

BEHAVIORAL OR STRUCTURAL SOLUTIONS: PROSPECTS FOR A DEREGULATED NATURAL GAS INDUSTRY

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A matter of great relevance to local natural gas distribution companies (LDCs) is the continued and accelerated consideration by state legislators and state utility regulators of affirmative codes of conduct governing the relationship of public utilities and non-regulated marketers of products and services. These codes are drafted with the intention of “leveling the playing field” with respect to the affiliated and non-affiliated providers of these non-regulated, market-priced services or products.

Inherent in the promulgation of these codes, whether as the result of legislation, administrative rulemaking or adjudication, is a two-pronged premise: first, public utility regulators are empowered by statute, or should be so empowered, to consider non-affiliated market entrants as a protected constituency; and second, public utilities, by virtue of their monopoly on the delivery of regulated utility services, have the opportunity and the motivation to discriminate unfairly against the non-affiliated competitors of their corporate affiliates.

The first prong of this premise—that public utility commissions have or need the authority to protect non-affiliated entrants into the products and services marketplace in their service territories—is flawed. Not only is such authority unnecessary, it may in fact detract from the ability of state utility regulators to protect the interests of their core constituency, the consumers of regulated utility delivery service. This is not to say that state utility regulators, and the Federal Energy Regulatory Commission (FERC), should ignore issues touching on market power of the entities over which they exercise jurisdiction. It is clear that regulators properly consider these issues in ensuring that their protected constituency, the consumers of regulated utility delivery service, have access to the services and products offered by parties unrelated to the utility monopolist. However, when these regulators lose focus on their statutory constituency of consumers and instead focus on the protection of new market entrants, they step outside their area of expertise with unanticipated results. Moreover, ample authority is already in the hands of other state and federal authorities to ensure that no anticompetitive advantage is accorded to affiliated marketing companies or to divisions over non-affiliated marketing companies.

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The primary mission of state utility regulators is to ensure that the providers of monopoly utility services do so at just and reasonable rates and without unreasonable discrimination between consumers or classes of consumers. This mission recognizes that without ruinous and duplicative investment in redundant delivery systems, a single monopolist delivering an essential service such as electricity or natural gas delivery might be able to exact unreasonable monopoly rents for the service which otherwise cannot be obtained by the consumer. Thus, state utility regulatory codes routinely require state regulators to establish just and reasonable rates for the monopoly delivery service.¹ Just as typically, the state statutory schemes prohibit conditions of service that unreasonably discriminate between classes of consumers.² Note, however, that "reasonable" discrimination—differentiation in service terms and conditions justified by different quality of service or unique characteristics of the customer or class of customer thereby affected—is authorized.

Additionally, the Federal Trade Commission (FTC), the Antitrust Division of the Justice Department and state attorney generals have shown no reluctance to exercise their authority under state and federal laws governing fair competition in deregulating industries. A recent case on point is the Order issued on February 20, 1998, by Judge Telesca of the United States District Court for the Western District of New York denying cross-motions for summary judgment in *United States v. Rochester Gas and Electric*.³ In that Decision and Order, Judge Telesca determined that the State of New York had an actively supervised, clearly articulated, affirmative policy of discounted rates for the purpose of preventing under-utilizations of utility capacity. Nevertheless, Judge Telesca held, in a situation where the offer of a discount was made to a consumer who was also a potential competitor of the utility for the purpose of inducing the consumer not to compete against the utility, no state action exemption from the Sherman Act⁴ could be found.⁵ The Court found that a question of fact remained because it had to be determined whether the offeree in this instance was a potential competitor.⁶ Nonetheless, it is clear that in the Court's view the utility may be liable for a *per se* violation of the Sherman Act if this fact is established. In the context of the discussion at hand, Judge Telesca noted:

1. See, e.g., OHIO REV. CODE ANN. § 4905.22 (West 1995 & Supp. 1999); CAL. PUB. UTIL. CODE § 728 (Deering Supp. 1999); KY. REV. STAT. ANN. § 278.030 (Michie 1989 & Supp. 1998); 66 PA. CONS. STAT. ANN. § 1301 (West 1979 & Supp. 1998) and FLA. STAT. ch. 366.041 (1997).

2. OHIO REV. CODE ANN. § 4905.22 (West 1995 & Supp. 1999); CAL. PUB. UTIL. CODE § 728 (Deering Supp. 1999); KY. REV. STAT. ANN. § 278.030 (Michie 1989 & Supp. 1998); 66 PA. CONS. STAT. ANN. § 1301 (West 1979 & Supp. 1998) and FLA. STAT. ch. 366.041 (1997).

3. *United States v. Rochester Gas and Electric*, 4 F. Supp. 2d 172 (N.Y. Civ. Ct. 1998). A Consent Judgment was entered into by the parties and filed on February 20, 1998.

4. The state action exemption from the Sherman Act derived from *Parker v. Brown*, 317 U.S. 341 (1943). In that case, the Supreme Court held that the Sherman Act was not intended to prohibit states from imposing restraints on competition. *Id.* at 343. The Court's decision was premised on the assumption that Congress, in enacting the Sherman Act, did not intend to compromise the States' ability to regulate their domestic commerce. *Southern Motor Carriers Rate Conference, Inc. v. United States*, 471 U.S. 48, 56 (1985).

5. *Rochester Gas and Elec.*, 4 F. Supp. 2d at 175.

6. *Id.* at 177.

Finally, RG&E argues that its contract, and the allegedly anticompetitive provisions contained therein, are authorized under State law on grounds that the Public Service Commission has rigorously reviewed the contract, and has found it to be not only acceptable under New York State Law, but a model for agreements offering rate reductions. *The Public Service Commission, however, is not charged with enforcing federal antitrust law, and did not review the contract to determine whether or not it violates that law.* The fact that the New York Public Service Commission has approved the contract at issue does not mean that the State has authorized, and shielded from federal law, allegedly anticompetitive behavior.

Judge Telesca's observation on this issue is both insightful and accurate: public utility regulatory agencies are not charged with or equipped to apply state or federal competitive statutes. Moreover, the state action exemption merely suggests if, in the exercise of their jurisdiction over regulated utility service, utility commissions should authorize allegedly anticompetitive conduct as appropriate for the protection of utility service consumers, that authorization may stand only under narrowly-prescribed circumstances.⁸ Those agencies charged with enforcement of the antitrust laws will strictly construe the scope of the authorized anticompetitive conduct.

The second governing premise is that public utilities are uniquely situated to provide an unfair competitive advantage to affiliates over their non-affiliated competitors. This assumption has become quite ingrained in our thinking. This is well-illustrated by a brochure distributed last spring to announce a jointly sponsored satellite broadcast entitled "*LDC's Come Out Swinging - With Marketing Affiliates Bare Knuckles Competition in the Unbundled Battlefield of the Market.*" The co-sponsors of this broadcast, which took place on January 29, 1998, were the Southern Gas Association and the Federal Energy Bar Association. Panelists included Don Santa of LG&E Energy Corp., Jim Hawes of Philadelphia Gas Works, FERC Commissioner Massey and Chester Messer of Boston Gas. The panel dealt with subjects identified in the brochure such as "the muscular LDCs flex their power in the market; the marketing affiliates take up the battle cry; the non-affiliated competitors unleash their battalions; the Olympian regulators play with the mortals." While the tenor of the text can partially be attributed to aggressive marketing, it nevertheless depicts the extent to which it is assumed without much challenge that LDCs possess "market power" regarding something other than the regulated utility service that our state utility commissions continue to regulate quite comprehensively—either with respect to deregulated commodity marketers, or non-regulated products and services which may or may not be energy related.

This market power argument is nothing more than a red herring waved in the faces of regulators, and has merit only to the extent that non-regulated marketers of commodities, products, and services are considered an appropriate client group of the state utility regulatory community. For the reasons already stated, there is no compelling reason for state utility regulators to adopt this

7. *Id.* at 176 (emphasis added).

8. *Southern Motor Carriers*, 471 U.S. at 56-57 (employing a two prong inquiry in applying the state action exemption defense: 1) clearly articulated affirmative state policy, and 2) active supervision of anticompetitive conduct by private actors).

client group in addition to their primary charge of protecting the interests of consumers of regulated utility services. That charge is adequately handled by the governmental agencies previously identified. In fact, by adopting increasingly complex and prescriptive codes of conduct, state regulatory agencies may very well be *reducing* competitive choices for their primary constituency.

If affiliated market entrants, through the promulgation of conduct codes, are either hampered in marketing their product and service alternatives or prohibited altogether from bringing their offerings before the consumer, the winners are the non-affiliated market entrants rather than the consumer. Codes of conduct can and should ensure a level playing field *for the consumer of regulated utility services* in evaluating or choosing among competitive offers for non-utility services or products. Anything beyond this scope will reduce, rather than promote, increased choices for consumers.

Having set the analytical framework for the roles and responsibilities of state utility commissions in the context of policing utility relationships with affiliated and non-affiliated market entrants, one may well ask whether codes of conduct should be considered at all. Should we instead look to a different type of device to ensure no tilting of the playing field due to corporate relationships?

William J. Baer, Director of the Bureau of Competition for the Federal Trade Commission, delivered some remarks on December 4, 1997, to the "Conference on the New Rules of the Game for Electric Power: Antitrust & Anticompetitive Behavior," dealing with the topic of the FTC's perspectives on antitrust enforcement in an era of power deregulation.⁹ There are obvious parallels between the deregulation of the natural gas industry and the deregulatory efforts now commencing in the electric industry. Director Baer opined that new antitrust rules are not required in a deregulatory environment:

One of the strengths of the antitrust laws is that they are industry-neutral. That makes it easier to stay focused on the basic economic principles and values that underlie the antitrust laws and their application, and it avoids a crazy quiltwork of laws that would be difficult to administer and even more difficult to rationalize.¹⁰

Director Baer went on to share a number of observations about the role of antitrust enforcement in a deregulating industry. He cogently noted that the transition to a more competitive environment "can be complicated by a mix of regulation and the involvement of several different regulatory bodies, as well as the antitrust agencies."¹¹ Of particular relevance to the issue at hand, he noted:

[G]iven the role of the individual states in regulation, some participants may be subject to market forces while others are still regulated, or different participants

9. William J. Baer, *FTC Perspectives on Competition Policy and Enforcement Initiatives in Electric Power*, Washington, D. C. (December 4, 1997) available in Federal Trade Commission website <<http://www.ftc.gov/speeches/other/elec1204/htm>>.

10. The "crazy quiltwork" he refers to is the increasing number of possibly inconsistent state and federal statutes applied to different deregulating industries. Just as state and federal regulators might find these laws difficult to rationalize and apply, those firms engaged in multistate marketing operations could be subjected to significant costs and administrative inconvenience inherent in seeking to comply with the variety of rules thus created. *Id.* at 2.

11. *Id.* at 5.

may be subject to different regulatory rules. For example, potential anticompetitive behavior may be monitored by FERC, state public utility commissions, and/or the federal antitrust agencies, depending on the pace and mix of deregulatory efforts at the state and federal levels. Among the many considerations in working through the deregulation process, we should keep in mind the potential competitive implications of inconsistent regulatory requirements.¹²

Director Baer also identified the divergent approaches taken by utility regulators and by the antitrust enforcement community in dealing with remedial measures for competitive problems: "The basic choice is between a *structural approach* to remedies, which is the antitrust preference, and a *behavioral approach* that seeks to govern conduct through the use of rules, which is more typical of a regulatory regime."¹³ He described the "preferred" antitrust enforcement methodology as focused on "maintaining or restoring the independence of the relevant economic actors."¹⁴ He states that the Government's "strongly preferred remedy is divestiture"¹⁵ in mergers because it is the most effective means to overcome the incentive for the merging firms to engage in strategic interdependent behavior. Divestiture ensures that the resulting firms advance the self-interest of the separate businesses.¹⁶ In contrast, the regulatory approach to competitive problems in the same situation could be a behavioral one, which "might permit the transaction but impose some conduct requirements. Similar differences in approach can arise in the context of regulatory restructuring of an industry."¹⁷

Finally, Director Baer described what he views as shortcomings of the regulatory/behavioral approach as applied to the restructuring of a formerly regulated business:

A behavioral approach to addressing this kind of competitive problem has several drawbacks. First, it does not eliminate the incentive and opportunity to engage in exclusionary behavior. Rules can try to limit the opportunity, but few rules are invulnerable to evasion. Second, detection of violations can be very difficult. For example, discrimination in access could take the form of a subtle reduction in quality of service, whose effects could be difficult to identify and measure. Third, behavioral rules can require long-term monitoring of compliance, which can be a costly process. A structural approach minimizes the cost of monitoring compliance with the order. With a divestiture order, for example, that usually is a short-term requirement because the principal monitoring function is to make sure that the divestiture takes place in the manner required by the order. Fourth, it may be difficult to know whether we have selected the right rules. Even a simple cease-and-desist order, which is commonly used in antitrust cases, can be difficult to frame, because we do not want to prohibit too little or too much. More complex orders, especially those that try to guide¹⁸ conduct through affirmative requirements, can be more difficult to frame properly.

12. Baer, *supra* note 9, at 5.

13. *Id.* at 7 (emphasis added).

14. Baer, *supra* note 9, at 7.

15. *Id.*

16. Baer, *supra* note 9, at 7.

17. *Id.*

18. *Id.* at 7-8.

Nevertheless, Director Baer acknowledged that structural remedies, while simple and clear cut, may not be optimal. The complete separation of business functions may itself be costly or difficult to effect, with consequent loss of legitimate efficiencies attributable to integration.¹⁹ The list of deficiencies in the behavioral or regulatory approach to addressing competitive issues identified by the Director of the Bureau of Competition provides an interesting yardstick to be applied to the codes of conduct which have been promulgated over time.

Perhaps the oldest and best known is the set of standards the Federal Energy Regulatory Commission created in the Order 497 series.²⁰ These standards of conduct properly focus on discrimination by interstate pipelines in the application of tariff provisions to parties similarly situated; on the even-handed application of mandatory tariff provisions; on handling similar requests for transportation in the same manner in the same time period; and on the fair sharing of information relating to transportation between non-affiliated shippers and marketing affiliates contemporaneously. Notably, standard (g) provides that “[t]o the maximum extent practicable [the interstate pipeline’s] operating employees and the operating employees of its marketing affiliate must function independently of each other.”²¹

The FERC’s relatively clear and logical format fits the theory that as gas deregulates further, if behavioral approaches to structuring conduct appropriately in competitive situations are to “carry the day” in the face of the arguably simpler structural solutions of complete divestiture, they must be simple, easily understood, and require relatively little monitoring for compliance at manageable cost.

The proof of the viability of these FERC standards is the relatively few times they have been the subject of complaints regarding violations. However, a fresh example of what appear to have been rather flagrant violations of several of the standards was the subject of a FERC Order, issued January 16, 1998, in *Amoco Production Co. v. Natural Gas Pipeline Co.*,²² where the Commission assessed a civil penalty of \$8.8 million, but conditionally suspended \$4.4 million

19. *Baer, supra* note 9, at 7-8. It should be noted that the presence of integrative efficiencies in an integrated firm is not violative of the Sherman Act. In *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979), *cert. denied*, 444 U.S. 1093 (1980), the court recognized that integrated companies competing in several product or service lines can properly take advantage of integrative efficiencies:

[A] large firm does not violate [Section] 2 [of the Sherman Act] simply by reaping the competitive rewards attributable to its efficient size, nor does an integrated business offend the Sherman Act whenever one of its departments benefits from association with a division possessing a monopoly in its own market. So long as we allow a firm to compete in several fields, we must expect it to seek the competitive advantages of its broad-based activity more efficient production, greater ability to develop complementary products, reduced transaction costs, and so forth. These are gains that accrue to any integrated firm, regardless of its market share, and they cannot by themselves be considered uses of monopoly power.

Id. at 276.

20. 53 Fed. Reg. 22,161 (1988), *as amended* by Order No. 497-A, 54 Fed. Reg. 52,792 (1989); Order No. 497-E, 59 Fed. Reg. 255 (1994); Order No. 566, 59 Fed. Reg. 32,897 (1994); Order No. 566-A, 59 Fed. Reg. 52,904 (1994). *See also* 18 C.F.R. § 161.3 (1997).

21. Standards of Conduct for Interstate Pipelines with Marketing Affiliates, 18 C.F.R. § 161.3 (1997).

22. *Amoco Prod. Co. v. Natural Gas Pipeline Co.*, 82 F.E.R.C. ¶ 61,038 (1998) [hereinafter *Natural*].

provided that no further violations of the standards occur during the succeeding two years. As reported in *Inside FERC* (January 26, 1998), Chairman Hoecker was quoted as saying that the proposed penalties and sanctions, including limitations on transfer of employees and bifurcation of corporate strategic advice between the pipeline and its marketing affiliate, send the message “that if we have adopted regulations, we expect pipelines to conform to the spirit and the letter of those regulations,”²³ rather than trying to “circumvent” them. Commissioner Hebert added that “in cases where we find harm to the industry as a whole, we’re . . . going to make sure you clean up your act, because in the end that’s what we’re here for.”²⁴ Without reciting the specifics of the violations identified by the FERC’s audit team, the overall message is that Natural Gas Pipeline Company (Natural) was not functioning separately from its marketing affiliate, primarily due to the interaction of two organizational groups, the System Optimization Group and the Order Management Group, listed as Natural employees, with MidCon Gas employees. Additionally, it was found that Natural had provided information to MidCon Gas that was not contemporaneously provided to non-affiliated shippers.²⁵

MidCon Gas was subsequently acquired by KN Energy. According to the compliance plan filed by Natural on February 17, 1998, strenuous efforts are being made to satisfy the conditions of FERC’s January 16, 1998 Order, including payment of the civil penalty. In fact, one reason for the conditional suspension of half the penalty was the cooperation displayed by Natural in dealing with the Commission’s auditors, and its remedial efforts after the audit report was issued.²⁶

However, it is important to point out that one of the remedies the FERC considered, but rejected, was “divorcement” of Natural from MidCon Gas.²⁷ This suggestion was made by Burlington Resources Oil & Gas, a non-affiliated marketer.²⁸ Exxon did not go so far as to recommend divestiture, but suggested that “the Commission’s remedies should include the right [of non-affiliated marketers] to match any affiliate bid accepted by a pipeline.”²⁹

To summarize, Order No. 497 standards appear to be workably drafted in fairly simple, understandable terms. They satisfy the objective of leveling the playing field in favor of the recipients of regulated pipeline transportation services and eliminating discrimination in terms of access to pipeline systems by reducing discriminatory practices between competing shippers. The *Natural* order exposes the tactics of those non-regulated market entrants who would go much further than required to secure these legitimate objectives—either through outright structural separation or competitive disadvantages to affiliated

23. Chris Newkumet, *FERC, as Cop on the Beat, Hammers Natural Over Affiliate Relations*, INSIDE F.E.R.C., Jan. 26, 1998, at 1, 12 [hereinafter *Newkumet*].

24. *Id.* at 13.

25. *Id.*

26. 82 F.E.R.C. ¶ 61,038, at 61,171.

27. *Newkumet*, *supra* note 23, at 41.

28. 82 F.E.R.C. ¶ 61,038, at 61,171.

29. *Id.*

marketing entities of such magnitude to effectively render them non-competitive. In declining the invitation offered by Burlington and Exxon in this complaint proceeding, the FERC acted properly in that it continued to be mindful of the proper reach of its concern over competitive matters.

On the state level, since the FERC instituted the first behavioral code with the issuance of Order No. 497, there has been a disturbing trend toward trying to do much more with codes of conduct than maintain the level playing field so that recipients of regulated LDC delivery services can make their own informed choices among competing non-regulated service or product offerings.³⁰ Suffice it to say that there is a mixed bag of behavioral and structural remedial approaches, and that over time, the complexity has increased.

These approaches have included the prohibition in New York against an LDC's marketing affiliates doing business in the LDC's service territory – which was later rescinded. By subsequent order, the New York Public Service Commission issued "Interim Standards for Transactions between LDCs and Related Companies."³¹ In New Mexico, the Public Service Commission has prohibited marketing or brokering activities by jurisdictional utilities, as the Commission has proposed to do in Oklahoma, where utilities would only be allowed to offer regulated services to end users.³² In Wisconsin, the Commission has prohibited the common use of corporate logo or brand name by an LDC and its affiliated marketer.³³ In Maine, legislation has been passed under which the state utility commission must order divestiture of an affiliate where it determines there has been a "knowing violation" of the utility standards of conduct. The standards generally prohibit preferential treatment for affiliates; prohibit joint advertising and marketing; require a utility to provide lists of competitive, non-regulated electricity providers in random order; and provide that employees may not be shared; physical separation is required unless the utility demonstrates that sharing would not have an anti-competitive effect and the costs of employees and facilities can be fully and accurately allocated.³⁴

State regulatory action is also pending in many states. One of the recently opened dockets is in Kentucky. The Commission is considering utility and interested party responses to detailed data requests on the scope and nature of

30. *Summary of State Commission Activity Concerning Standards of Conduct for Gas Utility Marketing Affiliates*, GOVERNMENTAL REL. ISSUES SUMMARY (Am. Gas Ass'n., Arlington, Va., October 1997, and revised, June 1998) <<http://www.aga.com/scripts/at-test1search.exe>>.

31. Order Concerning Compliance Filings, No. 93-G-0932, 1996 WL 159878 (N.Y. Pub. Serv. Comm'n. Mar. 28, 1996).

32. Final Order Adopting First Revised N.M.P.U.C. Rule 660, No. 2472, 1994 WL 88336 (N.M. Pub. Util. Comm'n. Feb. 7, 1999) (*discussing Rule 660.12*, Notice of Intent to Solicit Proposed Rules, No. RM97000009, 1997 WL 120606 (Okla. Corp. Comm'n. Feb. 18, 1997)).

33. Order Adopting Standards of Conduct, No. 05-GI-108, 174 P.U.R. 4th 605 1998 WL 413510 (Wis. Pub. Serv. Comm'n. Jan. 9, 1997).

34. 1998 Me. Laws 237. The Maine Public Utilities Commission issued a proposed rule that requires standards of conduct concerning the use of customer specific information and prohibits utility preference for an affiliate. Additionally the proposed rule imputes a royalty payment to the utility if the affiliate uses the name of the utility or engages in joint marketing or advertising with the utility. Order Provisionally Adopting Rule and Statement of Factual and Policy Basis, No. 97-886, 1998 WL 413510 (Me. Pub. Util. Comm'n. Feb. 18, 1998).

permissible activities by affiliated marketers of LDCs and the types of restrictions, if any, that the PSC should institute.³⁵ Data requests have reached such issues as royalties for use of the utility's brand and logo, operational separation, and the like. On September 3, 1998, the Commission issued a draft code of conduct and cost allocation guidelines for comment.³⁶

A dramatic distinction can be drawn between Order No. 497's FERC standards of conduct and the rules of conduct recently adopted by the California Public Utilities Commission (California Commission).³⁷ The California Commission's 100-page order adopted Affiliate Transaction Rules set forth in a 20-page appendix, single spaced.³⁸ This is in comparison to the three pages of standards that the FERC adopted. Additionally, the California Affiliate Transaction Rules go far beyond the legitimate ends of state regulatory authority which are to ensure that non-regulated activities of a LDC's affiliates do not adversely affect regulated utility services to consumers. These rules, by virtue of their complexity, their record keeping and reporting obligations, and multiple safeguards for non-affiliated marketing entities, can render ineffective the behavioral remedy they seek to implement. As one who believes that consumers will benefit from the continued vitality and participation in the marketplace of marketers affiliated with public utilities, my concern is that the deficiencies with this behavioral code will ultimately cause the affiliate transaction rules to be frustrating, ineffective, and, finally, may cause them to be rejected in favor of the "simple and easy" solution of organizational divestiture for affiliated marketing entities.

The excruciating detail of the California rules is well-illustrated by the following examples. While an affiliate is permitted to use the common logo and brand of the jurisdictional utility, that use is encumbered by the requirement of a multi-pronged disclaimer.³⁹ The utility is prohibited from joint

35. Order Granting a Motion to Withdraw a Petition for Regulatory Exemption of Enhanced Telecommunications Services, No. 92-369, 1993 WL 613607 (Ky. Pub. Serv. Comm'n. Feb. 1, 1993).

36. See Interrogatories issued by the Kentucky Public Service Commission, Administrative Case No. 369 (Dec. 19, 1997 Order - Appendix C); See also Appendix A and B to Order issued September 3 in same proceeding.

37. Order Instituting Rulemaking to Establish Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates, Rulemaking 97-04-011, and Order Instituting Investigation to Establish Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates, Investigation 97-04-012, 1997 WL 377061 (Calif. Pub. Util. Comm'n. Apr. 9, 1997).

37. Appendix A to Decision 97-12-088 is set forth in its entirety at the conclusion of this article.

38. See *infra* Appendix A, Rule V:

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 . . . 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.

advertising/marketing activities with its affiliates, including joint sales calls, joint proposals (including responses to requests for proposal), and even from participating in California-sited trade shows or conferences with affiliates.⁴⁰ Severe restrictions on the transfer of employees between the utility and affiliates are imposed, and a royalty based on twenty-five percent of the transferred employees' total annual compensation is to be credited to the utility's cost of service.⁴¹ A utility is prohibited from making "temporary or intermittent [employee] assignments or rotations to its affiliates."⁴² A California utility can no longer share the costs of research and development activities with affiliates.⁴³ It may not be provided corporate support services by a parent holding company or service affiliate in the areas of "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."⁴⁴

California's code also addresses the issue of physical separation. While the rule includes a prohibition against shared office space, office equipment, services, and systems with affiliates (with limited exceptions earlier noted for corporate support services), and states a preference for separate buildings, the rule allows, as an alternative, separate elevator banks "and/or security-controlled access."⁴⁵ In the area of business development and customer relations, Rule III(E) prohibits a utility from providing leads to affiliates, soliciting business on behalf of affiliates, acquiring information from or providing it to affiliates, or requesting authorization from its customers to pass on customer information exclusively to its affiliates, among other prohibitions.⁴⁶

As previously stated, the California scheme, in attempting to become the guardian and protector of non-affiliated market entrants in competitive markets, strays far from the mark and the code's cost to implement and police—both in terms of dollars and manpower—and will lead to frustration that some may seek to cure by looking for "cleaner" structural solutions. Notably, Commissioner Gregory Conlon dissented, based on his belief that the Decision and Order stopped short of the full range of behavioral limitations it should have embodied:

One of the major issues in today's decision on affiliate transactions addresses our concern over a potential for market power abuse in the direct access market we are

The fallacy in requiring such detailed disclaimers is the mistaken underlying premise that the logo and brand name of the utility are assets owned by the consumers of regulated utility services. The better view is that logo and brand name are assets owned by the utility's investor; as held by the Minnesota Supreme Court in *Minnegasco v. Minnesota Pub. Util. Comm'n.*, 549 N.W.2d 910 (1996), the brand and logo of a utility, or the integrated company of which the utility is an affiliate or division, are the asset of the investors of the corporation; this asset does not become the property of the utility's regulated service consumers simply because the utility is subject to regulation of its rates and conditions of service.

40. *Infra* Appendix A, Rule V(F)(4).

41. *Infra* Appendix A, Rule V(G)(2).

42. *Infra* Appendix A, Rule V(G)(2)(e).

43. *Infra* Appendix A, Rule V(F)(5).

44. *Infra* Appendix A, Rule V(E). Legal services, along with payroll, taxes, insurance, benefits management and lobbying, are permitted.

45. *Infra* Appendix A, Rule V(C).

46. *Infra* Appendix A.

creating; that is the advantages that an affiliate of an incumbent utility has in marketing to customers in the new competitive marketplace. This includes the ability of the affiliate to use the name, logo, and goodwill of the utility. My goal has been to maximize the number of competitors in the new direct access market that we are creating. In my mind, it does not make sense to open up the electric market to competition if the newly created direct access market itself could be dominated by the affiliates of the incumbent utilities.

* * *

The only reason I can see for the affiliate's better success than its competitors is the ability of the affiliate to piggy-back off of the brand name, logo, advertising and name recognition of the sister utility. As Commissioner Bilas noted, referring back to the textbook on microeconomics that he authored as a college professor in 1971, brand name identification is a barrier to entry and if significant could lead to market abuse.⁴⁷

These statements crystallize the dangers, identified by Director Baer, in deregulating an industry with various agencies at state and federal levels all trying to protect competition. There is no recognition that other governmental agencies at the state and federal level have ample authority, and the willingness to employ it, to ensure that competition can flourish as the gas and electric industries deregulate more fully. The statements also suggest a complete disregard for the legitimate claim of an integrated company, as identified in *Berkey Photo*, to the benefits arising from integration. The extreme protectionist view embodied in the California Affiliate Transaction Rules also completely discounts the ability of consumers—given full information from competing products and services—to make their own intelligent decisions among the competing offers.

Not all recent state commission investigations have resulted in overly complex behavioral codes. On February 23, 1998, the Maryland Public Service Commission (Maryland Commission) issued Order No. 74038, concluding its investigation into affiliated transactions and affiliate standards for gas and electric companies operating in Maryland.⁴⁸ Order No. 74038 is seventy-eight pages in length, but it adopted two conduct codes that take up just over two pages single spaced.

The more detailed of the two codes governs a gas or electric utility's relationship with "core-service" affiliates, which are defined as those affiliates engaging in "activities previously provided by a utility as a monopoly service."⁴⁹ The Maryland Commission identified these as currently consisting of a utility's gas or electric marketing affiliates, even though it held open the prospect that in the future, more affiliates might be designated as "core-service related" and thus, subject to the core service standards of conduct. This code has been identified as a "generic version" of the conduct code earlier adopted in a case

47. *Id.* at 2-3 (Conlon, dissenting).

48. In the Matter of the Investigation by the Commission into Affiliated Transactions and Affiliate Standards of Conduct of Companies Providing Gas or Electric Service in Maryland, Order No. 74038, 1998 WL 159021 (Md. Pub. Serv. Comm'n. Feb. 23, 1998).

49. *Id.*

involving Baltimore Gas & Electric.⁵⁰ In these standards, neither utility nor affiliate may state that any advantage or detriment in terms of basic utility service may flow from dealings with the affiliate; joint sales calls can be initiated only at the customer's request; and joint promotions can be used only if the same terms and conditions are available to non-affiliated marketers. The utility cannot share leads with its affiliate, or imply that it speaks on the affiliate's behalf. All service requests must be handled on an even-handed basis and with the same promptness. Tariff provisions must be applied without discrimination and regulated service cannot be tied to any other service or product. Customer information relating to regulated services cannot be shared without the consumer's informed written consent. The only quasi-structural provision is that the utility and core service marketers must operate from "physically separate locations to avoid the inadvertent sharing of information."⁵¹

A more relaxed approach was adopted by the Maryland Commission with respect to "non-core service affiliates." Only four standards were created. These standards include: a prohibition on either the utility or the affiliate representing that any utility service advantage is tied to the non-regulated service or product offering; no preference can be given to customers of the non-core affiliate in regulated utility service; regulated utility service cannot be conditioned or tied to any other product or service offering; and advertising material utilized by either the utility or its affiliate can identify the association between the two.⁵²

While the Maryland Order is not a model of perfection,⁵³ the Maryland Commission approached the promulgation of these standards with an accurate perception of the legitimate purpose of a behavioral code, as illustrated by the following excerpt from the Order:

The restructuring of the gas and electricity industries means that once vertically-integrated utilities are no longer the sole suppliers of various energy services. Moreover, in an effort to expand business opportunities beyond the regulated sector, utilities have diversified into numerous unrelated, unregulated activities. In order to ensure non-discriminatory access to a utility's monopoly distribution system(s), to regulate the dissemination of certain information by a utility to its affiliates, and to protect the customers of a regulated utility, we find it appropriate to adopt certain standards of conduct. However . . . we anticipate that these codes

50. *Re Inquiry into Natural Gas Brokering of BNG, Inc., a Subsidiary of Baltimore Gas and Elec. Co.*, Case No. 8709, 87 Md. Pub. Serv. Comm'n. 43, 1996 WL 656736 (1996).

51. *In the matter of the investigation by the Commission into affiliated transactions and affiliate standards of conduct of companies providing gas or electric service in Maryland*, Case No. 8747, Order 74038 at 43-44, 1998 WL 159021 (Md. Pub. Serv. Comm'n. Feb. 23, 1998).

52. *Id.* at 44-45.

53. For example, in the allocation of costs of assets and services transferred within the affiliated group, the Commission establishes a requirement that assets transferred from the utility to a non-utility affiliate must be priced at the higher of fully depreciated cost or market value, while assets received by a utility from non-utility affiliates must be priced at the lower of fully depreciated cost or market value; this "assymetrical pricing" model sets up a potential conflict for public utility holding companies registered under the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79, 792-6, due to its restrictions on utilities transferring goods to associated companies at more than cost. See Order 74038, *supra* note 51, at 29-32.

of conduct⁵⁴ may be relaxed in the future as energy markets become more competitive.

It is important to note that stewardship for non-regulated market entrants was *not* identified as a motivating reason for these standards. It is also worth noting that interest groups representing potential competitors of utility affiliates were well represented and that recommendations were submitted by such intervenors for far more complex behavioral restrictions along with full structural separation.⁵⁵

Narrowly framed behavioral remedies are viable and worthwhile. Codes of conduct *can* work effectively, if limited to the right ends (ensuring that the consumers of regulated utility services can make their own intelligent choices when presented with competing market-valued services). Informed consumers will not be duped by the affiliation of one of the competing market entrants with a regulated utility. When codes of conduct promote a level playing field by preventing abusive conduct among affiliates—as the FERC Order No. 497 standards do—consumers can make meaningful selections and can trust our antitrust enforcement brethren fully and effectively to uphold laws protecting competition among new market entrants.

In this regard, consider the “Principles on Standards of Conduct for Utilities and Their Marketing Affiliates” recently adopted by the American Gas Association (set forth in their entirety as Appendix B to this Article). These Principles, if followed by state regulators, will ensure that the behavioral codes of conduct they create will be focused on preventing undue advantage to affiliated entities while simply and clearly protecting the full range of competitive choices for informed consumers.

To go further in crafting conduct codes with all the painful detail we have seen in California, and suggested but rejected in Maryland, foreshadows a breakdown in this remedial approach, and the onset of more explicitly structural remedies. The loser in that instance would be the consumer.

54. *See supra* note 51.

55. For example, the Maryland Alliance for Fair Competition, the Air Conditioning Contractors of America-National Capital Chapter and the Mid-Atlantic Petroleum Distributors submitted recommendations for standards requiring:

structural separation; operational separation; personnel separation; competitive procurement for utility-sponsored programs; information and billing separation; non-discrimination regarding discounts, rebates, terms of service, *etc.*; competitive marketing and sales practices; prohibitions of joint promotions, use of utility logo by affiliates, and sales leads; financial support separation; cost allocation procedures; continual informational filings; written procedures for training and education; a complaint procedure; and, enforcement procedures.

Id. at 38. That the Maryland Commission was able for the most part to focus on consumers of regulated services rather than their “wannabe” constituents—the marketers, contractors and dealers who would be faced with competition from affiliated market entrants in non-regulated products and services—is apparent in the standards ultimately adopted in Order No. 74038.

APPENDIX A⁵⁶**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 percent 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 the 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

56. *Opinion Adopting Standards Of Conduct Governing Relationships Between Utilities and Their Affiliates*, Decision 97-12-088 (Cal. Pub. Util. Comm'n. Dec. 16, 1997).

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 instructions:

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, 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.

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.

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 conduit to circumvent any of these Rules.

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. 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 affiliates.

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, 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 and 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 by independent auditors that verify that the utility is in compliance with the Rules set forth herein. The utilities shall file this audit with the Commission's Energy Division beginning no later than December 31, 1998, 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 their 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 capital, minimal or no new forms of liability or business risk being incurred by the utility, and minimal or no direct management control; and

e. the utility offering is restricted to less than 1% of the number of customers in its customer base.

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 and 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 recovery in the Transition Cost Proceeding, A.96-08-001, or other applicable 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.

2. 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.

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 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

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

Appendix B⁵⁷**PRINCIPLES ON STANDARDS OF CONDUCT FOR UTILITIES AND THEIR MARKETING AFFILIATES**

If state regulatory agencies and legislatures choose to adopt standards of conduct for utilities and their marketing affiliates, A.G.A. recommends that they consider the following principles as guidelines:

- The purpose of the standards should be to protect and benefit the consumers of regulated services and protect such consumers' competitive choices, rather than competitors.
- The standards should use existing state regulatory authority to prevent inappropriate cost-shifting between the regulated and unregulated activities of utilities and their affiliates.
- Consumers should be able to choose among commodity and non-commodity services from a selection of suppliers that includes the local utility, should it offer these services.
- Standards that apply to any marketers should apply equally to all marketers, in order to avoid handicapping either the utility as merchant or its affiliates. Neither the utility as merchant nor its marketing affiliates should be placed at a disadvantage to unaffiliated marketers.
- Standards should permit the realization of economies of scope and scale, which benefit the consumer by decreasing the costs of doing business for the utility and its affiliate.
- Utilities and their marketing affiliates should be permitted to use the same or similar name or logo and utility affiliates should be permitted to identify themselves as such in order to provide consumers with meaningful information. A utility's marketing affiliates should be permitted to operate in the utility's home service territory.
- A utility should apply its tariff provisions relating to essential services on a non-discriminatory basis to all similarly situated competitors.
- A utility that makes available non-customer-specific and non-public information about customers or utility services to any affiliated or unaffiliated marketer should have that information available for all marketers on a non-discriminatory basis.

57. Excerpt provided by the American Gas Association (1998).

