D.P.U./D.T.E. 97-96

Investigation by the Department of Telecommunications and Energy (formerly known as the Department of Public Utilities) upon its own motion commencing a rulemaking pursuant to 220 C.M.R. §§ 2.00 et seq., establishing standards of conduct governing the relationship between electric distribution companies and their affiliates and between natural gas local distribution companies and their affiliates.

I. INTRODUCTION

On October 17, 1997, in D.P.U./D.T.E. 97-96, the Department of Telecommunications and Energy ("the Department," formerly known as the Department of Public Utilities) opened a rulemaking to revise the Department's rules on standards of conduct governing relationships between electric and gas distribution companies and their affiliates. Included with the order was a set of proposed regulations. The current regulations are set forth at 220 C.M.R. § 12.00. The proposed regulations would have extended the standards of conduct to distribution company affiliates engaged in non-energy-related businesses. The Department proposed the revisions in order to address concerns raised by the increasing convergence of the business of electricity and gas distribution with other, non-energy businesses such as telecommunications and cable television. Shortly after the Department issued its order opening the rulemaking, the Legislature passed its Restructuring Act, (St. 1997, c. 164), which also addressed the relationship among utility distribution, transmission, generation, and marketing affiliates.

After notice duly issued, the Department received an initial round of 23 written comments.[1] The Department conducted a public hearing on December 15, 1997, at its offices in

---

[1] The Department received initial written comments from Cablevision Systems Corporation, Eastern Power Distribution, Inc. and Eastern Energy Marketing, Inc., Bay State Gas Company, Eastern Edison Company, Fitchburg Gas & Electric Company, Boston Gas Company, Essex County Gas Company, Enron Energy Services, Locals 273, 369, 392, and 431 of the Utility Workers' Union of America, AFL-CIO and the Massachusetts Alliance of Utility Unions (collectively referred to as "the Unions"), New Energy Ventures East, Massachusetts Electric Company, Boston Edison Company, Colonial Gas Company, the Attorney General of Massachusetts, Green Mountain Energy Resources, the Division of Energy Resources, Berkshire Gas Company, New England Cable Television Association, Inc., Fall River Gas Company, Northeast Chapter of the Air Conditioning Contractors Association and Plumbing, Heating & Cooling Contractors of Massachusetts, Western Massachusetts Electric Company, Edison Electric Institute, and Cambridge Electric Light Company, Commonwealth Electric Company, and Commonwealth Gas Company (collectively referred to as "COM/Energy").

Boston, Massachusetts, on the proposed revisions and the effect, if any, of the Restructuring Act on the standards of conduct. Fifteen persons testified at the public hearing. After the public hearing, the Department received sixteen final written comments.[2] In this order, the Department discusses the proposed regulations, then addresses the following issues: the Department's authority to regulate affiliate transactions; extension of the current standards of conduct to non-energy affiliates; the pricing of transfers between distribution companies and competitive affiliates; and joint marketing and advertising restrictions and the use of a distribution company's corporate name. We conclude by adopting final regulations, which will take effect upon publication in the Massachusetts Register.

II. PROPOSED REGULATIONS

The Department opened this rulemaking in order to consider the need for standards of conduct governing the relationships between electric and gas distribution companies and their affiliates in non-energy-related businesses. The current regulations apply to "competitive affiliates" that engage in the "selling or marketing of natural gas, electricity, or related services on a competitive basis, including, but not limited to, natural gas or electric supply or capacity, and demand-side management." 220 C.M.R. § 12.02(2). The Department proposed to revise the definition of "competitive affiliate" to include affiliates engaged in non-energy related businesses. The proposed revision was meant to address concerns regarding the possible inappropriate use of

---

[2] The Department received final written comments from Cablevision Systems Corporation, Boston Edison Company, Enron Energy Services, the Division of Energy Resources, the Unions, Fitchburg Gas and Electric Company, Fall River Gas Company, New England Cable Television Association, Boston Gas Company, COM/Energy, Allenergy Marketing Company, Colonial Gas Company, Western Massachusetts Electric Company, Massachusetts Electric Company, Edison Electric Institute, and Berkshire Gas Company.

distribution company assets and resources on behalf of such non-energy-related affiliates, and also to further the policy goal of full and fair competition in other industries subject to the jurisdiction of the Department or related agencies, such as telecommunications and cable television.

After considering the oral and written comments on the proposed rules, the Department now issues final rules that protect customers of the regulated distribution companies subject to the Department's jurisdiction. The final rules provide appropriate safeguards but do not hinder utility affiliates competing in non-energy-related markets where their relatively unfettered participation may help bring the benefits of competition to consumers. The final rules also satisfy the Restructuring Act's requirement that the Department adopt standards of conduct similar, but not identical, to the existing standards set forth in 220 C.M.R. § 12.00 et seq. G.L. c. 164, § 1C. We address first the issues related to the Department's authority to regulate the relationship between distribution companies and their non-energy affiliates, including those issues raised by the passage of the Restructuring Act.

III. ISSUES

A. The Department's Authority to Regulate Affiliate Transactions

As discussed in D.P.U. 96-44, the Department has broad authority to regulate the relationships between and among distribution utilities and their affiliates, including affiliates in non-energy-related businesses.

> While some commenters have suggested that the Department lacks sufficient authority or a compelling reason to apply these standards to "non-energy" related activities, such application is well within the Department's authority since the rules are directed at the distribution company and its transactions with affiliated entities. The Department possesses ample authority to review and prescribe a distribution company's relationship with its affiliate, particularly where such transactions may have ratemaking implications. G.L. c. 164 §§ 76A, 76C, 85, 85A, 94A, 94B, 94C; see Electric Industry Restructuring

> D.P.U. 95-30, at 40-43 (1995). Because cross-subsidization issues exist regardless of the type of competitive activity engaged in by the affiliate, and because cross-subsidization is of critical concern in the ratemaking process, the Department believes that application of the Standards of Conduct to non-energy related activities would be a valid exercise of the Department's jurisdiction.

D.P.U. 96-44, at 7, n.5.

General Laws c. 164, § 76A grants the Department general supervisory authority over "every affiliated company," which authority pertains to

> all relations, transactions and dealings, direct or indirect, with the gas or electric company with which it is affiliated, which affect the operations of such gas or electric company . . . and [the Department] shall make all necessary examination and inquiries and keep itself informed as to such relations, transactions and dealings as have a bearing upon the price of gas or electricity supplied by such company or the quality thereof.

For purposes of § 76A, the words "affiliated company"

> shall include any corporation, society, trust, association, partnership or individual (a) controlling a company subject to this chapter, either directly, by ownership of a majority of its voting stock or of such minority thereof as to give it substantial control of such company, or indirectly, by ownership of such a majority or minority of the voting stock of another corporation or association so controlling such company; or (b) so controlled by a corporation, society, trust, association, partnership or individual controlling as aforesaid, directly or indirectly, a company subject to this chapter; or (c) standing in such a relation to a company subject to this chapter that there is an absence of bargaining power between the corporation, society, trust, association, partnership or individual and the company so subject, in respect of their dealings and transactions.

G.L. c. 164, § 85.

The Department has general supervisory authority over a gas or electric company's relations with any affiliate, to the extent those relations "affect the operations of such gas or electric company" or "have a bearing upon the price of gas or electricity supplied by such company or the quality thereof." G.L. c. 164, § 76A. Because this authority extends to entities "so controlled by a corporation, society, trust, association, partnership or individual so controlling as aforesaid, directly or indirectly, a company subject to this chapter," the Department has the

authority to regulate transactions between a distribution company and a non-energy-related affiliate where they are both subsidiaries of a holding company or other parent. To effect the public protection purposes for which the Department is established, the Department

> may be authorized . . . to examine the books, contracts, records, documents and memoranda or the physical property of any company subject to this chapter, and of any affiliated company with respect to any relations, transactions or dealings, direct or indirect, between such affiliated company and any company so subject, and, for any examination so authorized, shall be entitled to full access to the subject matter thereof.

G. L. c. 164, § 85. Section 85 authority is broad and not subject to express qualification.

Most commenters on this subject argued that the Department has sufficient authority pursuant to these statutory sections to regulate the transactions between a distribution company and any affiliate (see, e.g., Division of Energy Resources ("DOER") Initial Comments at 4-6, Cablevision Systems Corporation ("Cablevision") Initial Comments at 6-9, Enron Energy Services ("Enron") Initial Comments at 2-5, New England Cable Television Association ("NECTA") Initial Comments at 6-7, Attorney General Initial Comments at 2, and Unions Initial Comments at 7-12). These commenters argue that virtually any transaction could be said to have a bearing on the price or quality of the service provided by a distribution company, or to otherwise affect the operations of the company and, thus, would be subject to regulation.

Those who believe the Department's authority is constrained take that position based on their interpretations of the Restructuring Act, which amended G.L. c. 164 to add § 1C. This section provides that

> Any marketing company formed by an electric company shall be in the form of an affiliate of the electric company and shall be separate from any generation, transmission, or distribution company affiliate of the electric company. The department shall promulgate standards of conduct which shall ensure the separation of such affiliates and which shall be

consistent with the following provisions. . . .[3]

COM/Energy argues that this section ratified the Department's existing regulations with respect to energy-related affiliates but precludes extending the standards to non-energy-related affiliates:

> The statute is intended to address the impact of energy-related marketing and generation affiliates on electric restructuring. Mindful of the arguments that distribution companies could use their status to provide a competitive advantage to energy affiliates that might be marketing in their service territories, the General Court codified in statute the Department's standards, without expanding the scope of that authority. In the context of industry restructuring, the statute applies the standards of conduct to the relationship between distribution companies and unregulated marketing affiliates that would be providing service in the newly restructured industry.
>
> There is no indication that the Legislature intended to provide the Department with additional authority to expand the existing regulations into non-marketing affiliates, and G.L. c. 164, § lC provides the appropriate limits to the scope of the standards of conduct regulations.

(COM/Energy Initial Comments at 10-11).

[3] The provisions listed therein are similar, but not identical, to existing standards in 220 C.M.R. § 12.03, as discussed further below.

In its reply comments, Cablevision argues that COM/Energy's interpretation of G.L. c. 164, § 1C would result in implicit repeal of the statutory authority contained in G.L. c. 164, §§ 76A and 85, discussed above. Cablevision argues that G.L. c. 164, § 1C directs the Department to regulate transactions between electric distribution companies and any marketing affiliate, since the term "marketing company" as used in that section is not limited by definition to electric marketing companies.

The Department finds that it has the authority to regulate distribution company transactions with all affiliates, pursuant to pre-existing statutory authority in G.L. c. 164, §§ 76A and 85, to the extent they "affect the operations of such gas or electric company" or "have a bearing upon the price of gas or electricity supplied by such company or the quality thereof." The pricing of asset transfers or the provision of services between a distribution company and an affiliate could have a bearing on the price of the monopoly service. For example, if services are provided to an affiliate at fully allocated cost and if there are economies of scope from the sharing of these services between the distribution company and the affiliate, the price of the monopoly service may be reduced from what it otherwise would have been.[4] General Laws c. 164, §§ 76A and 85, thus, provide sufficient authority for the revised standards of conduct that the Department adopts in its final rules.

The Department also finds that G.L. c. 164, § 1C does not limit the Department's authority to regulate electric company affiliates, as COM/Energy argued. The Restructuring Act did not repeal the pre-existing statutory authority in G.L. c. 164, §§ 76A, 76C, 85, 85A, 94A,

---

4 This is because the fully allocated cost generally would be greater than any incremental costs incurred by the utility in providing services to an affiliate.

94B, and 94C, and pursuant to which the Department may still act.[5]

The Department further finds that the Restructuring Act does not compel the Department to regulate on equal terms transactions between electric distribution companies and all affiliates, as Cablevision argued.[6] While the statute does not define the term "marketing company," St. 1997, c. 164, § 193, otherwise deals entirely with the provision of electric service in a restructured environment, in which electric companies will be separated into distribution, transmission, marketing, and generation affiliates. Interpreting the term "marketing company" to include any affiliate that is engaged in any competitive business would introduce an expansive element of regulation that would be inconsistent with the section's focus on the provision of electric service, especially since the standards of conduct set forth in G.L. c. 164, § 1C deal mostly with antitrust concepts that have little relevance to utility involvement in non-energy-related markets in which they have not been shown to have market power.[7]

The Department further finds that several sections of existing 220 C.M.R. § 12.03 must be revised to incorporate the requirements of G.L. c. 164, §1C. These sections are §§ 12.03(3), (6),

---

[5] We note that COM/Energy's primary concern, namely that the proposed rules would have the unintended effect of preventing affiliated regulated distribution companies (such as Cambridge Electric Light Company, Commonwealth Electric Company, and Commonwealth Gas Company) from sharing services, as they currently do, is addressed by the revised definitions of relevant terms in the final rules.

[6] The Department addresses below the argument, raised by several commenters, that the Restructuring Act compels the Department to adopt specific regulations governing the pricing of transfers between distribution companies and their competitive affiliates in energy-related and non-energy-related businesses.

[7] According to generally accepted economic theory, a firm with market power has the ability to raise the price of its product or service, and to sustain this price increase over a period of time, without losing so many sales that the price increase is not profitable. AT&T Communications of New England, Inc., D.P.U. 91-79, at 31, n.19 (1992).

(7), (8), (9), (10), (11), and (13), which require strict separation of marketing affiliates from the regulated functions of electric companies and non-discriminatory access by competitive suppliers to products, services, and information offered or held by distribution companies in their capacity as regulated monopolies.

B. Extension of the Current Standards of Conduct to Non-Energy-Related Affiliates

The proposed regulations expanded the scope of the standards of conduct to include all distribution company affiliates, not only "competitive affiliates," as that term was originally defined. The proposed revision of the definition of "competitive affiliate" to include all affiliates would have resulted in each and every standard of conduct in 220 C.M.R. § 12.03 being applied to non-energy-related affiliates. Commenters split on the question of whether such wholesale extension of the standards of conduct is required by the increasing presence of gas and electric distribution company affiliates in non-energy-related businesses. One group, consisting of the Attorney General, DOER, Cablevision, NECTA, and the Unions, argues that extending all of the standards of conduct is the only way to prevent what would otherwise be inevitable cross-subsidization by ratepayers of unregulated ventures into non-energy-related businesses (see, e.g., Tr. at 156-160; DOER Initial Comments, Att. 1 at 8; Attorney General Initial Comments, Att. 1 at 24-27).

This group also argues that extension of all current standards of conduct is necessary to ensure that distribution companies maximize the value of their assets, for the benefit of ratepayers. They argue that because ratepayer funds helped to build any value above cost that the company's products, services, or assets may have, this value should be returned to ratepayers whenever those

products, services, or assets are transferred to any other entity.

Finally, this group argues that the standards of conduct should be extended to prevent utility affiliates from enjoying an unfair competitive advantage in non-energy-related businesses into which the utility diversifies (see, e.g., Tr. at 154-156). They believe that the "concern that anticompetitive behavior may stagnate emerging competition is no less real where the emerging market is for telecommunications rather than energy services" (Tr. at 154).

Another group, mainly consisting of gas and electric distribution companies and the Edison Electric Institute, argues that concerns about cross-subsidization should not be used to justify protecting incumbents in non-energy-related markets (see, e.g., Tr. at 69-70). This group argues that gas and electric distribution companies have no inherent market power in non-energy-related markets and, in the rare instances in which they might have market power, such concerns are adequately addressed by existing antitrust law or, in Massachusetts, by other measures such as G.L. c. 166, § 25A (the pole attachment statute). They also argue that the proposed wholesale application of 220 C.M.R. §§ 12.00 et seq. to non-energy-related affiliates would serve only to prevent new utility-affiliate entrants from being competitive in non-energy-related markets, to the detriment of consumers who stand to benefit from increased competition in those markets and from continued growth in consumers' ability to procure multiple services from the same provider (see, e.g., Tr. at 99-105). Commenters in this group did argue, however, that certain standards that protect against cross-subsidization (such as 220 C.M.R. § 12.03(14), with respect to separate bookkeeping for distribution companies and competitive affiliates) and that apply antitrust principles (such as 220 C.M.R. §§ 3, 5, 6, 7, 8, and 14, as they apply to tariffed public utility services) probably should be applied to all competitive affiliates, not just those in energy-related

fields.

Finally, COM/Energy argues that extending the standards of conduct to all affiliates could have the unintended consequence of preventing regulated distribution company affiliates in a holding company structure (such as Cambridge Electric Light Company, Commonwealth Gas Company, and Commonwealth Electric Company) from reducing operating costs through a management services subsidiary (such as COM/Energy Services). COM/Energy recommends that the Department should retain a distinction between competitive affiliates and regulated distribution affiliates.

As the Department found in D.P.U. 96-44, standards of conduct that govern the relationships between distribution companies and their competitive affiliates in energy-related fields are appropriate because of the inherent market power enjoyed by monopoly distribution companies, and because of the risk of cross-subsidization of the unregulated businesses by the captive customers of the regulated business. The Department finds, however, that gas and electric distribution company affiliates have no such inherent market power in non-energy-related markets, except in limited circumstances that are adequately addressed by other statutes (for example, G.L. c. 166, §25A, with respect to pole attachments) or by antitrust principles such as the essential facilities doctrine. See, e.g., Otter Tail Power Co. v. United States, 410 U.S. 366 (1973); U.S. v. Terminal Railroad Association, 224 U.S. 383 (1912); MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1132 (7th Cir.), cert. denied, 464 U.S. 891 (1983) (describing four elements of an "essential facility"). The risk of cross-subsidization can be addressed adequately through appropriate transfer pricing rules. Wholesale extension of 220 C.M.R. §§ 12.00 et seq. to non-energy-related affiliates, beyond that necessary to prevent cross-subsidization or

discriminatory transfers of tariffed public utility services or other products, services, or information in which the distribution company has market power, would result primarily in competitive handicapping of those affiliates. Such a wholesale extension would benefit incumbents in those non-energy-related markets, but not the public at large or even, necessarily, distribution company ratepayers.

The Department finds that, while the standards of conduct should not be extended in their entirety to distribution company relationships with non-energy affiliates, they should be amended to include an appropriate method for pricing transfers between distribution companies and their affiliates. These transfer pricing rules are discussed below. In addition, the Department will extend to non-energy-related affiliates those standards of conduct that require non-discriminatory access to tariffed public utility services. In these final rules, therefore, the Department extends 220 C.M.R. §§ 12.03(3), (5), (6), (7), (8), and (14), to the provision of tariffed public utility services to non-energy-related affiliates. 220 C.M.R. §§ (1), (2), (3), (5), (6), (7), (8), and (16) (as revised). Finally, in order to allow regulated distribution company affiliates to continue freely to share services for the benefit of ratepayers, the Department adopts definitions of relevant terms that retain the concept, present in the current regulations, that standards of conduct should govern the relationships between distribution companies and their competitive affiliates, without hindering the sharing of costs and services among regulated distribution company affiliates. 220 C.M.R. §§ 12.02(1), (3), (4), (5), (10), and (11) (as revised).

C. The Pricing of Transfers Between Distribution Companies and Competitive Affiliates

A number of commenters discuss transfers of assets and services to competitive non-

energy affiliates and how such transfers should be priced so that ratepayers do not unfairly subsidize the activities of a distribution company's competitive affiliate in non-energy-related businesses. The commenerts fall into two broad groups: those who favored pricing of transfers within a cost-range bounded by the distribution company's incremental cost and its fully allocated cost, and those who favor pricing at the higher of market price or the distribution company's book price. The first group includes Boston Electric Company ("BECo"), Boston Gas Company, Edison Electric Institute, Colonial Gas Company, Fall River Gas Company, Berkshire Gas Company, Western Massachusetts Electric Company, COM/Energy, Massachusetts Electric Company, and Bay State Gas Company. The second group includes Cablevision, NECTA, DOER, the Attorney General, Enron, Eastern Power Distribution, Inc. and Eastern Energy Marketing, Inc., the Unions, and Green Mountain Energy Associates.

BECo's arguments typify the position of the first group. BECo argues that gas and electric distribution companies and their affiliates have no market power in cable, telephone, or any other non-energy market and, thus, they cannot enjoy an unfair competitive advantage in those markets by pursuing economies of integration. BECo argues that existing antitrust law is the appropriate mechanism through which to address market power concerns, which would arise only with respect to products or services provided by the distribution company that might be considered essential facilities in the non-energy market.

These commenters believe that, other than enforcing existing antitrust laws, the state should ensure that distribution companies are not improperly cross-subsidizing unregulated activities. They argue further that those who favor additional regulation use an overbroad definition of cross-subsidization:

> The sharing of economies is not cross-subsidization. You are burdened by cross-subsidization if other functions are undertaken and they pay less than the incremental costs they impose on the system. As long as . . . the unregulated or nonutility ventures pay the full incremental cost, then by definition there is no burden on the consumers, whom it is your responsibility to protect. That statement becomes even stronger if instead these transactions are at something like fully allocated or average costs. In that case, not only is there no burden, but the purchasers of the regulated services share proportionately in the advantages of the economies of scope that are made possible or the economies of scale. So it's within that range of transfers at incremental cost and transfers at fully allocated cost that we amply fulfill the responsibility of protecting captive ratepayers from the burdens of cross-subsidization and indeed permit them to contribute. Anything beyond that constitutes a handicapping of competition . . .

(Tr. at 69-70).

These commenters assert that ratepayers are no worse off for their utility's involvement in non-energy markets, so long as affiliates are charged at least incremental cost for shared services, and that ratepayers actually share in the economies of integration if transfers are priced at fully allocated cost. BECo recommended pricing at fully allocated cost, albeit with some reservations (Tr. at 90).[8]

This first group identified an important exception to their general proposition:

> Where the purchasers of the regulated services have in fact bought the assets through the depreciation charges that have been incorporated in the rates that they paid, if it turns out that those depreciation charges have been excessive, with the result that the market value of the assets exceeds the net book value, then they've overpaid and they are really entitled to that differential.

(Tr. at 70).

With respect to the competitive impact of utility affiliate participation in non-energy-

---

[8] BECo's reservations have to do with the economic principle that mark-ups above incremental costs should be the least on demand-elastic services -- those available in competitive markets -- and the most on demand-inelastic services, such as those offered by a regulated monopoly. "That would tend to argue for going closer to transfers at incremental cost to the new competitive ventures" (Tr. at 92).

related businesses, these commenters argue that consumers should welcome the entry of utility affiliates into other markets, to which they could bring much-needed competition (Tr. at 66). They reject the argument that utility affiliates will overwhelm either incumbents or other competitors in markets such as cable and telecommunications, in which utility distribution companies have no market power, except in very limited circumstances that are addressed by existing antitrust law.

Finally, these commenters argue that transfers to unregulated affiliates should be monitored in order to prevent cross-subsidization. They recommend that utilities keep and file a log of transactions, which the Department would review periodically for compliance with the applicable rules (Tr. at 68-69).

The second group of commenters recommend that any transfer of a product or service to any utility competitive affiliate, including those in non-energy-related markets, be at the higher of market price or book value.[9] They argue that allowing transfers at less than market value gives an unfair competitive advantage to utility affiliates:

> If a gas or electric utility affiliate in competition with Cablevision receives elements of its system at less than full market value or preferential terms, it enables the affiliate to offer subscribers prices that do not reflect the real costs of the services offered. This distorts the marketplace and gives the affiliate a competitive advantage over Cablevision. This advantage is gained at the expense of the distribution company's ratepayers under regulation, who are saddled with the cost of subsidizing the company's entry into a non-energy-related market, without any commensurate benefit to their rates.

(Cablevision Initial Comments at 4-5; see also Enron Initial Comments at 4.)

These commenters argue that this competitive advantage on the part of utility affiliates

---

[9] These commenters also recommend pricing transfers from a competitive affiliate to the distribution company at the lower of book or market value.

will ultimately reduce competition in non-energy markets:

> [T]he prospect of facing a telecommunications market in which such abuses are likely may well discourage investment and a competitive presence from those who must invest extensively in new facilities in order to compete effectively. Such potential competitors are likely to prefer markets where they are not entirely dependent on after-the-fact protection to sanction such conduct.

(Tr. at 159).

This second group also contends that cost-allocation alone cannot prevent improper cross-subsidization. They argue that abuses of a system that depends on accounting practices for enforcement are not abstract or theoretical concerns. Rather, they argue, such abuses occur with great frequency and are more likely than not to occur in Massachusetts, where the resources devoted to utility regulation are a small fraction of utility revenues (Tr. at 158-159). They argue that accounting safeguards are easy to avoid and difficult to enforce.

> Reliance on accounting and on structural safeguards will lead in the end to scandal, after which more extensive protections will have to be adopted anyway. Indeed, to rely on accounting practices as the sole protection for customers in competitive markets is like relying on radar as the only assurance of automobile safety.

(Tr. at 159).

Several commenters in this second group also see transfer pricing as an opportunity to repay to utility customers value that they helped the company create:

> The regulated monopoly and its customers have created much of the value currently enjoyed by the Boston Edison Company. If some of that value is being leased, sold or otherwise transferred, the Company has an obligation to maximize the value of those assets on behalf of the residual regulated company and its captive ratepayers.

(DOER Initial Comments, Att. 1, at 3-4).

The Attorney General takes a similar position, arguing that capturing any market value in excess of book value in pricing transfers to affiliates is a quid pro quo for utility stranded cost

recovery. "In essence, the transaction that is occurring now is in exchange for paying the utilities' stranded costs, they are agreeing to give to their customers the right to choose and the above-market value of all their good assets" (Tr. at 169).

Finally, Cablevision and others argue that certain provisions of the Restructuring Act compel the Department to regulate electric distribution company transactions in order to price the transfer of all utility goods and services to any affiliate at market price, if market price is above book value. The Restructuring Act defines "mitigation" as, in relevant part,

> all actions or occurrences which reduce the amount of money that a distribution company seeks to collect through the transition charge, including those amounts resulting from both matters with the company's control and from matters not wholly within the company's control. Mitigation shall, in accordance with the provisions of section 1G, include, but not be limited to, the following: . . . (6) any market value in excess of net book value associated with the sale, lease, transfer, or other use of the assets of the company unrelated to the provision of transmission service or distribution service at regulated prices, including, but not limited to, rights-of-way, property, and intangible assets when the costs associated with the acquisition of those assets have been reflected in the company's rates for regulated service; provided, however, that the department shall determine their market values based on the highest prices that such assets could reasonably realize after an open and competitive sale . . .

St. 1997, c. 164, § 189.

Cablevision argues that this definition requires that distribution companies capture for the benefit of ratepayers any market value in excess of book value for the transfer of any asset or service to a competitive affiliate. They also point out that G.L. c. 164, § 1G(d)(1) requires that electric companies take "all reasonable steps to mitigate to the maximum extent possible the total amount of transition costs that will be recovered" as a condition precedent to recovery of any transition costs, and argue that mitigation should include transferring goods and services to all affiliates at market value.

Having considered these arguments, the Department finds that assets that have been included in rate base may be transferred to utility competitive affiliates, provided they are priced at the higher of their market value or net book value. Distribution companies may transfer assets that have not been included in rate base and may provide services to their affiliates, provided those assets and services are priced at the distribution company's fully allocated cost.

Transfers of assets that have been included in rate base should capture for the benefit of ratepayers any market value in excess of book value. This pricing mechanism for the transfer of assets that have been paid for through rates is also required by the Restructuring Act, pursuant to the definition of "mitigation" now set forth at G.L. c. 164, § 1.

With respect to other assets and services, pricing transfers at fully-allocated cost will allow customers of the distribution company to share in the economies of scope and scale with the customers of the competitive affiliate. These pricing rules will encourage electric companies to pursue such economies, which will result in lower costs for distribution company ratepayers and more competition in markets into which electric companies may wish to diversify.

As to affiliate-to-utility transfers, the Department concludes that the affiliate may charge a price no greater than the fair market value of the asset or services being provided. In this way, the distribution company can deal with its affiliates without the risk of anti-competitive behavior or pricing abuse by the affiliate. Imposing a rule requiring transfers from the affiliate to the distribution company to be at no more than book value is likely to preclude the professed intent of capturing all benefits of integration for customers of the regulated firm. An unregulated firm is unlikely to transfer property to the utility at book value if it could sell that property on the market for a higher price. Boston Edison Company and Boston Edison Mergeco Electric Company, Inc.,

D.P.U./D.T.E. 97-63, at 33-34 (1998).

The Department concurs with the many commenters who urge it to provide the maximum necessary protections for ratepayers. But pricing schemes intended to reduce rates for regulated service by requiring that all economies of scope and scale be returned to ratepayers will not accomplish this goal. If all savings from voluntarily undertaken cost-sharing measures must be allocated to customers of the regulated company, economically rational managers of such companies would not bother to invest in such measures. Similarly, a regulatory rule cannot compel an affiliate to transfer an asset to a distribution company at book value if the asset could be sold on the market for more than that amount. Standards of conduct should facilitate shared savings between distribution companies and their affiliates and cannot reasonably rely on the altruistic propensities of managers to capture the benefits of integration only for customers of the regulated firm.

The Department rejects as protectionist the argument that allowing utility affiliates competing in non-energy-related markets to share with distribution companies any economies of scope and scale would be unfair to the utility affiliate's competitors. The distribution company's fully allocated cost is a reasonable basis for pricing the distribution company's provision of services to an affiliate.[10] Forcing the provision of services to be priced at market value would likely ensure that utility affiliates entering new markets can only hope to meet, but not beat, the incumbent's price. No one benefits from such a scheme except the incumbent -- and certainly not

---

[10] In textbook economics, incremental cost would be the appropriate measure of the distribution company's real cost in providing a service to an affiliate. Pricing at incremental cost, however, prevents ratepayers from receiving any of the benefits provided by economies of scope and scale achieved through diversification.

the public.

The Department finds further that the Restructuring Act's definition of mitigation does not require that all transfers of assets and services to an affiliate be at prices that would recover any excess of market over book value. This requirement is limited to the transfer of assets "when the costs associated with the acquisition of those assets have been reflected in the company's rates for regulated service." G.L. c. 164, § 1. This reflects the fact that any risk associated with investment in those assets was borne by ratepayers under traditional cost-of-service ratemaking. Consistent with Department precedent, we place within this category (1) assets that have been included in rate base, and (2) assets that have been included in plant in service and have been placed into service for the benefit of ratepayers. D.P.U./D.T.E. 97-63, at 42, citing Western Massachusetts Electric Company, D.P.U. 88-250, at 38-39 (1989). With respect to other assets and services, the Department may adopt a different transfer pricing requirement, as in 220 C.M.R. § 12.04 (as herein revised).

The Department concurs in the concerns of DOER, the Attorney General, Cablevision, and others that preventing cross-subsidization of unregulated affiliates will require a high level of vigilance. Requiring distribution companies to keep a current log of all affiliate transactions, to file the log with the Department annually, and to justify the costs allocated to those transactions is an appropriate compliance mechanism. The Restructuring Act also provides for substantial penalties for violating the standards of conduct, which will serve to deter improper behavior. G.L. c. 164, § 1F(7).

D. Joint marketing and advertising restrictions and use of corporate name

A number of commenters argue that the existing restrictions on joint marketing and

advertising between distribution companies and their competitive energy affiliates, currently set forth in 220 C.M.R. § 12.03(11), should be extended to prevent joint marketing between distribution companies and their competitive non-energy affiliates. Cablevision argues that an electric company's name recognition gives its affiliates an advantage in even non-energy-related markets, and that that name recognition has been achieved to a great extent through advertising for which utility customers have paid (Cablevision Final Comments at 4). The Attorney General also argues that an electric company's name recognition is a tremendous advantage, at least in energy-related markets, and that the value of that name recognition should be captured for the benefit of ratepayers, although it is clear that the distribution company owns the name (Tr. at 170).

The distribution companies respond that

> Such favorable associations as consumers may have with brands - e.g., expectations of service quality and reliability (and certainly not all utility companies' brands carry such favorable rather than hostile associations!) - are an economy of scope, the benefits of which it would be anticompetitive to deny both the companies and consumers who place value on them. Competition consists legitimately in the attempt to secure just such favorable reputations.

(BECo Initial Comments, Att. A, at 13.) BECo argued further that the recognition afforded by a corporate name or logo is one means of overcoming any barriers to competition in non-energy-related markets, in which incumbents such as Bell Atlantic and Cablevision have their own brand names, logos, and goodwill associated therewith (Tr. at 72-74).

Several commenters perceive abuses, especially by gas companies such as Bay State Gas Company and Colonial Gas Company, of the current standards of conduct, which forbid joint marketing and advertising between distribution companies and affiliates engaged in selling or

marketing of natural gas, electricity, or related services on a competitive basis. For example, a representative of a heating and cooling business testified at the public hearing that gas companies improperly use their position as distribution companies to direct heating related business to corporate affiliates (Tr. at 7-15). This representative testified as to irregularities in the way gas companies refer customers to heating contractors and that gas companies have leads on work as a result of their monopoly function, and asserted that such leads are not made available to competitors of their affiliates, although those competitors would be willing to pay for those leads. According to this witness, a violation of the existing standards of conduct with respect to non-discriminatory information sharing results from such activities, but benefits would redound to distribution company ratepayers if that information were shared with non-affiliate contractors that are willing to pay for it (Tr. at 13-15).

The gas companies respond that the term "the selling or marketing of natural gas, electricity, or related services on a competitive basis" should be narrowly defined to include only "activities traditionally performed by distribution companies where there is a potential for monopoly abuse" (Tr. at 214-215). Thus, activities such as boiler replacement would not be "a related service" since distribution companies have not traditionally performed those services and there is no potential for monopoly abuse (id.; see also Colonial Gas Company Final Comments at 5-6). Bay State Gas Company and Boston Gas Company acknowledge, however, that the term "the selling or marketing of natural gas, electricity, or related services on a competitive basis" should be clarified (Tr. at 181, 219).

The Department concludes that any restrictions on the use of a distribution company's corporate name and logo should be drafted narrowly. There are several reasons for this

conclusion. First, the corporate name and logo belong to shareholders, not ratepayers and, excessive restriction of their use could violate a company's First, Fifth, and Fourteenth Amendment rights. See, generally, Pacific Gas & Electric Company v. Public Utilities Commission of California, 475 U.S. 1, 22 n. 1, Marshall, J., concurring (1986), and Minnegasco v. Minnesota Public Utility Commission, 549 N.W.2d 904 (Minn. 1996) (regarding utility's ownership of name, reputation, and good will); Duquesne Light Co. v. Barasch, 488 U.S. 299 (1988); Wisconsin v. Federal Power Commission, 373 U.S. 294 (1963); Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) (discussing Supreme Court takings analysis); Central Hudson Gas v. Public Service Commission of New York, 447 U.S. 557 (1980) (striking down as overbroad a complete ban on promotional advertising by electric utility). Second, the corporate name and logo provide information that customers seek and value -- namely, the affiliations of the companies from which they are considering buying products or services. Finally, customer confusion, or subtle forms of tying, that purchase of a competitive non-energy affiliate's service is a condition of receiving gas or electric distribution service, seems highly unlikely to occur from mere use of a corporate name or logo. The claims are overdrawn. Existing state and federal laws that regulate advertising offer remedies for fraudulent or deceptive advertising. These laws offer adequate protection.

In energy-related businesses, however, the use of a distribution company name or logo could result in customer confusion that might give a utility affiliate an unfair advantage. To prevent such confusion, the Department will require that use of a distribution company's name or logo by competitive energy affiliates be accompanied by a statement to the effect that no advantage accrues to a customer in the use of the distribution company's services as a result of

that customer dealing with a competitive energy affiliate, and that a customer need not purchase any product or service from any competitive energy affiliate in order to obtain services from the distribution company on a non-discriminatory basis. The statement should be written or spoken, as appropriate given the context in which the name or logo is used.

The Department also concludes that the term "energy-related" should be clarified in order to provide guidance to distribution companies, their affiliates, and competitors of their affiliates in determining whether an affiliate's activities might violate these regulations. The most appropriate scope of activities that should be considered "energy-related" are those services whose costs distribution companies have recovered through rates approved by the Department. 220 C.M.R. § 12.02(9) (as herein revised). Services that distribution companies may have provided without recovering their costs through rates were not part of the monopoly function and the Department should not presume the existence of utility market power in such non-monopoly activities. If a competitor complains that such market power does, in fact, exist, these regulations do not displace State or Federal antitrust law, which would be the more appropriate means to redress any valid complaints.

Finally, the Department addresses the concern that distribution companies may take advantage of their status as monopoly providers in order to communicate business leads to competitive affiliates, whether those affiliates are involved in energy-related or non-energy-related businesses. Distribution companies occupy a unique position from which they may obtain detailed information about ratepayers; and distribution company employees may even gain access to a ratepayer's home in order to fulfill the company's obligation to provide distribution service. Under the rules adopted here, business leads obtained from such access may not be passed on selectively

to utility affiliates, whether that lead concerns, for example, a utility customer's need for furnace repair or his desire to upgrade his cable television service. 220 C.M.R. § 12.03(10) (as herein revised).

IV. ORDER

Accordingly, after due notice, hearing, and consideration, it is

DETERMINED: That the revised regulations attached hereto, and designated as 220 C.M.R. §§ 12.00 et seq. are reasonably necessary for the administration of Chapter 164 of the General Laws; and it is

ORDERED: That the regulations designated as 220 C.M.R. §§ 12.00 et seq. and entitled "Standards of Conduct for Distribution Companies and Their Affiliates" attached hereto are hereby ADOPTED; and it is

FURTHER ORDERED That these regulations shall take effect upon publication in the Massachusetts Register.

By Order of the Department,

____
Janet Gail Besser, Chair

____
James Connelly, Commissioner

____
W. Robert Keating, Commissioner

____
Paul B. Vasington, Commissioner

220 CMR 12.00 STANDARDS OF CONDUCT FOR DISTRIBUTION COMPANIES AND THEIR AFFILIATES

Section

12.01 Purpose and Scope
12.02 Definitions
12.03 General Standards of Conduct
12.04 Pricing of Transactions Between Distribution Companies and Affiliates
12.05 Penalties

12.01: Purpose and Scope

(1) Purpose. 220 C.M.R. 12.00 sets forth the Standards of Conduct governing the relationship between a Distribution Company and its Affiliates transacting business in Massachusetts.

(2) Scope. 220 C.M.R. 12.00 applies to all Distribution Companies under the Department's jurisdiction. 220 C.M.R. 12.00 does not supersede existing applicable law and regulations.

12.02: Definitions

(1) Affiliate refers to any "affiliated company," as defined in G.L. c. 164, § 85, or any unit or division within a Distribution Company or its parent, or any separate legal entity either owned or subject to the common control of the Distribution Company or its parent.

(2) Antitrust Laws are federal and state statutes, including the Sherman Act, 15 U.S.C. §§ 1-7, the Clayton Act, 15 U.S.C. §§ 12-27, and the Massachusetts Antitrust Act, G.L. c. 93, §§ 1-14A, and related judicial decisions.

(3) Competitive Affiliate refers to any Affiliate that is engaged in the sale or marketing of products or services on a competitive basis.

(4) Competitive Energy Affiliate refers to any Competitive Affiliate that is engaged in the sale or marketing of natural gas, electricity, or Energy-related Services on a competitive basis.

(5) Competitive Non-Energy Affiliate refers to any Competitive Affiliate that is engaged in the sale or marketing of products or service, other than natural gas, electricity, or Energy-related Services, on a competitive basis.

(5) Department refers to the Department of Telecommunications and Energy.

(6) Distribution Company refers to a natural gas local distribution company or Electric Company that provides distribution services under the Department's jurisdiction.

(7) Electric Company is defined as in G.L. c. 164, § 1.

(8) Employee refers to an officer, director, employee or agent who has specific knowledge of, or direct access to, information not otherwise available to Non-affiliated Energy Suppliers that could provide a Competitive Energy Affiliate with an undue advantage.

(9) Energy-related Services are those services the costs of which have been recovered by Distribution Companies through rates approved by the Department.

(10) Non-affiliated Energy Supplier refers to any entity, including aggregators, engaged in marketing, brokering or selling natural gas, electricity, or energy-related services to retail customers where such product or service is also provided by a Competitive Energy Affiliate.

(11) Non-affiliated Supplier refers to any entity engaged in selling or marketing products or services where such product or service is also provided by a Competitive Affiliate.

12.03: General Standards of Conduct.

(1) A Distribution Company shall apply tariff provisions in the same manner to the same or similarly situated entities if there is discretion in the application of the provision.

(2) A Distribution Company shall strictly enforce tariff provisions for which there is no discretion in the application of the provision.

(3) A Distribution Company shall not, through a tariff provision or otherwise, give its Competitive Affiliate or customers of its Competitive Affiliate preference over Non-affiliated Suppliers or their customers in matters relating to any product or service that is subject to a tariff on file with the Department.

(4) If a Distribution Company provides its Competitive Energy Affiliate, or a customer of its Competitive Energy Affiliate, any product or service other than general and administrative support services, it shall make the same products or services available to all Non-affiliated Energy Suppliers or their customers on a non-discriminatory basis.

(5) A Distribution Company shall not offer or sell electricity or natural gas commodity or capacity to its Competitive Affiliate without simultaneously posting the offering electronically on a source generally available to the market or otherwise making a sufficient offering to the market.

(6) (a) If a Distribution Company offers its Competitive Energy Affiliate, or a customer of its Competitive Energy Affiliate, a discount, rebate or fee waiver for any product or service, it shall make the same available on a non-discriminatory basis to all Non-affiliated Energy Suppliers or customers.

(b) If a Distribution Company offers a Competitive Affiliate, or a customer of a Competitive Affiliate, a discount, rebate or fee waiver for any product or service that is subject to a tariff on file with the Department, it shall make the same available to all Non-affiliated Suppliers and their customers simultaneously, to the extent technically possible, on a comparable basis.

(7) A Distribution Company shall process all same or similar requests for any product, service, or information in the same manner and within the same period of time, consistent with the rules set forth in paragraph (6) above.

(8) A Distribution Company shall not condition or tie the provision of any product, service, or rate agreement by the Distribution Company to the provision of any product or service by its Competitive Affiliate.

(9) A Distribution Company shall not release any proprietary customer information to an Affiliate without the prior written authorization of the customer.

(10) To the extent that a Distribution Company provides a Competitive Affiliate with information not readily available or generally known to any Non-affiliated Supplier, which information was obtained by the Distribution Company in the course of providing distribution service to its customers, the Distribution Company shall make that information available on a non-discriminatory basis to all Non-affiliated Suppliers transacting business in its service territory. This provision does not apply to customer-specific information obtained with proper authorization, information necessary to fulfill the provisions of a contract, or information relating to the provision of general and administrative support services.

(11) A Distribution Company shall refrain from giving any appearance of speaking on behalf of its Competitive Affiliate in any and all contacts or communications with customers or potential customers. The Distribution Company shall not represent that any advantage accrues to customers or others in the use of the Distribution Company's services as a result of that customer or others dealing with the Competitive Affiliate.

(12) The Distribution Company shall not engage in joint advertising or marketing programs of any sort with its Competitive Energy Affiliate, nor shall the Distribution Company directly promote or market any product or service offered by any Competitive Affiliate.

(13) Subject to paragraph (12), a Distribution Company may allow an Affiliate, including a Competitive Energy Affiliate, to identify itself, through the use of a name, logo, or both, as an Affiliate of the Distribution Company, provided that such use by a Competitive Energy Affiliate shall be accompanied by a disclaimer that shall state that no advantage accrues to customers or others in the use of the Distribution Company's services as a result of that customer or others dealing with the Competitive Energy Affiliate, and that the customer or others need not purchase any product or service from any Competitive Energy Affiliate in order to obtain services from the Distribution Company on a non-discriminatory basis. The disclaimer shall be written or spoken, or both, as may be appropriate given the context of the use of the name or logo.

(14) If a customer requests information about Energy Suppliers, the Distribution Company shall provide a current list of all Energy Suppliers operating on the system or registered with the Department, including its Energy-related Competitive Affiliate, but shall not promote its affiliate. The list of Energy Suppliers shall be in random sequence, and not in alphabetical order. The list shall be updated every sixty (60) days to allow for a change in the random sequence.

(15) Employees of a Distribution Company shall not be shared with a Competitive Energy Affiliate, and shall be physically separated from those of the Competitive Energy Affiliate. The Distribution Company shall fully and transparently allocate costs for any shared facilities or general and administrative support services provided to any Competitive Affiliate.

(16) A Distribution Company and its Competitive Affiliate shall keep separate books of accounts and records which shall be subject to review by the Department in accordance with the provisions of G.L. c. 164, § 85.

(17) The Department may approve an exemption from the separation requirements of 220 C.M.R. 12.03(15) upon a showing by the Distribution Company that shared employees or facilities would be in the best interests of the ratepayers and have minimal anticompetitive effect, and that the costs can be fully and accurately allocated between the Distribution Company and its Competitive Energy Affiliate. Such exemption shall be valid until such time that the Department determines that modification or removal of the exemption is necessary.

(18) A Distribution Company shall establish and file with the Department a dispute resolution procedure to address complaints alleging violations of 220 C.M.R. 12.00. Such procedure shall designate a neutral person to conduct an investigation of the complaint; require that said person communicate the results of the investigation to the claimant in writing within 30 days after the complaint is received; and require that such communication describe any action taken and notify the complainant of his or her right to complain to the Department if not satisfied with the results of the investigation.

(19) A Distribution Company shall maintain a log of all new, resolved, and pending complaints alleging violations of 220 C.M.R. 12.00. The log shall be subject to review by the Department and shall include the date each complaint was received; the complainant's name, address, and telephone number; a written description of the complaint; and the resolution of the complaint, or the reason why the complaint is still pending.

(20) Notwithstanding any other provisions in 220 C.M.R. 12.00, in emergency circumstances, a Distribution Company shall take any actions necessary to ensure public safety and system reliability. A Distribution Company shall maintain a log of all such actions, subject to review by the Department.

12.04: Pricing of Transactions Between Distribution Companies and Affiliates

(1) A Distribution Company may sell, lease, or otherwise transfer to an Affiliate, including a Competitive Affiliate, an asset, the cost of which has been reflected in the Distribution Company's rates for regulated service, provided that the price charged the Affiliate is the higher of the net book value or market value of the asset. The Department shall determine the market value of any such asset sold, leased, or otherwise transferred, based on the highest price that the asset could have reasonably realized after an open and competitive sale.

(2) A Distribution Company may sell, lease, or otherwise transfer to an affiliate, including a Competitive Affiliate, assets other than those subject to paragraph (1), and may also provide services to an affiliate, including a Competitive Affiliate, provided that the price charged for such asset or service is equal to or greater than the Distribution Company's fully allocated cost to provide the asset or service.

(3) An Affiliated Company may sell, lease, or otherwise transfer an asset to a Distribution Company, and may also provide services to a Distribution Company, provided that the price charged to the Distribution Company is no greater than the market value of the asset or service provided.

(4) A Distribution Company must maintain a log of all transactions with Affiliated Companies made pursuant to paragraphs (1) through (3). The log shall include the date of the transaction, the nature and quantity of the asset or service provided, the price charged, and an explanation of how the price was derived for purposes of compliance with this section. All log entries must be dated and made contemporaneously with relevant transactions. The log shall be kept up to date. The Distribution Company shall file a copy of the log with the Department no later than January 15 of each year, covering the previous year.

12.05: Penalties

(1) Any Distribution Company or Affiliate that violates any provision of this section shall be subject to a civil penalty not to exceed $25,000 for each violation for each day that the violation persists; provided, however, that the maximum civil penalty shall not exceed $1,000,000 for any related series of violations. Any such penalty shall be determined by the Department after a public hearing.

(2) In determining the amount of any penalty assessed pursuant to paragraph (1), the Department will consider the following: the appropriateness of the penalty to the size of the business of the Distribution Company or Affiliate charged; the gravity of the violation; the good faith of the Distribution Company or Affiliate in attempting to achieve compliance after notification of a violation; and any other criteria deemed appropriate by the Department under the circumstances.

(3) Nothing in 220 C.M.R. 12.00 shall be construed to confer immunity from state and federal Antitrust Laws. A penalty assessed pursuant to this subsection does not affect or preempt antitrust liability but rather is in addition to any antitrust liability that may apply to the activity.

REGULATORY AUTHORITY

220 CMR 12.00: G.L. c. 164, §§ 1, 1C, 1F, 76A, 76C, 85, 85A, 94A, 94B, 94C