

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE NEED FOR)
AFFILIATE TRANSACTION RULES AND COST) ADMINISTRATIVE
ALLOCATION REQUIREMENTS FOR ALL) CASE NO. 369
JURISDICTIONAL UTILITIES)

ORDER

On September 3, 1998 the Commission issued a draft Code of Conduct and draft guidelines addressing accounting requirements for cost allocation and affiliate transactions. All parties were afforded an opportunity to file comments on the drafts. After receipt of the comments, the Commission notified the parties that discussion on the draft Code of Conduct was being suspended to allow more time to consider the filed comments while the Commission continued its work on the cost allocation guidelines.

An informal conference was held on the cost allocation and affiliate transaction guidelines and after undergoing numerous revisions they were issued by Order dated December 20, 1999. The cost allocation guidelines address the accounting treatment to be used to prevent cross subsidization between regulated and nonregulated activities of utilities and their affiliates. That Order also gave notice that the investigation on the Code of Conduct was being resumed and a hearing was scheduled on January 20, 2000. Numerous parties appeared at the hearing to provide comments.

The Commission heard testimony at the hearing that a Code of Conduct was not necessary at this time because Kentucky has not moved to deregulate utilities to create

competitive markets. However, utilities are establishing affiliates to provide nonregulated activities, some of which are related to utility services. For this reason, the Commission believes that a Code of Conduct is necessary. However, based on a review of the comments of record, the Commission finds that the Code of Conduct should at this time be applicable only to major, investor owned utilities. Compliance with the provisions of the Code of Conduct will be difficult and costly for all other utilities and may well result in preventing them from engaging in unregulated activities.

The result of imposing these regulatory requirements on all utilities may not be in the best interests of the customers the Code of Conduct is designed to protect. To avoid such an unintended consequence, the Code of Conduct will not be applicable to non-profit utilities, cooperatives, associations, districts, and small for-profit utilities. Due to the size of these utilities, it may not be feasible for them to comply with the provisions of the Code of Conduct and the cost of complying with the code may outweigh any benefits to the customers. These smaller utilities have a minimal level of nonregulated activity at this time.

The Commission also takes note of the fact that the Cost Allocation and Affiliate Transaction Guidelines will provide adequate safeguards from the potential for cross-subsidization of nonregulated activities by the customers of the utilities exempted from these rules at this time. Should there be a restructuring of the utility industries, such that some or all of the services that are now regulated become unregulated, or, if circumstances should change with regard to the small utilities, the need to expand the application of the Code of Conduct will have to be reviewed.

Three motions are also pending before the Commission. The first, filed by BellSouth Telecommunications, Inc. ("BellSouth"), requests that all telecommunications utilities be exempted from the draft Code of Conduct. In support of the exemption, BellSouth states that its business transactions are already governed by comprehensive, detailed rules and regulations imposed by the Telecommunications Act of 1996 ("Telecom Act") and the Federal Communications Commission ("FCC"). The motion includes an eleven-page appendix which demonstrates that for each provision of the Commission's draft Code, there is a federal requirement applicable to the same activity. No party filed an objection to BellSouth's motion.

Based on BellSouth's unopposed motion and the comments of the other telecommunications utilities, the Commission finds good cause to exempt all telecommunications utilities from the draft Code of Conduct. Existing provisions of the Telecom Act and rules of the FCC are adequate to provide ratepayer protections similar to those in the draft Code of Conduct.

The other two motions, filed by The Union Light Heat & Power Company and jointly by Louisville Gas and Electric Company and Kentucky Utilities Company, request that attorneys not licensed to practice law in Kentucky be authorized by the Commission to represent their respective client in this case. Neither motion cites any authority for the proposition that an administrative agency, such as this Commission, has the jurisdiction to authorize an out-of-state attorney to practice law in the Commonwealth. Therefore, the Commission will deny for lack of jurisdiction both motions based on the finding that the rules for the practice of law are within the exclusive province of the Supreme Court of Kentucky, Rule 3.030(2).

The draft Code of Conduct as revised is attached hereto as Appendix A. The next step in this process is to promulgate a regulation that will be in the form of the Code of Conduct set forth in Appendix A.

IT IS THEREFORE ORDERED that:

1. The motion of BellSouth to exempt all telecommunications utilities from the draft Code of Conduct is granted.
2. The draft Code of Conduct as set forth in Appendix A shall be given further consideration in the process to promulgate a regulation.
3. The motions to authorize out-of-state licensed attorneys to practice before this Commission are denied for lack of jurisdiction.
4. This administrative case is terminated.

Done at Frankfort, Kentucky, this 18th day of February, 2000.

By the Commission

SEPARATE OPINION OF COMMISSIONER GARY W. GILLIS,
CONCURRING IN PART AND DISSENTING IN PART

I concur with the majority to exempt all telecommunications utilities from the Code of Conduct and I concur that the motions to authorize out-of-state attorneys should be denied for lack of jurisdiction. However, I respectfully dissent from the

majority opinion expressed in this Order that concludes the enclosed Code of Conduct should be promulgated as a Commission regulation.

In our December 20,1999 Order in this case, we issued guidelines for cost allocation and affiliate transactions that apply to any utility that engages in a non-regulated activity or conducts business with a non-regulated division, subsidiary, or affiliate. These guidelines, which acknowledge federal preemption and existing requirements of the Federal Communications Commission, will be promulgated as a regulation and are a timely and necessary first step toward addressing many of the issues presently before this Commission.

With regard to imposition of a Code of Conduct at this point in time in Kentucky, however, I believe it is an idea whose time has not yet come. While certainly not the only reason, many state utility commissions have become much more focused on the Code of Conduct issue as both natural gas and electricity markets become subject to competitive forces. In a review of actions on this issue in other states, it is often mentioned that the Code of Conduct is meant to aid in the development of competitive markets, and to promote fair competition and a level playing field. The need to foster confidence in the viability of customer choice has also been expressed.

Restructuring of the electric industry has not yet come to Kentucky's retail market. In Kentucky, only non-residential gas customers have choice, although this Commission has approved recently a residential retail choice program for one local gas distribution utility. I believe it is premature to impose a Code of Conduct on Kentucky's utilities at this time. When it becomes clearer whether electric restructuring will occur in

Kentucky, and if so, in what manner, issues relating to a Code of Conduct that must be addressed will likewise be more evident.

To impose the proposed Code of Conduct on a limited number of subject utilities now may place them and their customers at a disadvantage. We need to explore further ramifications of a Code of Conduct in order to explore the benefits to be obtained and to determine the detriments of the behavioral standards that this code will create.

Gary W. Gillis, Commissioner

ATTEST:

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 369 DATED FEBRUARY 18, 2000

CODE OF CONDUCT FOR UTILITIES

WITH NONREGULATED ACTIVITIES OR AFFILIATES

A code of conduct (“this Code”), governs a public utility company’s activities relative to the sharing of information, databases, and resources between its employees or affiliates involved in the marketing or provision of nonregulated services and its employees or affiliates involved in the provision of regulated services. This Code shall apply to any jurisdictional utility, with certain exceptions, that engages in any nonregulated activity or conducts any business with a nonregulated division, subsidiary, or affiliate.

The following are exempted from this Code: telecommunications utilities subject to Federal Communications Commission jurisdiction as to interstate matters; utilities organized as non-profit corporations including cooperatives, associations, or districts; and utilities with gross revenues of less than \$10 million.

Definitions

- 1) “Affiliate” is considered to be any party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the utility. For purposes of this Code, an affiliate includes a division or subsidiary.

- 2) "Arms Length" is defined as the standard of conduct under which unrelated parties, each party acting in its own best interest, would negotiate and carry out a particular transaction.
- 3) "Control" is considered to be the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise.
- 4) "Cost Allocation Rules" refer to the guidelines issued in the Commission's December 20, 1999 Order in Administrative Case No. 369.
- 5) "Utility" as referred to herein is defined as provided for under KRS 278.010.

Code of Conduct

1. Nothing in this Code is intended to affect or modify the obligations or duties imposed upon a utility or the utility's affiliates under orders or regulations of a federal agency with preemptive rights. The utility shall file with the Commission a notice of any provision in this Code that conflicts with that of a federal agency such that compliance with this Code and the federal requirement is impossible.

2. A utility and its affiliates shall be separate corporate entities and shall maintain separate books and records in accordance with its cost allocation manual developed to comply with the Commission's Cost Allocation and Affiliate Transaction Rules.

3. Any utility that engages in nonregulated activities directly rather than through an affiliate shall separately account for all investments, revenues, and expenses in accordance with the requirements of the appropriate Uniform System of Accounts and

the utility's cost allocation manual developed to comply with the Commission's Cost Allocation and Affiliate Transaction Rules.

4. A utility may not provide advertising space in its billing envelope to its affiliates or for its nonregulated activities unless it offers the same to competing service providers on the same terms it provides to its affiliate. This rule applies to competitive services only.

5. A utility may not attempt to persuade customers to do business with its affiliates by offering rebates or discounts in combination with regulated utility services.

6. No utility employee shall share any customer information with its affiliate unless such information is readily publicly available or is simultaneously made publicly available.

7. All dealings between a utility and its affiliate shall be at "arms length."

8. A utility may carry out joint research and development with an affiliate engaged in competitive activities subject to cost allocation guidelines.

9. Employees transferring from the utility to an affiliate may not take with them competitively sensitive information or material.

10. Where a utility offers a nonregulated service, marketing employees shall not have access to customer information provided to order takers.

11. Utilities may not provide any type of preferential treatment to its affiliates or customers of its affiliates to the detriment of a competitor or customer.

12. If a utility receives a request for a recommendation from a customer seeking a nonregulated service which is offered by the utility's affiliate, or by the utility itself, the

utility shall notify the customer that competing suppliers of that service exist, if it mentions its own affiliate or, that it provides the service.

13. The utility name, trademark, brand, or logo shall not be used by an affiliate unless a disclaimer is used. The disclaimer shall be prominently displayed and shall specifically state that the affiliate is a nonregulated affiliate. The form, content, and appearance of the disclaimer shall be pre-approved by the Commission.

14. A utility shall not allow an affiliate to obtain credit under any arrangement that would encumber or pledge any utility assets or earnings.

15. Utilities shall inform the Commission of all new nonregulated activities by the utility or an affiliate within 10 days after the start of the activity.

16. The Commission may require that the utility file periodic reports of information related to affiliate relationships when necessary to monitor compliance with these guidelines.

17. A utility may request and be granted an exemption from any provision of the Code upon showing that an exemption would not adversely impact regulated rates or service.