.

For example, assuming the total retail sales within a distribution utility's service territory in calendar year 2002 was 9,000,000,000 kWhs, an affiliated competitive provider could not sell more than 2,970,000,000 kWhs (9,000,000,000 * 0.33 = 2,970,000,000) within that distribution utility's service territory in calendar year 2003 without incurring a penalty. If, hypothetically, in 2003 the affiliated competitive provider sold 34% of the 2002 total retail kWh sales within its affiliated distribution utility's territory, received $91,800,000 in revenues associated with those sales and the average market clearing price for capacity and energy in 2003 was $0.025 per kWh, a penalty of $450,000 would be due: [(0.34 • 9,000,000,000 kWhs = 3,060,000,000 kWhs; excess sales = 3,060,000,000 - 2,970,000,000 = 90,000,000 kWhs; average revenue per kWh = $91,800,000/3,060,000,000 kWhs = $0.030 per kWh sale price; therefore the penalty = 90,000,000 • (0.030 - 0.025)=$450,000].

2. If the affiliated competitive provider's actual retail sales (measured in kilowatt-hours) plus its contracted retail sales (measured in kilowatt-hours) in the current calendar year exceed 35% of the total retail sales in its affiliated distribution utility's service territory in the prior calendar year, the penalty equals the penalty as determined in subsection 1 plus the average revenue per kilowatt hour the affiliated competitive provider received for sales in the service territory during the current calendar year multiplied by the kilowatt hours in excess of 35% of the total retail kilowatt-hours sold within the affiliated distribution utility's service territory in the prior year, up to a maximum penalty of $10,000 per day.

For example, using the same assumptions as in subsection 1 except that in 2003 the affiliated competitive provider sold 38% of the 2002 total retail kWh sales within that distribution utility's territory and received $102,600,000 in revenues associated with those sales, a penalty of $9,000,000 would be due: [(0.38 * 9,000,000,000 kWhs = 3,420,000,000 kWhs; sales in excess of 33% but up to 35% =

(0.35 * 9,000,000,000) - 2,970,000,000 = 180,000,000 kWh; sales in excess of 35% = 3,420,000,000 - (0.35 * 9,000,000,000 kWhs) = 270,000,000 kWhs; therefore the penalty = 180,000,000 * (0.030 - 0.025) + (270,000,000 * 0.030) = $900,000 + $8,100,000 = $9,000,000].

C. Divestiture. The Commission shall require a distribution utility to divest an affiliated competitive provider if the Commission determines in an adjudicatory proceeding that:

1. The distribution utility or its affiliated competitive provider has knowingly violated Title 35-A M.R.S.A. § 3205, or this Chapter and the violation resulted or had the potential to result in substantial injury to retail consumers of electric energy or to the competitive retail market for electric energy; or

2. An affiliated competitive provider obtains an unfair market advantage as a result of an entity's ownership of 10% or more of the stock of the distribution utility.

§ 8 CONSUMER-OWNED UTILITIES

A consumer-owned utility must report to the Commission any wholesale sale or sales of generation service that, over any 12-month period, cumulatively exceed 5% of the total kilowatt hours sold at retail by the utility over the same period. The report must describe the details of the transaction and explain why the sale was incidental and necessary to reduce the cost of providing retail service.

§ 9 WAIVER OR EXEMPTION

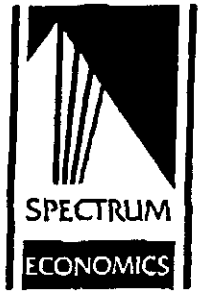
Upon the request of any person subject to this Chapter or upon its own motion, the Commission may, for good cause, waive any requirement of this Chapter that is not required by statute. The waiver may not be inconsistent with the purposes of this Chapter or Title 35-A. The Commission, the Director of Technical Analysis, or the Presiding Officer assigned to a proceeding related to this Chapter may grant the waiver.

BASIS STATEMENT: The factual and policy basis for this rule is set forth in the Commission's Statement of Factual and Policy Basis and Order Provisionally Adopting Rule, Commission Docket No. 98-457, issued on December 7, 1998, and in the Commission's Order Finally Adopting Rule and Statement of Policy Basis issued on June 29, 1999. Copies of this Statement and Order have been filed with this rule at the Office of the Secretary of State. Copies may also be obtained from the Administrative Director, Public Utilities Commission, 242 State Street, 18 State House Station, Augusta, Maine 04333-0018.

AUTHORITY: 35-A M.R.S.A. §§ 104, 111, 3205, 3206, 3207, 3203(9)
Resolves 1999, ch. 36

EFFECTIVE DATE: This rule was approved as to form and legality by the Attorney General on JUN 30 1999. It was filed with the Secretary of State on JUL - 1 1999 and will be effective on JUL 31 1999.

APPENDIX C



IMPACTS OF UTILITY ENTRY INTO AIR CONDITIONING INSTALLATION AND MAINTENANCE FOR THE AIR-CONDITIONING CONTRACTORS ASSOCIATION

BY

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EXECUTIVE SUMMARY

If done properly, electric deregulation promises to create a competitive market for retail sales of electricity which should lead to substantial energy cost savings for most consumers. However, early experience with deregulation has demonstrated that there are several substantial, unexpected problems. One such problem is the cross-subsidization of utility affiliates in unregulated service industries which threatens to undermine competition in these service industries as well as to reduce cost savings to consumers of electricity. The current pattern of electric deregulation creates strong economic incentives for such cross-subsidized market entry.

The most obvious example of cross-subsidized utility entry into new markets is the move of several utilities into the heating, ventilation, air-conditioning and refrigeration (HVACR) market. Members of the HVACR service industry have witnessed an unprecedented and growing incursion into the HVACR service market by utility affiliates in recent years. In a few states, such as Delaware and Maryland, utility affiliates have used their market power and cross-subsidies to suddenly gain over a 20% share of the HVACR market. These affiliates have enjoyed substantial cross-subsidies from their related utilities in the form of free advertising, free marketing, free customer information, free or reduced cost employees and free equipment. These cross-subsidies impose costs on the electric onsumer and are contrary to the goals of open competition on which deregulation is premised.

This report, prepared by Spectrum Economics of Palo Alto, California examines the issue of cross-subsidization of utility affiliates in the HVACR market and its potential implications for deregulation of the electric power industry. The key issues explored and conclusions reached are as follows:

- **Deregulation and Cross-Subsidization:** This section reviews the long history of the problems of cross-subsidization created by earlier deregulation of other industries such as natural gas and long-distance service. In all of these industries, strict safeguards against cross-subsidization were required.

- **Cross-Subsidization Defined:** The National Regulatory Research Institute has defined cross-subsidization and demonstrated how regulation creates incentives for cross-subsidization.

- **Utility Cross-Subsidization of HVACR Affiliates and Its Public Policy Implications:** Examines why deregulation creates incentives to cross-subsidize unregulated affiliates and the forms of cross-subsidization. Partial deregulation encourages cross-subsidization because subsidy costs can be hidden in regulated operations and passed on to consumers. Such subsidies both increase costs to electric consumers and in the long run would lead to high price monopolies in the unregulated HVACR business.

- **Utility Entrants into HVACR Markets and Regulatory Responses:** Surveys the entry of utility affiliates into the HVACR market as well as regulatory responses in seven key states: New York, Nevada, Colorado, Maryland, Virginia, Ohio and Michigan. Among these states, the strongest utility HVACR programs are in Maryland and Ohio. Many states are considering tough rules to prohibit cross-subsidies, but Minnesota has enacted the toughest regulations.

- **Impacts of Cross-Subsidization on Competition:** The California PUC has found that cross-subsidies in California alone are approaching over $100 million per year. This would translate into a national consumer loss of over $2 billion per year. Short term job loss to existing workers could reach 60,000.

The report concludes that legislation to deregulate electric generation must address the issue of cross-subsidization in order to avoid substantial harm to competition and consumers.

I. INTRODUCTION

The U.S. heating, ventilation, air conditioning and refrigeration (HVACR) industry has revenues of over $67 billion per year and employs over 530,000 people .[1] [2] About 70% of the employees work for small contractors who employ less than 50 people, and almost half work for employers with less than 10 employees.[3] The industry pays high wages to its employees, who average about $17 per hour and provides independent livelihood to over 53,000 small business owners and their families. [4] [5]

Increasingly, the future of these independent contractors is threatened by anticompetitive practices associated with the entry of large electric and gas utilities into the HVACR industry through unregulated affiliates. About 42% of utilities are now active in the HVACR business, but most of their activity is recent.[6] In the early 1990s only two major utilities, Consumer's Power of Michigan and Public Service of Colorado, had major HVACR businesses. By 1997, the number of utilities in the HVACR market had grown to over 50. The change in utility participation in the HVACR business is shown in Chart 1. This report examines some of the reasons for utility entry into the HVACR market, the potential for cross-subsidization of unregulated affiliates in the HVACR market, how this development threatens to reduce consumer savings in the soon-to-be deregulated electric power market, and utility actions and regulatory responses in seven states: Nevada, Colorado, Ohio, Michigan, New York, Maryland and Virginia.

II. DEREGULATION AND CROSS-SUBSIDIZATION

Recent U.S. efforts to deregulate major industries such as airlines, trucking, railroads and natural gas have by and large led to more competition and lower prices for most consumers. It is

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[1]Projected from 1992 Census of Construction Industries output of $41 billion, based on recently released 6 digit SIC detail. HVACR includes SIC 17111, SIC 171116 (mechanical), SIC 171118 (Refrigeration), SIC 171122 (Combination), and N.S.K (Other). Projection based on growth in earnings and employment through 1997.

[2]Employment and Earnings, Nov. 1997, Table B-12, HVACR is 66% of SIC 171, Plumbing, Heating and Air-Conditioning.

[3]U.S. Bureau of the Census, County Business Patterns, U.S. Summary, 1995, p.7

[4] Employment and Earnings, Nov. 1997, Table B-15, data is for SIC 171

[5] Op.cit., County Business Patterns, p.7

[6] 1996 data from Energy Users News, July 1997.

anticipated that deregulation of electric generation will produce many of the same benefits for consumers of electric power. However, if the transition to competition is not properly handled, deregulation could result in new economic inefficiencies both in the market for electric power and in related markets such as HVACR services. The recent and sudden expansion of electric utilities into the HVACR business is the leading edge of the potential for large energy supply and service conglomerates that could achieve near monopoly status in some industries. While integrated conglomerates are not in themselves problematic, the potential for anticompetitive impacts contrary to the intent of deregulation arises from the potential for utilities to use cross-subsidies from their regulated business to enter into and unfairly dominate other related but unregulated industries.

In contrast to European and Asian encouragement of industrial consolidation, the United States has historically sought to prevent monopolies. When industrial consolidation went too far, the government broke up such near monopolies as Standard Oil, IBM and AT&T. Today Microsoft has come under increasing government scrutiny for allegedly monopolistic actions. Active U.S. enforcement of antitrust laws, in contrast to European and Asian protection of inefficient industrial giants, is one of several reasons for the relatively greater economic success of the United States. Where monopoly was thought to be inevitable, the U.S. has traditionally regulated such "natural monopolies" as water, electricity, gas and communications. Through regulation, monopolies prices were constrained, but they were also protected against competition. Thus regulated monopolies were both restricted and protected by their regulators.

Regulated firms generally were subject to another restriction: they were rarely allowed to enter unregulated businesses. This restriction was put in place to prevent these regulated monopolies from subsidizing their entry into new businesses using assets paid for by the ratepayers or from shifting part of that cost to consumers in the regulated industry. However, changing telecommunications and energy markets have led to partial deregulation first of natural gas and long-distance service, then of electricity generation. Partial deregulation of these industries has led to a "mixed-market" environment in which portions of the industry have been opened to competition while other portions have remained subject to regulation.

As part of this deregulation process, utilities have been allowed to establish unregulated subsidiaries, but initially only under carefully controlled conditions. The first major utility deregulation effort, that of long-distance rates, required AT&T to divest its regulated regional

Bell operating companies (RBOC's) and limited its entry into a variety of information publishing sectors.[7] [8]

III. WHAT IS CROSS-SUBSIDIZATION?

Cross-subsidization is one of the key problems created by a mixed market environment. Concern about the potential for cross-subsidization prompted many of the restrictions described above and has posed a persistent problem for regulators. Cross-subsidization occurs when an affiliate in an unregulated market is able to price its product or services below cost due to its relationship with a regulated entity. Whether this cross-subsidy takes the form of covering the affiliates losses with revenues from the regulated utility or arises from the use of assets of the regulated entity to reduce the cost of providing service, the unregulated affiliate enjoys a competitive advantage due to its relationship with the regulated monopoly. This internal subsidy is borne, directly or indirectly, by the consumers of the regulated entity.

The result of this cross-subsidy is both inefficiency in the regulated market and a skewing of competition in the unregulated market as the affiliate is able to drive out otherwise efficient rivals through below cost pricing. The cross-subsidy enjoyed by the affiliate may allow the affiliate to offer prices far enough below its cost to allow it not only to drive out competitors but to prevent new entrants into the market. Once competition is eliminated, prices in the unregulated market will rise and the threat of predatory pricing will be sufficient to dissuade potential new entrants. Obviously, cross-subsidies pose adverse consequences for consumers and competitors alike.

IV. UTILITY CROSS-SUBSIDIZATION OF HVACR AFFILIATES AND ITS PUBLIC POLICY IMPLICATIONS

A. Why Deregulation Creates Incentives For Utilities To Cross-Subsidize Their Entry Into The Market for HVACR Services

The utility industry is a huge industry undergoing the stress of market change and deregulation. The $213 billion electric utility industry dwarfs the $67 billion air conditioning

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[7] See 47 U.S.C., Sections 272 (separate affiliates for competitive activities, 274 (separate affiliate for electronic publishing), 275 (delayed entry into alarm monitoring services).

[8] For an excellent discussion of the economic theory of why regulated firms should be kept out of unregulated markets, see Timothy Brennan, "Why Regulated Firms should be Kept Out of Unregulated Markets: Understanding the Divestiture in United States v. AT&T, The Antitrust Bulletin, Fall 1987, P. 741 to 793.

installation and maintenance business.[9] Several individual electric utilities are larger than an entire state's HVACR industry. Natural gas utilities are "only" a $60 billion industry. The relative sizes of the HVACR, Electric Utility and Gas Utility industries are shown in Chart 2.

Deregulation creates powerful incentives for gas and electric utilities to move into HVACR installation and service. The key incentive shared by all utilities and created by deregulation is the search for long-range profits. By hiding part of the costs of establishing themselves in the unregulated HVACR business, utilities can force their electric customers to help finance corporate expansion. In the long-run, after competitors are driven out by predatory pricing unregulated monopoly profits can be earned in the new business.[10]

The second reason is bundling: using service contracts bundled with gas or electric purchases to encourage customers not to shift to new, more cost-competitive energy supplies. Fearful that they will be unable to compete on price alone due to stranded costs and other factors, utilities are hoping to retain customers by offering services like HVACR installation and service along with the base gas or electric service as a single package. Alternate suppliers of cheap gas and electricity can compete on price more easily than they can compete on service. Many utilities believe that they have a better chance of retaining consumer loyalty for their base electric and gas products by providing a bundle of energy services, including HVACR and appliance services, at a single package price. These utilities are deliberately under-pricing service contracts as loss leaders, to convince customers to accept long-term electric or gas purchase contracts. The main incentive to do this is that many utility costs are largely fixed, so that the loss of a small number of customers can significantly reduce profits.

Under deregulation both electric and gas utilities share another powerful reason for diversifying into HVACR installation and service: institutional survival. Their existing businesses are slow growing, and new competitors will almost surely take some of that current business. Established organizations generally try to avoid staff cuts. Most utilities must cut staff to remain competitive in their core business, but they are desperate to shift these workers to new business to avoid the organizational morale and political problems of significant layoffs. Many utilities will grasp at any possibility to maintain the size of the organization, even if it will not be immediately profitable. Regulatory politics encourages such investments. Electric deregulation and general rate freezes are occurring at a time of declining interest rates and declining fuel prices. These fortuitous circumstances make many utilities potentially so profitable that they risk a political backlash against deregulation. After languishing for most of the last five years, utility earnings per share growth rates are expected to more than double from 2.5% per year to almost

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[9]Monthly energy review, December 1997, KWH sales times average price.

[10] For an analysis of the economic and regulatory incentives for cross-subsidies see Jaison Abel, An Economic Analysis of Marketing Affiliates in a Deregulated Electric Power Industry, National Regulatory Research Institute, Ohio State University, Feb. 1998

6% per year in the next five years under deregulation. [1] The decision facing utility executives is simple: If they don't take the diversification risk, their own jobs are at risk, and the profits saved from utility staff cuts may be recaptured by regulators in any case. If utility executives do invest in risky, initially money losing diversification, their jobs are saved and they are effectively risking the money of their regulated customers, not their shareholders.

Avoiding layoffs through diversification only works if the utility can be cost competitive in the new business or if it can use cross-subsidization to kill competitors. Utilities cannot be cost competitive in the HVACR business with their existing staff -- their wages are too high. Thus, utilities must either cross-subsidize or use non-union contractor personnel in the new HVACR enterprises: They must choose between an economic problem and a political one. However, many utilities are doing so by utilizing their ratepayer-based assets to cross-subsidize their entry into the market for HVACR services. Through cross-subsidization, the affiliate's costs are lower than other participants in the market for HVACR services and are able to use their cost difference to force out current HVACR service providers and discourage new market entrants. Thus, while the initial result of cross-subsidization may be to lower the cost of HVACR services, these prices will surely rise as competition is eliminated. In addition, the cost of providing these below-cost services is actually being paid by the customers of the regulated part of the utility.

B. Utility Cross-Subsidization and Public Policy

Both gas and electric utilities have many ways to cross-subsidize their HVACR affiliates. Some key cross-subsidies include providing the following services to unregulated affiliates at low or no cost:

- **Customer Data:** Utilities have amassed large volumes of information on their customers and those customers' usage patterns during their tenure as monopoly utility service providers. Obviously, this type of information becomes extremely valuable in a competitive marketplace. By sharing this data with its unregulated affiliate, the utility provides the affiliate with a substantial competitive advantage.

- **Employees and Employee Benefits:** Costs associated with employees and employee benefits are substantial, and the potential for cross-subsidization arises when employees are shared between the utility and its affiliate.

- **Finance:** Regulated entities generally receive a lower costs of capital than firms in competitive markets. If this advantage is passed on to the unregulated affiliate, that entity enjoys lower costs of capital than similarly placed independent firms solely by virtue of its relationship with the utility. Borrowing for these

[1] Zack's Earnings forecasts, April 24, 1998

unregulated subsidiaries raises interest costs paid by general utility customers.

- **Shared Logos or Trademarks:** The "name brand" recognition possessed by utility logos and trademarks is the result of their monopoly status and should be considered to be a ratepayer asset in a competitive environment. Allowing unregulated affiliates to advertise, trade upon, or promote their affiliation with the utility through the use of shared logos or trademarks results in a ratepayer asset being used to create an unfair competitive advantage in the market for HVACR services.

- **Bill Inserts:** Direct mail advertising is expensive. Many utilities provide free advertising to their affiliates by allowing them to insert advertising in the utility's monthly billings.

- **Preferential Referrals:** Many consumers call their utility when they experience problems with major appliances or HVACR systems. Often utilities refer these callers only to their unregulated affiliate rather than informing them of the existence of numerous qualified service providers.

While requesting the freedom to subsidize their own entry into the HVACR business through their affiliates, electric utilities have at the same time opposed subsidies to their competitors. Investor owned utilities have spent over 50 years fighting subsidized public power projects. They objected to the public power industry receiving subsidies from taxpayers in form of below market interest rates, low or no taxes and free administrative support. The Edison Electric Institute, a coalition of investor-owned utilities, was formed over 50 years ago to fight public power subsidies. These public power subsidies are similar to the utility's cross-subsidies of their unregulated affiliates.

Many of these same utilities are currently proposing new subsidies to themselves. These proposed subsidies would require customer payment for so-called "stranded costs" (e.g., unsuccessful past investments which firms in normal competitive industries would be forced to write off). These proposed stranded cost assessments amount to a subsidy to electric utilities of between $100 and $160 billion. [12] While the utilities plead financial necessity to obtain stranded cost recovery, many of these same utilities are pouring tens of millions of dollars into entering the HVACR business.

The economic and public policy reasons for limiting cross-subsidization of unregulated affiliates in the HVACR industry are well described in a recent report issued by the National Regulatory Research Institute entitled, "The Problem of Regulating Utility Affiliate Interactions

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[12] A. Thierer, "Electricity Deregulation: Separating Fact From Fiction in the Debate Over Stranded Cost Recovery", March 1997, The Heritage Foundation, Washington D. C.

in a Mixed Market Environment" by Kenneth Costello and Robert Graniere. [13] The Institute is supported by the National Association of Regulatory Utility Commissioners (NARUC). The report makes the following key points:

- Cost shifting from unregulated affiliate to regulated utility can be accomplished in myriad ways;
- Cost based regulation provides a substantial economic incentive for such cost shifting;
- The regulatory challenge of reviewing such cost shifting is difficult, if not impossible;
- Cost shifting is economically inefficient: it taxes utility customers to finance unfair competition by the unregulated affiliate; and
- In the long run, the potential for cost-shifting limits competition in the industry entered by the utility's unregulated affiliate.

The ability of regulated utilities to leverage their market power into closely related sectors such as HVACR service through cross-subsidization of unregulated affiliates presents significant problems for both regulators and competitors in these unregulated industries. Even Robert Pitofsky, Chairman of the Federal Trade Commission and one of the top government officials charged with enforcing the antitrust laws, concedes: "[cross-subsidization] is one of the most difficult issues to deal with in antitrust enforcement, because the books are in the hands of the person who is doing the cross-subsidizing, and the allocation problems are enormously difficult."[14] Even where regulators have attempted to maintain effective regulations against subsidized utility entry into new market, detailed controls against cross-subsidies have been difficult to implement. California has imposed stringent controls on utilities' affiliate transactions, including corporate separation, and has tried to closely monitor these relationships for such giant utilities as Pacific Gas and Electric. Nevertheless, a late 1997 audit of PG&E's subsidiaries found cross-subsidiaries amounting to $33.7 million dollars. California PUC staff projected that PG&E subsidies to its unregulated subsidiaries were growing at such a rate that they could amount to $300 million over the next three years. Unfortunately, no other PUC has

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[13]For a detailed review of how utilities can cross subsidize, see Costello and Graniere, "The Problem of Regulating Utility-Affiliate Interactions in a Mixed Market Environment, National Regulatory Research Institute, April 1997.

[14]Antitrust Aspects of Electricity Deregulation before the House Committee on the Judiciary, 105th Congress, 1st Session, at 68 (1997) (statement of the Honorable Robert Pitofsky, Chairman, Federal Trade Commission).

completed such a study of the actual costs of cross-subsidies. Projecting the California PUC results for PG&E to a national level, however, the annual national cost for these cross-subsidies would amount to approximately $2 billion per year. The estimated cross-subsidy cost to utility consumers by state is shown in Table 1.

V. A SAMPLING OF UTILITY ENTRANTS INTO THE HVACR MARKET AND REGULATORY RESPONSES IN MAJOR STATES

A. Overview

Utility participation in the HVACR market has taken a variety of forms, including:

- o contractor certification programs;
- o sales of referrals for customers seeking HVACR service;
- o sales of HVACR maintenance plans (either directly or through an affiliate); and
- o general HVACR maintenance and contracting.

In response to this development, many state regulatory commissions have begun crafting standards of conduct to govern utility affiliate transactions, particularly those states moving towards a deregulated market. Among these states, many are moving towards stricter requirements of physical and financial separation for electric utilities and their non-regulated affiliates. New Hampshire and California have required that the utilities and their affiliates be separate corporate entities. Iowa, while not requiring complete separation, has prohibited the sharing of vehicles, service tools and other assets between the utility and its unregulated affiliates. Minnesota probably enacted the strictest rules: it required that unregulated affilaiates pay a 1% of revenues franchise fee to the regulated utility. (This was later overturned by state courts.) Many other states are currently considering similar rules including charges for shared data processing and administrative support, permitting sharing of marketing and other data only if it is available to all competitors on a nondiscriminatory basis, and other rules to prevent abuse of utility market power. The degree to which such rules are enacted and effectively enforced will determine whether HVACR service remains a bastion of small business.

B. Status In Key States

The nation's most aggressive utility moves into air-conditioning installation and maintenance are in Maryland, Virginia, and Colorado.

Maryland -- Baltimore Gas and Electric is moving aggressively into the HVACR business. Through their Home Products and Services division , formed in 1994, BG&E sells HVACR and

appliance service contracts, repairs and installs HVACR systems, and sells appliances. BG&E's Commercial Building Systems division designs, finances and supervises the installation of commercial HVACR systems. BG&E clearly cross-subsidizes its affiliates, which pay nothing for such vital services as advertising, data or customer referrals from the regulated utility.

Delmarva Power (recently renamed Connectiv), which supplies electricity to Delaware and Eastern Maryland, has been even more aggressive in the HVACR area. Delmarva/Connectiv has purchased several electrical contractors and now sells, finances and installs residential and commercial central air conditioning systems. Connectiv recently announced that its HVACR business tripled to $95 million in 1997. This amounts to a market share of over 20% in Connectiv's territory.

The Washington, D.C., area gas utility, Washington Gas, is also aggressively selling HVACR services. Its HVACR service programs go back at least to the early 1980's. They sell appliance and HVACR service contracts and finance purchases through a "Thrift Purchase Plan". The actual service work is done by a combination of Washington Gas staff and "Trade Associate" contractors. Washington Gas also operates a contractor referral program.

Several Maryland area utilities are not entering the HVACR business, as of late 1997. Allegheny Power, which services western Maryland, is not pursuing air conditioning installation and maintenance. Columbia Gas also has no major programs.

Maryland regulators and the Maryland legislature are currently debating how to regulate these utility programs. The staff of the Maryland PSC has recommended strict separation between BG&E and its affiliates, including open competitive bidding for all utility contracts and open purchase of all utility services such as customer data. The legislature passed tight cost allocation rules for utility subsidiaries.

In nearby Delaware, the State Legislature passed a Joint Resolution establishing Fair Conduct rules for utility subsidiaries. Delmarva Power had bought several HVACR contractors and the utility was referring customers to these unregulated subsidiaries without informing the customers of the corporate relationship. The Delaware Public Service Commission examiner found Delmarva Power's actions to be in clear violation of the Code Of Conduct.[15]

Virginia -- Virginia Power (VEPCO) had an aggressive HVACR program but is pulling back from this business as of late 1997. VEPCO designs, builds and manages commercial HVACR systems. It created a "Comfort Assured" Preferred Dealer Network to install and service residential heat pump systems and provides low interest loans through these contractors. VEPCO also bought an appliance and HVACR service contract and warranty business. Under significant legal and political pressure, VEPCO is now selling the warranty business and is

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[15] State News, October 19,1997

reducing its other HVACR service business. Under intense pressure, VEPCO signed an agreement with the Virginia Coalition for Fair Competition to follow strict "standards of Conduct."[16]

Colorado -- Public Service of Colorado both services air conditioning systems and appliances and is constructing a large chilled water plant to provide cooling to downtown Denver. The plant will use off-peak power in the evening to chill water for day time use. PSC has reduced its once aggressive appliance service business to cover the Denver area only.

The most aggressive utility provider of HVACR services in Colorado and several nearby states is KN Energy, once mainly a gas transmission and distribution company. KN Energy provides appliance service (including HVACR), and appliance warranties along with a wide variety of gas and telecommunications services.

A nearby utility, NorAmEnergy, now part of Houston Industries, is aggressively expanding its appliance and air conditioning service business in Texas, Oklahoma, Arkansas, Louisiana and Minnesota and may soon enter the Colorado market.

Colorado's Public Utilities Commission is finalizing a modestly strict code of conduct rules for unregulated affiliates which require full payment to the utility for all data and other services.

New York -- New York utilities are discussing providing a variety of HVACR services but relatively few programs are being implemented as of late 1997. The most active program is that of Brooklyn Union Gas and their merger partner Long Island Lighting (LILCO) -- now Keyspan Energy. Brooklyn Union sells and installs gas air conditioning and sells gas appliance maintenance contracts. Any further Keyspan entry into the HVACR business is being held up by negotiations surrounding the merger.

The other major New York utilities, Niagra Mohawk, Consolidated Edison, Rochester Gas and Electric and New York State Electric and Gas are not aggressively pursuing the HVACR business.

The New York PUC has ordered all state utilities, including Brooklyn Union/Keyspan out of the HVACR business by 2000, unless the utilities can prove they are not cross-subsidizing. The April 4, 1997 PSC order requires that all utility HVACR services be provided by separate subsidiaries, that past expenditures be refunded to customers and that HVACR service prices be immediately raised to unsubsidized levels.

Michigan -- Consumers Power has been aggressively trying to enter the HVACR business for 15

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[16]Lawrence DeSimone, Senior Vice President of Virginia Power, letter of Nov. 4, 1997

years, but they have been held up by litigation and the Michigan Coalition for Fair Competition has continued to fight these utility HVACR programs. Consumers Power sells appliance and HVACR service contracts for residences and is discussing broader HVACR services. Consumers Power also has a referral program which includes a 10% kickback from the contractor.

Detroit Edison sells appliance and HVACR service contracts. Detroit Edison is also installing its Liquid Pressure Amplification Pump as part of commercial refrigeration and air conditioning systems.

Michigan Consolidated Gas (part of MCN Energy) has expanded from servicing gas appliances to selling service contracts for central air conditioning systems in the Detroit and Grand Rapids areas. Michigan Consolidated advertises its"100 years of gas appliance service experience."

These utility programs and potential cross-subsidy problems would be severely limited, if not killed by pending Michigan legislation enacting utility standards of conduct. The proposed Michigan standards would prohibit unregulated subsidiaries using the utility's name, staff or data bases. The Michigan Alliance for Fair Competition has repeatedly sued successfully to limit regulated utility provision of HVACR services.

Ohio -- Ohio utilities are discussing entering many aspects of the HVACR business, but no programs were actively implemented until 1997. In 1997, Ohio Edison (now part of First Energy which includes Toledo Edison and Cleveland Electric Illuminating) bought two of the nation's largest mechanical contractors, Roth Brothers and RPC Mechanical, with combined revenues of over $90 million. Ohio Edison has announced that through these contractors it will supply the full spectrum of HVACR, roofing, and building services primarily to commercial and industrial customers. They are also starting a "one call" appliance service program. This dramatic move makes Ohio Edison/First Energy a major HVACR player.

American Electric Power is indirectly entering the HVACR business through its proposed 10 year guaranteed savings programs. For large customers willing to contract for buying electricity for 10 years, AEP guarantees cost savings and installs energy saving equipment, including HVACR equipment, for free. It is unclear how extensive these new power contracts will be and what their impacts will be on existing HVACR contractors.

Columbia Gas has an appliance warranty program in Ohio. Consolidated Natural Gas is experimenting with an appliance warranty program in nearby Pennsylvania, which may be extended to the territory of CNG's East Ohio Gas.

Neither of Ohio's other major electric utilities, Cincinnati Gas and Electric (now Cinergy) and Dayton Power and Light, are actively pushing air conditioning installation and maintenance programs.

The Ohio legislature is considering utility standards of conduct which would control these programs, but passage is uncertain.

Nevada -- Nevada Power proposed a preferred dealer network where it would sell referrals to selected contractors, but this program was effectively killed by PSC action. They are also planning a central chilled water cooling system for the Las Vegas "Strip." Having lost the dealer referral battle, Nevada Power is now entering the home and appliance warranty business (including HVACR) through an insurance affiliate, First Choice Insurance. This program is running into problems with the contractor's licensing board, as is a similar insurance program run by Old Republic. Sierra Pacific has no similar programs.

Southwest Gas has some contractor referral programs, but these are operated in cooperation with existing contractor organizations.

The Nevada Legislature passed a new law requiring that all unregulated work be run through separate affiliates, but the standards of conduct for these affiliates will be established as part of complex new laws and new rules for de-regulating electric power generation.

VI. POTENTIAL IMPACTS OF CROSS-SUBSIDIZATION ON LONG-TERM COMPETITION

Since electric and gas markets will continue to be partially regulated, the opportunities and incentives for cross-subsidization will also continue. The market power of existing regulated electric and gas monopolies may decline, but will not disappear. Therefore, careful regulation to prevent unfair cross-subsidization will continue to be necessary in order to prevent diverting consumer savings from the electricity markets and causing substantial disruptions in unregulated markets such as HVACR services.

Consumers are harmed by cross-subsidization both in the market for electricity and in markets served by unregulated utility affiliates. The harm to the utility's customers lies in the fact that they bear, whether directly or indirectly, the cost of the internal subsidy to the utility's unregulated affiliate. The harm to consumers in the market for HVACR services arises from the inefficient skewing of that market caused by the cross-subsidy. Again, the utility affiliate's ability to price its services at below cost in order to gain market share allows it to drive other competitors from the market. New competitors will be discouraged from entry by the affiliate's ability to incur short-term losses to eliminate competition. Therefore, while consumers may initially benefit from lower prices, these prices will rise rapidly once long term competition has been reduced.

Utility takeover of the HVACR business would be disruptive to the lives of both existing contractors and their workers. Delmarva/Connectiv's gaining of over a 20% market share in less than five years demonstrates how a large utility with unlimited funds can quickly dominate the

HVACR industry. If utilities takover only 10% of the existing market, total national job loss among existing workers would be 60,000 jobs. About 5,000 existing contractors would close down at this level of utility expansion.

Utilities have argued against restrictions on affiliate cross-subsidies on the grounds that they should be allowed to achieve economies of scale like other large integrated entities. There is inevitably a tension in deregulating monopolies between allowing realization of the benefits of economies of scale and creating an environment in which the benefits of market competition can be fully realized. However, past deregulation efforts demonstrate that legislators and regulators have seen fit to balance these interests by imposing at least some restrictions on the incumbent monopolists' ability to utilize their accumulated market power. These restrictions are necessary in order to create a marketplace in which open competition can flourish.

In the long run, without restrictions, energy utilities will be able to gain monopoly level profits in related, unregulated service industries. Once cross-subsidies have been used to drive out existing competitors, prices can be raised to high levels, generating monopoly profits for the unregulated subsidiaries of the utilities. These high prices and profits can be maintained because potential new entrants will be frightened off by the risk of predatory low prices charged by the utilities.

Finally, allowing cross-subsidization of utility affiliates represents an unwise investment for utilities themselves. Utilities will face extremely difficult competitive forces in their core business in the coming years. Cross-subsidization diverts needed resources, that could be devoted to providing core utility services in the new competitive environment, to side ventures subsidized by the utility's customers.

CHART 1
UTILITIES IN HVACR BUSINESS

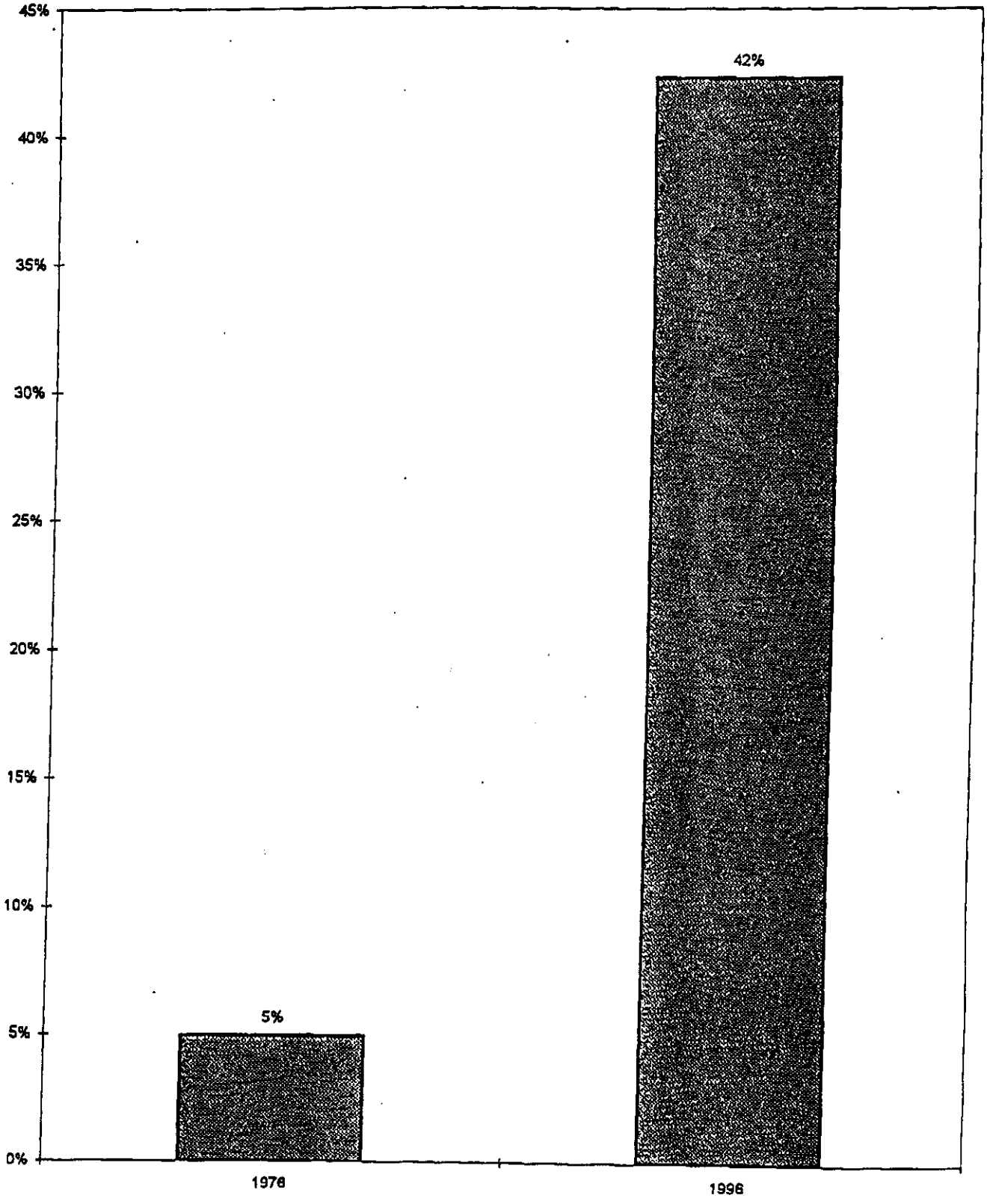

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CHART 2
RELATIVE SIZE 1997

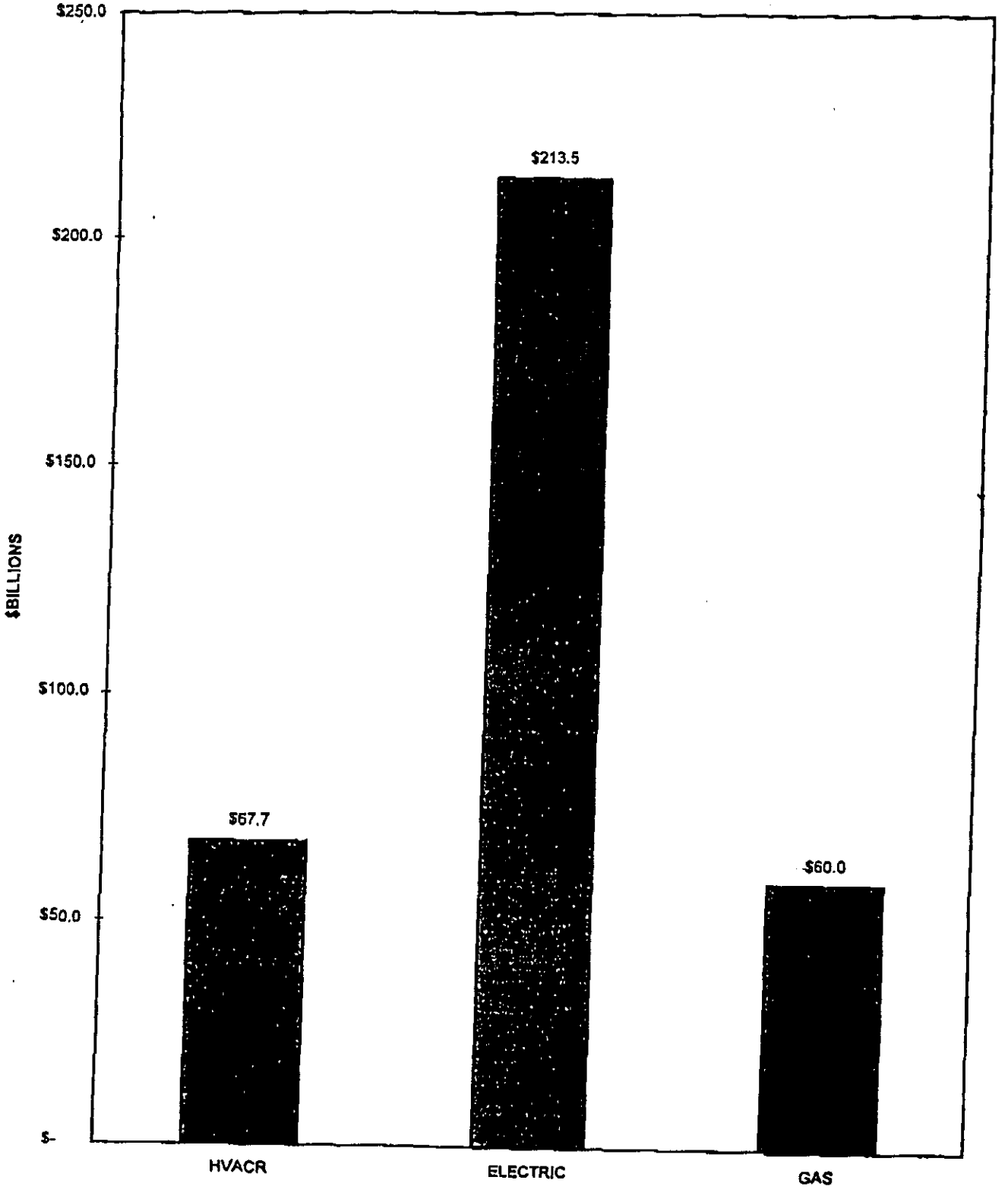

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TABLE 1

POTENTIAL ANNUAL CROSS-SUBSIDIES BY STATE
($ IN MILLIONS)

COLORADO	$	28.7
MARYLAND	$	38.5
MICHIGAN	$	72.5
OHIO	$	84.5
NEW YORK	$	137.4
VIRGINIA	$	50.6
U.S. TOTAL	$	1,000.0

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