Comments of the Independent Regulatory Review Commission

Pennsylvania Public Utility Commission Regulation #57-287 (IRRC #2929)

Code of Conduct

April 26, 2012

We submit for your consideration the following comments on the proposed rulemaking published in the February 11, 2012 *Pennsylvania Bulletin*. Our comments are based on criteria in Section 5.2 of the Regulatory Review Act (RRA) (71 P.S. § 745.5b). Section 5.1(a) of the RRA (71 P.S. § 745.5a(a)) directs the Pennsylvania Public Utility Commission (PUC) to respond to all comments received from us or any other source.

1. Need for the regulation.

This regulation proposes amendments to the Code of Conduct for electric distribution companies (EDC) and electric generation suppliers (EGS) providing service to Pennsylvania customers, in accordance with the Electricity Generation Customer Choice and Competition Act. *See* 66 Pa.C.S. §§ 2801, *et. seq.* The existing Code of Conduct was implemented in July of 2000.

Section 5.2 of the RRA (71 P.S. § 745.5b) directs the Independent Regulatory Review Commission (IRRC) to determine whether a regulation is in the public interest by considering criteria set forth in the RRA, including the need for the regulation. *See* 71 P.S. § 745.5b(b)(3)(iii). As explained below, we do not believe the PUC has established a compelling need for the amendments to the regulation sufficient for us to make a determination that the amendments are in the public interest.

Commentators on the proposed amendments, representing a broad range of interested parties, do not see a need for the amendments. According to the Energy Association of Pennsylvania (Energy Association):

> Pennsylvania EDCs have employed considerable resources and successfully implemented the current regulations as evidenced by lack of complaints or requests for mediation filed over the last twelve years under the existing Code of Conduct. While the Association commends the periodic review of long-standing regulations, major regulatory changes are not warranted where, as here, no evidence or support has been offered to suggest that the existing rules do not serve to deter or prevent the undesired behavior....

The joint comments of PPL Electric Utilities Corporation and PPL Energy Plus, LLC (PPL) note that: "the existing Code of Conduct has worked well and has aided in the successful development of Pennsylvania's electric retail market." Other commentators expressed similar sentiment.

In our consideration of the need for the amendments to the regulation, we have reviewed the Preamble (as contained in the Proposed Rulemaking Order for this regulation), the Regulatory Analysis Form (RAF) and the proposed regulation. The PUC itself acknowledges that most parties found the existing Code of Conduct effective. In this proposed rulemaking, there is no information in the PUC's Preamble that demonstrates a compelling public need. For example, the PUC states the regulation provides a safeguard against cross-subsidization between an EDC and its affiliated EGS. The existing Code of Conduct has been in place for more than ten years. However, the PUC did not provide any specific findings, such as complaints filed with the PUC or an investigation, to substantiate that cross-subsidization is a significant problem.

Therefore, we recommend that in the final-form regulation submittal the PUC specifically explain the need for this regulation, and in particular describe any instances of misconduct or other circumstances that warrant changes to the existing regulation.

2. Fiscal impact of the regulation.

IRRC is also required to consider economic or fiscal impacts of the regulation in our determination of whether the regulation is in the public interest. *See* 71 P.S. § 745.5b(b)(1). Questions 14 through 18 of the RAF are intended to provide a cost and impact analysis of the regulation. In response to Question 17, the PUC did not identify savings or costs to the regulated community associated with implementation of this regulation. Question 18 of the RAF asks the PUC to explain how the benefits of the regulation outweigh any cost and adverse effects.

The PUC responded to this question with the following explanation:

> While the costs associated with the regulation are not fully known at the present time, there will be significant economic benefits to Pennsylvania electricity consumers resulting from the elimination of cross-subsidization of service between electric distribution companies and their affiliated electric generation suppliers....

Several commentators refute the PUC's evaluation of costs. They demonstrate that implementation of this regulation will impose significant costs on the regulated community, thereby impacting how much consumers will actually pay for their electric services. The joint comments of Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company, and West Penn Power Company (FirstEnergy) estimate increased operating expenses of $26 to $43 million per year, as well as a capital investment exceeding $100 million due to implementation of this regulation. Commentators assert that significant costs will be incurred without any identifiable benefit to consumers.

Also relating to fiscal impact, we question who will ultimately bear the costs of the amendments to the Code of Conduct. Costs incurred by an EDC are likely to be recovered through PUC-

approved rates charged to the EDC's captive customers because the costs were incurred to comply with the PUC's regulations. On the other hand, similar costs incurred by a competitive EGS would not be recovered with the same degree of certainty and would presumably be recovered either through the EGS's rates, thereby harming its competitiveness in the marketplace, or by absorbing the costs, thereby lowering the EGS's profits. Consequently, a logical business decision for anyone with common interests in both an EDC and an EGS may be to incur costs through changes to the EDC rather than the EGS. For example, to comply with the PUC's proposed regulation, an entity may change the EDC's logo and maintain the EGS's logo. From a business perspective, this entity could recover the costs through the EDC while simultaneously maintaining the EGS's profits and competitive place in the marketplace. In this scenario, the costs imposed by the amendments to the Code of Conduct could be imposed almost exclusively on the captive customers of the EDC through rates, and possibly rate increases, approved by the PUC.

Upon review of the information provided by the PUC in the proposed regulation submitted, we do not believe sufficient information was provided to evaluate the economic or fiscal impact of this regulation. We recommend that the PUC carefully review costs with the regulated community. In addition, the PUC needs to explain who will bear the costs imposed by the amendments to the regulation. In the final-form regulation submittal, the PUC needs to provide a detailed economic and fiscal impact analysis so that we can determine whether the regulation is in the public interest.

3. Determination of whether the regulation is in the public interest.

Sections of the RAF and Preamble submitted with this rulemaking lack the necessary information to allow IRRC to make a determination that the regulation is in the public interest. For example, the statutory authority references contained in the RAF are inconsistent with those contained in the Preamble. The RAF (#8) cites the following from the Public Utility Code as the statutory authority for this regulation: 66 Pa. C.S. §§ 501(b), 504, 505, 506, 508, 701, 1301, 1304, 1502, 1505, 1701-1705, 2101-2107, 2804, 2807(d), 2809, and 2811(a). Not only is it unclear how several of these citations are directly applicable to the proposed rulemaking, but the Preamble cites only §§ 501, 2804(2) and 2807(e).

Another example pertains to the description of how the regulation compares with those of other states. (RAF #22). The RAF highlights Texas, Illinois, New Jersey, Maryland, Ohio, and Massachusetts as states having similar Codes of Conduct as the proposed regulation. Commentators, however, argue that other states do not operate under comparable requirements.

In summary, the information contained in the RAF and Preamble is not sufficient to allow us to determine if the regulation is in the public interest. We recommend that the PUC revise both the RAF and the Preamble to ensure that all of the information provided in the final-form regulatory package is accurate, complete and consistent between the two documents. The Preamble should also provide a more detailed description of the basis for the amendments proposed in each section of the regulation.

4. Recommendation for an Advanced Notice of Final-Form Rulemaking.

As noted above, in 2010, the PUC issued an Advanced Notice of Proposed Rulemaking Order, and the regulated community had the opportunity to review and comment on the regulation. Comments were provided by several parties. The PUC states that these comments, as well as additional safeguards identified by the PUC, were taken into consideration in developing and drafting the proposed regulation. (RAF #19). At both the proposed and advanced notice stages, however, the regulated community indicated that modifications are not necessary, as the existing Code of Conduct already affords the appropriate protections against misconduct between the EDC and its affiliated EGS.

We commend the PUC for providing the regulated community with an advanced opportunity to comment on the proposed regulation. We strongly encourage the PUC to continue this dialogue with stakeholders as it develops the final-form regulation. Additionally, we recommend that the PUC publish an Advanced Notice of Final Rulemaking to allow the opportunity to review the costs and resolve any remaining issues prior to submittal of a final-form regulation.

Section 54.122 (3) Prohibited transactions and activities.

5. Subsection 54.122 (3)(ii). - EDC sale of assets - Statutory authority; Adverse effects on prices and competition; Reasonableness.

Subsection (3)(ii) states that: "An electric distribution company may not sell, release or otherwise transfer to an affiliate electric generation supplier, at less than market value, assets, services or commodities that have been included in regulated rates." Both PPL and the Energy Association assert that while the Public Utility Code allows the PUC to regulate transfers and sales between these parties, the Public Utility Code does not permit the PUC to mandate the price. *See* 66 Pa.C.S. § 2102. The final-form regulation should explain the PUC's statutory authority for regulating the fair market value of a transferred or sold electric asset, service or commodity.

The joint comment of UGI Corporation, UGI Utilities, Inc. and UGI Energy Services, Inc. contends that implementation of this provision would result in out-of-state EGS marketers gaining a competitive advantage over an EGS affiliated with a Pennsylvania EDC, because those located out-of-state are unaffected by the regulation and are therefore still able to acquire assets at below market value. This would result in a significant barrier for EGS affiliates to compete in the interstate market. The PUC should explain how Subsection (3)(ii) will not place Pennsylvania EGS affiliates at a competitive disadvantage over out-of-state affiliates.

6. Subsections 54.122 (3)(iv) and (v) - Conflicting language - Possible conflict with regulation.

Both of these subsections pertain to whether an EDC and its affiliated EGS may advertise a shared name. It appears that the name sharing requirements in each subsection conflict.

Subsection (3)(iv) states that: "An electric generation supplier may not use a word, term, name, symbol, device, registered or unregistered mark or a combination thereof (collectively and singularly referred to as "EDC identifier") that identifies or is owned by an electric distribution company, in connection with the sale, offering for sale, distribution or advertising of goods or services, **unless the electric generation supplier includes a disclaimer and enters into an appropriate licensing agreement specifying the rights.**" (Emphasis added.)

However, Subsection (3)(v) states that: "An electric generation supplier **may not** have the same or substantially similar name or fictitious name as the electric distribution company or its corporate parent . . ." (Emphasis added.)

We recommend that the PUC reconcile these subsections in the final-form regulation.

7. Subsection 54.122 (3) - Name prohibition - Statutory authority; Fiscal impact; Consistency with federal law; Need; Implementation procedures.

Subsection (3)(v) prohibits an EGS from having the same or "substantially similar" name as the EDC or its corporate parent.

a. Statutory authority

Commentators argue that the PUC does not have the authority to restrict the naming rights of an EDC or its corporate parent. Several commentators state that the Public Utility Code limits the PUC's jurisdiction to regulating rates, facilities and services. *See* 66 Pa.C.S. §§ 501 and 1501. Commentators assert that the Legislature did not intend for the PUC's authority to extend beyond these functions, as the Public Utility Code does not explicitly grant authority pertaining to name prohibition. What is the PUC's statutory authority for prohibiting an EGS from using the same name as the EDC or its corporate parent? The final-form regulation should clarify this authority.

b. Need and Fiscal impact

The majority of the commentators oppose Subsection (3)(v) for several reasons. First, according to PPL, there is no evidence that "consumers are being harmed or that competitors are being prevented from entering the market" as a result of an EGS sharing the name of its EDC or corporate parent.

Second, commentators argue that this provision will severely hinder affiliated EGSs from continuing to operate in Pennsylvania. They contend that the name that an existing EGS affiliate shares with its EDC or corporate parent has been well established through the branding process, and to require the EGS to change its name would result in a complete overhaul of that company's brand. Commentators argue that this overhaul would negate significant investments made since 2000 in developing its brand and consequently result in increased costs for the EGS as it re-invents its brand name. In addition, these costs also will affect the relationship between the Pennsylvania affiliate EGS and the corporate parent. We are particularly concerned by comments that the corporate parent, who is able to share its name in other jurisdictions, may

simply require its affiliates to leave Pennsylvania altogether in order to avoid the added expense of a name change.

Third, commentators argue that customer confusion would result during the transition process. According to FirstEnergy Solutions Corp.: "the requirement that an EGS conceal its affiliation with an EDC runs counter to the obligation to provide customers with adequate and accurate information to enable them to make informed choices regarding the purchase of electricity service." Several EGSs also emphasize that the name itself is not the key, but more important are the disclosures that should be made to the consumer about the relationship between the EDC and the EGS affiliate. With this information, the consumer would be able to understand which party is providing what service, regardless of whether they share a name.

Finally, commentators contend that no state has this name sharing prohibition. According to the Preamble, use of this restriction "varies" in other jurisdictions. However, commentators point out that no state mentioned by the PUC in the RAF prohibits name sharing between the EGS and the EDC or corporate parent.

We believe commentators raise valid concerns relating to the name sharing prohibition. In contrast, the PUC has not demonstrated a compelling public need for imposing these requirements. Therefore, the PUC should explain not only the need for this subsection, but also how the costs imposed are warranted.

c. Conflict with federal law

Commentators assert that state regulation of trademarks is a violation of existing federal law. According to commentators, the Lanham Act establishes the regulation of trade names and trademarks as an area of exclusive federal jurisdiction. *See* 15 USC §§ 1051, *et seq.* They further assert that to prohibit an affiliated EGS from name sharing with an EDC will result in the EGS changing federally trademarked names in order to do business in Pennsylvania. We will review the PUC's response to these comments as part of our determination of whether the regulation is in the public interest.

d. 6-month timeframe

According to Subsection (3)(v), an EGS that shares the same or substantially similar name as the EDC or its corporate parent must change its name within 6-months after the effective date of the rulemaking. Commentators have established that to change a name would require companies to create an entirely new brand, which would be a very time-consuming process. We recommend that the PUC review the branding processes detailed in comments, and provide an explanation of how an EGS can reasonably comply with the timeframe specified in the final-form regulation.

8. Subsection 54.122 (3)(vii) - Joint Marketing, Sales and Promotional Activities. - Clarity.

This subsection states that an EDC and its affiliated EGS may not engage in "joint marketing, sales or promotional activities" unless a similar opportunity is "offered to electric generation suppliers in the same manner under similar terms and conditions." A commentator questions

whether these activities would extend to providing information beyond that related to the affiliated EGS's product or service, for example to educational materials. To improve clarity, we recommend that the final-form regulation specify what encompasses "joint marketing, sales or promotional activities."

9. Subsection 54.122 (3)(ix) - Prohibition of sharing office space. - Statutory authority; Fiscal impact; Consistency with federal law; Need; Reasonableness.

This subsection prohibits an EDC and its affiliated EGS from sharing office space and requires that they must be "physically separated by occupying different buildings."

a. Statutory authority

Commentators argue that there is no provision in the Public Utility Code that would allow the PUC to force this type of structural separation. They cite Section 2804(5) of the Public Utility Code, which states that: "the commission may permit, **but shall not require**, an electric utility to divest itself of facilities or to reorganize its corporate structure." (Emphasis added.) Commentators suggest that their current method for maintaining operations separate from their affiliated EGS is through offices on separate floors in the same building. According to FirstEnergy, complying with this provision would: "impose a wall of separation between EDCs and their affiliated EGSs so pervasive that it would be the functional equivalent of a forced reorganization or divestiture, which the Public Utility Code does not permit." The PUC should explain how the occupation of different buildings by an EDC and its affiliated EGS is consistent with the Public Utility Code.

b. *Need and Reasonableness*

According to the Preamble, occupation of different buildings is a common limitation imposed on EDCs and their affiliated EGSs in other jurisdictions. However, commentators argue that while most states prohibit shared office space, the physical separation is imposed by placing the EDC and its affiliated EGS on different floors, not in different buildings. For example, a commentator points out that Texas law permits the EDC and its affiliated EGS to operate in the same building, as long as their offices are on separate floors or have separate access. *See* 16 Texas Admin. Code § 25.272 (d)(5). Additionally, the PUC has not provided specific examples of abuses or complaints which would warrant a requirement for occupying different buildings. The PUC should delete this requirement or explain why it is needed and reasonable.

c. Consistency with federal law

Additionally, requiring the EDC and its affiliated EGS to occupy different buildings may be inconsistent with federal regulations. Commentators state that, according to the Federal Energy Regulatory Commission's (FERC) Standards of Conduct and Affiliate Rules: "to the maximum extent practical, the employees of a market-regulated power sales affiliate must operate 'separately' from the employees of any affiliated franchised public utility with captive customers." *See* 18 C.F.R § 35.39(c)(2)(i). Commentators further assert that while FERC's rule requires that employees must operate separately, it does not mandate different buildings.

Therefore, the PUC should explain why it is in the public interest to require Pennsylvania's EDC and its affiliated EGS to occupy different buildings, which is more stringent than the employee separation requirements imposed by FERC.

d. *Fiscal impact*

According to the RAF (#10), the PUC asserts that: "Most electricity consumers in the Commonwealth are likely to benefit from this regulation." However, commentators indicate that moving entire organizations to different facilities will be a costly endeavor for utilities, ultimately resulting in increased costs of services to consumers. The PUC needs to evaluate the costs of this requirement and explain how the benefits of the requirement outweigh the costs.

Section 54.122 (4) Accounting and training requirements.

10. Subsection 54.122 (4)(ii) - A log of business transactions between the EDC and its EGS affiliate. - Clarity.

Subsection (4)(ii) requires an EDC with an EGS affiliate to document their business relationship through a cost allocation manual. According to Subsection (4)(ii)(A), this manual must include a "log of business transactions" between the EDC and the EGS, but the regulation does not detail specifically what types of business transactions should be included. We recommend that the final-form regulation specify what "business transactions" must be documented.

11. Subsection 54.122 (4)(iii) - Prohibition on sharing employees or services - Statutory authority; Fiscal impact; Consistency with federal law; Reasonableness; Clarity.

Subsection (4)(iii) prohibits an EDC and its affiliated EGS or transmission supplier from sharing employees or services, except corporate support services, emergency support services, and tariff services. The major area of concern for commentators is the exceptions included in Subsection (4)(iii)(A) as to what may constitute "corporate support services." According to this subsection, "corporate support services" does not include services such as: "information systems . . . strategic management and planning . . . legal services . . . lobbying. . ."

a. Statutory authority

Commentators argue that there is no provision in the Public Utility Code that would allow the PUC to prohibit an EDC and its affiliated EGS from sharing these excluded services. As noted above, Section 2804(5) of the Public Utility Code states that "the commission may permit, **but shall not require**, an electric utility to divest itself of facilities or to reorganize its corporate structure." (Emphasis added.)

Many EDCs represent branches of larger parent companies, with service provided in many states. According to commentators, while an EDC and its affiliate EGS may provide services specifically to Pennsylvania customers, certain internal functions may be provided by the EDC or the parent company, for example legal or Information Technology assistance. Subsection (4)(iii)(A) would bar the EGS from continuing to receive these services from both the EDC and

the parent company. Commentators further argue that not only would this separation apply to specific services, but it may also affect the relationship between the EDC, the EGS and the parent company's board of directors, since Subsection (4)(iii)(A) specifically excludes "strategic management and planning" as a corporate support service.

We also question the PUC's authority to restrict the sharing of legal services between an EDC and its affiliate, since the Pennsylvania Supreme Court has the exclusive authority to regulate the practice of law in the Commonwealth. Similar concerns relate to the prohibition on the sharing of lobbying services.

Commentators conclude that these consequences run contrary to prohibitions already contained in Section 2804(5), as they would result in the functional equivalent of a forced reorganization or divestiture of an electric utility. Therefore, the PUC should explain how the exclusions contained in Subsection (4)(iii)(A) are consistent with the Public Utility Code.

b. Reasonableness and Clarity

The regulation does not clearly specify what constitutes "corporate support services." Subsection (4)(iii)(A) only provides what services are **not** considered corporate support, and does not establish what services are permitted to be shared between the parties. Furthermore, commentators question why the PUC prohibited the sharing of services such as legal, technical and strategic management and planning since this prohibition could have an adverse economic and operational impact on their companies. The final-form regulation should contain a definition of "corporate support services" that specifically identifies the services permitted to be shared by the EDC and its EGS affiliate. The PUC also should further explain why the services in Subsection (4)(iii)(A) are not corporate support services.

c. Consistency with federal law

Commentators note that the FERC Standards of Conduct and Affiliate Rules also contain requirements for employee sharing. According to commentators, FERC rules permit the sharing of corporate support employees and boards of directors as long as these employees do not participate in certain operational functions, such as marketing. *See* 18 C.F.R. § 35.39 (c)(2)(ii). The final-form regulation should explain how imposing more stringent requirements in Subsection (4)(iii)(A) than those imposed by FERC is in the public interest.

d. Fiscal impact

Commentators state that complying with Subsection (4)(iii)(A) will increase costs. This provision would prohibit the current efficiency of sharing costs of corporate support services. Commentators argue that not only will costs be imposed on the EGS, but also on the EDC and the parent company, as a result of the process for establishing this functional separation with the EGS affiliate. Has the PUC considered these costs? The Preamble and the RAF to final-form regulation should include a detailed explanation of the costs imposed by Subsection (4)(iii)(A) on the regulated community and how the benefits of the exclusions in Subsection (4)(iii)(A) outweigh the costs.

Section 54.122 (5) Dispute resolution procedures.

12. Subsection 54.122 (5)(ii) - Notice of the dispute - Implementation procedures; Clarity.

This subsection requires EDCs to adopt dispute resolution procedures to address alleged violations of the regulation.

Subsection (5)(ii) requires designated representatives of the parties to attempt to resolve the dispute informally within five days of receipt of notice of the dispute. We question whether five days provides enough time, and ask the PUC to explain how it determined five days was an appropriate timeframe for resolution.

Additionally, several commentators suggest that the PUC offer a hotline for confidential reporting of conduct violations. Has the PUC considered this option?