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STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

MICHIGAN PUBLIC SERVICE
COMMISSION

JAN 11 2000

In the matter of the approval of a code of)
conduct for CONSUMERS ENERGY)
COMPANY AND DETROIT EDISON)
COMPANY.)
_____)

FILED

Case No. U-12134

QUALIFICATIONS AND TESTIMONY OF

WILLIAM J. CELIO

MICHIGAN PUBLIC SERVICE COMMISSION

January 11, 2000

QUALIFICATIONS OF WILLIAM J. CELIO

CASE NO. U-12134

PART I

1 Q: Please state your name and business address.

2 A: My name is William J. Celio. My business address is 6545 Mercantile Way, P.O.
3 Box 30221, Lansing, Michigan 48909.

4 Q: What is your position with the Michigan Public Service Commission?

5 A: I am the Director of the Electric Division.

6 Q: What is your educational background?

7 A: In 1967, I received a Bachelor of Science Degree in Electrical Engineering from
8 the University of Illinois at Urbana, Illinois. In 1969, I received my Master of
9 Business Administration Degree also from the University of Illinois. I have also
10 taken several graduate courses in electrical engineering, other courses and
11 seminars related to the energy and telecommunications industries.

12 Q: Would you briefly outline your work experience?

13 A: As a student engineer for the Chicago Transit Authority I performed scheduled
14 testing and maintenance of relays and control circuits in the various substations on
15 the CTA system.

16 In 1969, I began my employment with the Illinois Power Company where I
17 designed and monitored construction of electric transmission lines of 69,000 volts
18 and above. I also prepared and supervised the preparation of long-range studies
19 which outlined the development of distribution, subtransmission and transmission
20 systems.

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PART I

1 In June 1974, I joined the Michigan Public Service Commission where my initial
2 duties consisted of preparation of cost-of-service studies, various other
3 investigations concerning presentation of rate cases for the Commission Staff,
4 review of applications for electric line extension permits and review of various
5 tariff-related filings.

6 In 1979 I was assigned to the Chief of Staff's office where I was responsible for
7 activities involving policy setting or implementation in each of the Staff's utility
8 and support divisions.

9 In January 1982, I was transferred to the newly-created Operational Development
10 Division as Supervisor of the Operational Analysis Section responsible for the
11 strategic planning efforts of the Commission and its Staff. The first effort of this
12 section was the development of a comprehensive strategic plan for MPSC
13 involvement in federal activities in the natural gas arena.

14 In August 1983, I transferred to the Communications Division where I ultimately
15 served as its Director for over 14 years. In March 1999, I was transferred to the
16 Electric Division as its Director.

17 Q: Have you previously testified before the Commission?

18 A: Yes. Further, I have testified on behalf of the State of Michigan and the Michigan

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1 Public Service Commission before the Federal Energy Regulatory Commission. I
2 have also supported the Chairman and Commissioners in developing positions
3 and testimony before Congress.

4 Q: What other activities have you undertaken in the regulatory area?

5 A: I have been a guest lecturer at an American Gas Institute's course on regulatory
6 accounting at Michigan State University. From January 1977 through October
7 1987, I was the NARUC representative to the American National Standards
8 Institute (ANSI) Subcommittee Number 3 of Committee C2 which is involved
9 with revising portions of the National Electric Safety Code. In September 1978, I
10 was appointed to the NARUC Subcommittee on Cost Allocation.
11 I am a Registered Professional Engineer in Illinois and Michigan.

12 Q: Do you have any other general comments concerning your experience and
13 education?

14 A: Yes. Since 1979, my assignments at the Commission have involved developing,
15 recommending, and implementing regulatory policy. I have dealt with electric,
16 natural gas, and telecommunications issues. In addition, in the
17 telecommunications area, I served as a member of the Michigan Divestiture
18 Research Fund's Board of Directors. I was a 10 year member of the Advisory
19 Board to the Michigan Relay Center. I also served as a member of the 313 Area
20 Code Split Citizen's Committee. I also was appointed by the Governor as a
21 member of the Michigan Council on Telecommunications Services for Public

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PART I

1

Education.

2

I have worked with the Michigan Legislature in the development of major pieces

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of legislation including 1986 P.A. 32, the Emergency Telephone Service Act,

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1986 P.A. 305, amendments to the Telephone Act, and 1991 P.A. 179, the

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Michigan Telecommunications Act and its amendments. I have co-authored, with

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staff persons Elizabeth Durbin and Louis Passariello, a paper published by the

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NRRI on a methodology for determining long-run incremental costs for

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telecommunications providers. Additionally, I was a member of an internal

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Commission task force which issued a report on stray voltage.

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PART II

1 Q. What is the purpose of your testimony in this proceeding?

2 A. I am presenting the Staff's position on standards of conduct issues referred to as
3 oversight, enforcement and penalties. I will limit the approach solely to application
4 to the retail open access (ROA) or the customer choice (CC) program established by
5 the Michigan Public Service Commission (MPSC) through its orders and the Staff's
6 responsibilities related thereto. I would note, however, that the Staff approach could
7 be applied on a broader basis than simply ROA. Further throughout this testimony,
8 I consider the terms ROA and CC interchangeable.

9 Q. At the present time there are two provisional standards of conduct in place in
10 Michigan for electric utilities, one for Detroit Edison (DE) and one for Consumers
11 Energy (CE). Is your presentation limited only to those two utilities?

12 A. No. However from a practical standpoint much of my presentation will most directly
13 apply to those utilities. I do envision some spillover as other Michigan utilities enter
14 the Michigan ROA arena. Further as other large out of state electric utilities enter or
15 attempt to enter the Michigan market some portions of the Michigan code might
16 apply. If this is the case, it is logical that the oversight, enforcement and penalty
17 aspects of the Michigan code would also apply.

18 Q. What is the general theme embodied in the Staff's' proposal on oversight,
19 enforcement and penalties?

20 A. Staff expects each participant in Michigan's ROA program to follow the provisions

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1 of Michigan law, Commission orders, Commission approved tariffs and various
2 contracts associated with the relationship between participants. If actions of
3 participants are inconsistent with "the rules", Staff believes the participants should
4 be given the opportunity to resolve the differences prior to Commission intervention.
5 Further if the participants are unable to resolve differences and the Commission after
6 notice and hearing determines a violation has taken place, the "guilty" should be
7 penalized. In this case, I am particularly interested in violations of the Commission's
8 standards of conduct approved by the Commission.

9 Q. Do your recommendations apply only if the Commission chooses to adopt Staff's
10 comprehensive Standard of Conduct?

11 A. No. My recommendations are intended to apply as an enforcement mechanism for
12 any code or standard of conduct adopted by the Commission in its implementation
13 ROA. This includes the standards provisionally approved for Consumers Energy and
14 Detroit Edison even if they are not otherwise revised.

15 Q. What you describe could evolve into a time consuming process which might
16 encourage participants, particularly incumbent utilities, to violate the rules. How do
17 you propose to deal with that potential for abuse?

18 A. I believe a graduated and rapid dispute resolution process could minimize, but not
19 eliminate the incentive for violations.

20 Q. What do you mean by a graduated and rapid dispute resolution process?

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1 A. I recommend that at the time a party believes a violation has taken place, that party
2 formally notifies the other party of the possibility of a dispute or violation. That
3 notice could be by telefax (fax), e-mail, letter or any other means of communications
4 utilized by the parties in the normal course of conducting their business.

5 Five business days after that contact, each party shall identify an employee, agent or
6 representative to deal with the dispute. These persons shall have 15 business days
7 to resolve the dispute. If no resolution is achieved, but the promise of resolution
8 seems forthcoming in the judgement of the complaining party, that party may extend
9 this informal process an additional 15 days.

10 Q. What happens if the parties are unable to resolve the dispute after the informal
11 process you describe?

12 A. The complaining party has the option of filing a formal complaint pursuant to the
13 existing procedures at the Commission.

14 Q. Doesn't the formal process consume a great deal of time?

15 A. The process can, but it doesn't have to. There are a number options related to time
16 frames within the case process which give the Commission and the Administrative
17 Law Judge the ability to shorten the duration of cases.

18 Q. What are some of these options?

19 A. The Commission can shorten the response time for responses to filed complaints.

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1 Administrative Law Judges can accelerate hearing schedules, discovery turn around
2 time and briefing schedules. The Commission can elect to read complaint records.
3 This would eliminate the need for Proposed Decisions, exceptions and replies.

4 Q. Must the informal process always precede the filing of a formal complaint?

5 A. Not necessarily. Persons can file whatever they want, whenever they want, and the
6 administrative process can govern the merits of the filing. Parties may feel certain
7 violations are so egregious that the informal process will offer no possibility of relief.
8 This being the case, an accelerated formal process might be the best way to proceed.
9 The informal process, however does offer the potential to resolve disputes which are
10 the result of simple errors or misunderstandings without unnecessarily consuming the
11 parties' time and resources.

12 Q. You have covered the oversight and enforcement, what sort of penalty scheme to you
13 propose?

14 A. In the Commission's regulatory paradigm, the element of risk has been recognized
15 in determining the level of profitability for regulated electric utilities. I am
16 proposing an approach to penalties which recognizes the impact on utility risk of
17 actions which delay, or simply stonewall the implementation of the Commission's
18 ROA program.

19 Q. How would this approach work?

20 A. First we must assume that after a complaint, notice and hearing the Commission has

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1 determined a violation has taken place. The "guilty" party should be given an
2 opportunity to correct its behavior and the Commission should so rule. For example,
3 the Commission could rule the party has 10 days to correct the violation on a going
4 forward basis and to correct previous actions related to the particular violation.

5 If corrective action does not take place, the Commission on its own initiative, could
6 require an explanation for the non-compliance. If not satisfied with the explanation,
7 the Commission could raise the stakes.

8 Q. What do you mean by raise the stakes?

9 A. I will discuss this following my discussion of repeated violations.

10 Q. What else are you proposing?

11 A. If the Commission finds repeated violations of the same aspects of its code or
12 numerous different violations of its code, the Commission could conclude the party's
13 actions are specific and planned activities designed to forestall competition in the
14 Michigan electric market as envisioned by the Commission in its ROA program.

15 Q. What would be the results of such action?

16 A. Thwarting competition in the electric market in Michigan reduces the risk associated
17 with participating in that market particularly for the incumbent utilities. That being
18 the case, it is appropriate to recognize less risk related to an incumbent utility's
19 participation in the electric business in Michigan.

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1 Q. How would this be accomplished?

2 A. The simplest way would be to adjust the utility's authorized return on common
3 equity and then reduce rates for service accordingly. I believe this could be done in
4 the context of the current contested case proceeding or in the complaint process.

5 Q. Do you have any specific recommendations?

6 A. Exhibit S-___(WJC-1) presents an example of the approach. I have performed no
7 specific economic analysis to validate the numbers presented on the exhibit. The
8 exhibit should be viewed as a demonstration of my recommendation..

9 Q. Does this complete your direct testimony?

10 A. Yes.

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EXHIBIT OF
WILLIAM J. CELIO
MICHIGAN PUBLIC SERVICE COMMISSION

January 11, 2000

EXAMPLES OF RATE ADJUSTMENTS
DUE TO VIOLATIONS OF
STANDARDS OF CONDUCT

DETROIT EDISON

STEP 1: Violation found by Commission followed by Company compliance

No rate adjustment

STEP 2A: Violation found by Commission followed by Company non-compliance

Rates reduced by \$13,500,000 annually applied as a percentage reduction in charges (approx. 1.3%)

STEP 2B: Recurring violation as found in Step 1

Rates reduced by \$13,500,000 annually applied as a percentage reduction in charges (approx. 1.3%)

STEP 3: Numerous (more than 2) violations found by Commission applied as a percentage reduction in charges (approx. 2.5%)

Note: Inclusive of Step 2A or 2B.

CONSUMERS ENERGY

STEP 1: Violation found by Commission followed by Company compliance

No rate adjustment

STEP 2A: Violation found by Commission followed by Company non-compliance

Rates reduced by \$4,200,000 annually applied as a percentage reduction in charges (approx. 1%)

STEP 2B: Recurring violation as found in Step 1.

Rates reduced by \$4,200,000 annually applied as a percentage reduction in charges (approx. 1%)

Note: Step 2A & 2B are not cumulative.

STEP 3: Numerous (more than 2) violations found by Commission

Rates reduced by a total of \$8,600,000 annually applied as a percentage reduction in charges (approx. 2%)

Note: Inclusive of Step 2A or 2B.

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QUALIFICATIONS AND TESTIMONY OF

MARGARET ROBERTS VANHAFTEN

MICHIGAN PUBLIC SERVICE COMMISSION

January 11, 2000

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1 Q. What is the purpose of your testimony?

2 A. My testimony first offers Staff comments on the Retail Open Access Program
3 Standards of Conduct filed by the Consumers Energy Company (Consumers Energy
4 or Consumers), modified and provisionally approved by the Michigan Public Service
5 Commission (Commission) in Case No. U-11290 on March 8, 1999, and the Retail
6 Open Access Standards of Conduct filed by the Detroit Edison Company (Detroit
7 Edison), modified and provisionally approved by the Commission in Case No. U-
8 11290 on September 14, 1999. Next, I describe the types of measures that should be
9 included in an effective code or standards of conduct. I offer for the Commission's
10 consideration an improved code of conduct which Staff believes will provide
11 appropriate safeguards against anticompetitive behavior and thus enhance the
12 opportunity for the development of a competitive electricity generation market in
13 Michigan

14 Q. Are you offering exhibits?

15 A. Yes. Exhibit S - ____ (MRV-1) is the Staff paper titled "Developing and Implementing
16 Codes of Conduct for the Retail Electric Industry," which was filed in Case No. U-
17 11290 on December 23, 1998. Exhibit S - ____ (MRV-2) is the "Staff Report on Code
18 of Conduct Meetings," which was filed in Case No. U-11290 on June 4, 1999.
19 Exhibit S - ____ (MRV-3) is Staff's red-lined version of Consumers Energy's
20 standards of conduct. Exhibit S - ____ (MRV-4) is Staff's red-lined version of Detroit
21 Edison's standards of conduct. Exhibit S - ____ (MRV-5) is Staff's recommended code

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1 of conduct.

2 Q. In its March 8, 1999 order in Case No. U-11290, the Commission discussed the Staff
3 paper "Developing and Implementing Codes of Conduct for the Retail Electric
4 Industry" (S - ___, MRV-1). The Commission directed Staff to meet with Consumers
5 Energy, Detroit Edison, and other interested parties to discuss standards or codes of
6 conduct. In particular, the Commission asked whether there were "specific issues in
7 the electric market that would warrant modification" to the standards of conduct
8 applicable to Michigan's natural gas companies. Additionally, the Commission
9 requested that Staff "attempt to develop a consensus on what additional actions, in
10 any, are needed" and identify "any remaining issues that need be addressed by the
11 Commission." What was the result of this activity?

12 A. Staff held a series of meetings with small groups of interested parties and, at the end
13 of that process, a final meeting with all of the groups together. These meetings did
14 not result in an agreement on a code of conduct. The only code issue that all agreed
15 on was that a code of conduct is necessary to govern an electric utility's relationship
16 with its marketing affiliates. There was near consensus on the code structure, with
17 a preference for, or tolerance of, broad code provisions with specific illustrative
18 examples. However, there was little agreement on the specific provisions that should
19 be included in the code of conduct to be applied to Consumers Energy and Detroit
20 Edison. The results of these meetings are discussed further in the "Staff Report on
21 Code of Conduct Meetings," Exhibit S - ___ (MRV-2). As a result, in its September

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1 14, 1999 order in Case No. U-11290, the Commission initiated this proceeding to
2 determine what modifications, if any, should be made to the existing provisional
3 codes of conduct.

4 Q. For the purpose of this testimony, are you using the terms "standards of conduct" and
5 "code of conduct" interchangeably?

6 A. Yes.

7 Q. Are the provisional standards of conduct proposed by Consumers Energy and Detroit
8 Edison sufficient to prevent an incumbent utility from employing anticompetitive
9 behaviors to gain market dominance for its marketing affiliates?

10 A. No.

11 Q. Please explain.

12 A. First, there should be no misunderstanding that a code of conduct will prevent all
13 abusive market behavior. A code of conduct, no matter how comprehensive, cannot
14 eliminate market power or completely prevent anticompetitive behavior. Codes do
15 not remove the incentive for a utility to favor or subsidize its marketing affiliates. A
16 code can only establish behavioral guidelines to govern the utility's relationship with
17 its affiliates, providing a means to deter cross-subsidization and cost shifting,
18 discriminatory behavior, and inappropriate sharing of information. Staff emphasizes
19 that codes of conduct are only as effective as the provisions included in them, as the
20 oversight and enforcement mechanisms employed to ensure adherence to them, and
21 the penalties able to be assessed for violations.

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1 Neither Consumers Energy nor Detroit Edison's provisional standards of conduct are
2 sufficient to limit anticompetitive behaviors. The problems include both the language
3 of the existing provisions as well as provisions Staff believes to be necessary which
4 have been omitted from the provisional standards. In Exhibits
5 S - ____ (MRV-3) and S - ____ (MRV-4) Staff offers red-lined versions of Consumers
6 Energy and Detroit Edison's provisional standards of conduct. These red-lined
7 versions of the provisional standards serve as an initial step in the process to develop
8 an effective code of conduct.

9 Q. Please provide some examples of the concerns Staff has with the provisional codes.

10 A. Consumers Energy's two-tiered structure, as described in the first paragraph of its
11 provisional code (CAG-1, ____ - ____) presented by Mr. Gilzow, allows both the utility,
12 referred to as "first-tier" affiliates, and its separately-organized affiliates, referred to
13 as "second-tier" affiliates, to participate in the Retail Open Access Service program.
14 Staff opposes the utility offering competitive services and products. The lack of
15 adequate separation between the regulated and competitive businesses increases the
16 opportunity for discriminatory behavior, cross-subsidization and cost-shifting, and
17 inappropriate sharing of information. The less distinct the separation between the
18 entities offering regulated and competitive services or products, the greater incentive
19 for and opportunity to abuse its monopoly power. Staff believes that the separation
20 of regulated and competitive activities through the use of legally separate entities is
21 a hallmark of an effective code of conduct. To allow a structure such as that proposed

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1 by Consumers opens the door for anticompetitive behavior.

2 Staff notes that Detroit Edison's provisional standards of conduct does not include
3 the "first-tier / second-tier" designation.

4 Q. Since Section A of the Consumers and Detroit Edison's provisionals standards of
5 conduct are different, how does Staff recommend dealing with the discrepancies?

6 A. Consumers Energy states that its standards of conduct apply to "affiliates of
7 Consumers," and follows with an explanation of how the provisional standards will
8 apply to its first- and second-tier affiliates. Detroit Edison states that the standards
9 of conduct "shall apply to Detroit Edison and the affiliates of DTE Energy
10 participating in the Retail Open Access Service program." From a regulatory
11 perspective, it is problematic to have a utility attempt to commit its affiliates. Staff
12 also has concerns about the use of the term "affiliate." There are many different
13 definitions of "affiliate." Most refer to an organization that is related to another
14 through some type of ownership or control. Staff believes each utility has an
15 incentive to favor or subsidize all affiliates of its parent company, whether or not the
16 utility itself has direct ownership of or control over the affiliate. Therefore, to avoid
17 any confusion or misunderstanding, Staff has revised the language in Section A of
18 both Consumers Energy and Detroit Edison's provisional Standards of Conduct to
19 cover the utility in its relationships with its affiliates or the affiliates of its parent
20 company.

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1 Q. Are there any other comments you would like to make about the provisional codes
2 relating to separation of regulated and competitive activities?

3 A. Sections I and J of both Consumers Energy and Detroit Edison's provisional
4 standards are the primary provisions dealing with the separation of regulated and
5 competitive activities. In Section I, Staff recommends the language be changed to
6 state that the employees of the utility's regulated business and those of its affiliates
7 offering competitive services and products function independently of each other, be
8 employed by separate corporate entities, and maintain separate business offices. This
9 modified language is consistent with the language found in Consumers' Gas
10 Transportation Standards of Conduct, as illustrated in Witness Gilzow's Exhibit ____-
11 ____ (CAG-2).

12 In the same manner, Staff recommends that Section J be changed to state that the
13 books and records for all regulated services will be maintained separately from those
14 of the affiliates offering competitive services or products. This language reflects the
15 language used in the Natural Gas Transportation Standards of Conduct.

16 It cannot be emphasized enough that the more distinctly regulated and competitive
17 services or products are separated, the greater the likelihood that a competitive
18 market will thrive.

19 Q. Will these changes satisfy Staff's concerns about the lack of separation between the

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1 regulated and competitive activities?

2 A. The changes are necessary but not sufficient. Even with these language changes, the
3 provisional standards lack the necessary components to adequately separate the
4 regulated and competitive activities to prevent cross-subsidization and cost-shifting,
5 discrimination, and the inappropriate exchange of information. In their provisional
6 standards, Consumers and Edison use the model of functional separation. As Staff
7 has discussed previously, this degree of separation, or more appropriately, lack of
8 separation, provides the utilities significant opportunity to directly or indirectly
9 subsidize affiliate activities, shift costs from competitive to regulated customers, and
10 share proprietary information with affiliates offering competitive services or
11 products. Any standards of conduct adopted by the Commission should establish a
12 real separation between the regulated activities provided by the utility and the
13 competitive activities offered by the affiliate. Provisions A-E, G-I, and K-L in
14 Section II of Staff's recommended code of conduct (S -___ MRV- 5) contain
15 additional components necessary to ensure real separation between regulated and
16 competitive activities. These recommendations will be discussed later in this
17 testimony.

18 Q. Referring to the Staff's red-lined version of the standards of conduct, please discuss
19 other concerns raised by the Staff.

20 A. Sections B, C, E, and H of both Consumers and Detroit Edison's provisional
21 standards of conduct focus on discriminatory behavior and contain conditional

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1 language. Section B refers to "undue discrimination," Section C refers to "undue
2 preference," Section E uses the language "[t]o the extent practicable," and Section
3 H uses the language "unduly conditions." None of this conditional language is in the
4 Consumers' Gas Transportation Standards of Conduct, as cited by Consumers
5 Energy's Witness Gilzow in his Exhibit CAG-2 (___-___). Staff believes the
6 vagueness of this language leaves too much room for interpretation resulting in the
7 likelihood of discriminatory behavior. The terms "undue," "unduly," and "to the
8 extent practicable" should be omitted from both Consumers and Detroit Edison's
9 standards of conduct.

10 Q. Does Staff have additional concerns?

11 A. Yes. Staff recommends language revisions in several sections to clarify the meanings
12 of several provisions. Section C in both companies' provisional codes refers to the
13 utility not giving preference in "... matters relating to bidding, scheduling of power,
14 provision of ancillary services, billing, metering, curtailment policy or access to
15 customer information. . ." In this context, listing the services as both companies have
16 done can result in the exclusion of other services. For example, based on the
17 language in Section C, it could be argued that it would be acceptable for the utility
18 to discriminate in favor of an affiliate's customers when making line repairs or
19 connections. There should be no preference granted to affiliates in the provision of
20 any of the utility's regulated services. To clear up any potential misunderstanding,
21 Staff recommends that the listing of covered services be eliminated and that the

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1 codes for Consumers Energy and Detroit Edison contain language stating that the
2 utilities shall not give preference to affiliates or their customers in any manner.

3 In Section D, Staff recommends additional language to clarify that the utility also
4 will not communicate to the customer of any aggregator, broker, marketer or retailer
5 that advantages may accrue to them in the use of the utility's regulated services if
6 they choose an affiliated aggregator, broker, marketer, or retailer.

7 Regarding Section F, which refers to customer requests for information about
8 aggregators, brokers, marketers, or retailers, Staff recommends that the language be
9 changed to state that the utility will provide the names of such entities "authorized
10 by the Michigan Public Service Commission to provide service in Michigan." This
11 results in a clearer definition of which service providers should be included on the
12 list given to customers in response to requests for information about service
13 providers.

14 Section G contains language which could be misunderstood or misconstrued. The
15 provisional standards of conduct state that customer-specific sales volumes and usage
16 patterns will not be provided, but then goes on to explain under what conditions that
17 information will be provided. Staff has deleted the first part of the provision to avoid
18 confusion. Staff agrees with Detroit Edison Witness Padgett that the term "historic

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1 volumetric sales data” might be confusing and has recommended the term “historic
2 usage or billing data.” Finally, Staff clarified the overall language of the provision
3 to clearly state who can request customer information and under what circumstances
4 it should be provided by the utility.

5 In addition to the previously discussed recommended change to Section H, Staff
6 recommends edits to clarify the section.

7 Q. Has Staff made any other changes to the provisional standards of conduct?

8 A. Yes. Staff has added Section L to deal with oversight, enforcement, and penalties for
9 violating the standards of conduct. Mr. Celio will address this provision in his
10 testimony.

11 Q. Both Consumers’ Witness Mr. Gilzow, and Detroit Edison’s Witness Mr. Padgett,
12 suggest that the standards of conduct proposed by their respective companies are
13 sufficient for the initial phase of retail access through 2002. Mr. Gilzow goes on to
14 suggest that the provisional standards should be left in place “. . .for at least two
15 years to measure its effectiveness in addressing code of conduct issues.” Do you
16 agree with their positions?

17 A. No. By implementing a code of conduct that fails to cover at least the primary areas
18 of potential abusive behavior, each utility will be in the position to help its affiliates
19 gain a substantial market advantage at the onset of retail access. Staff believes that
20 the provisional standards of conduct filed by both Consumers Energy and Detroit

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1 Edison can result in anticompetitive behavior and could tip the scale in favor of each
2 utility's marketing affiliates. Once a dominant position is obtained or perpetuated,
3 it is difficult to subsequently establish a fair and balanced market environment.

4 Q. If the changes recommended in Staff's red-lined version are made, does Staff believe
5 the standards of conduct will be sufficient to deter a utility's anticompetitive
6 behavior?

7 A. The proposed changes will improve the effectiveness of the provisional standards of
8 conduct. However, Staff believes the resulting code of conduct will not be sufficient
9 to limit anticompetitive behavior.

10 Q. In Staff's opinion, what was omitted from the Consumers Energy and Detroit
11 Edison's provisional standards which render them ineffective?

12 A. Besides the limited scope of the separation and information-sharing categories, and
13 the narrow approach to affiliates, the provisional standards of conduct do not deal at
14 all with either the relationship between the utility and alternate suppliers or oversight,
15 enforcement, and penalties for violation of the standards. Staff believes provisions
16 dealing with these issues, as well as added provisions dealing with separation,
17 discrimination, and information not covered in the provisional standards of conduct,
18 are essential components of an effective code of conduct.

19 Q. Since Staff believes Consumers Energy and Detroit Edison's provisional standards
20 of conduct are insufficient to deter anticompetitive behavior, what types of provisions
21 would Staff recommend including in a code of conduct?

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1 A. The issues which Staff believes should be included in a code of conduct are:
2 Separation Standards; Provisions to Prevent Discrimination; Disclosure and
3 Information Standards; Utility - Alternate Supplier Relationship; Oversight,
4 Enforcement, and Penalties; and Applicability.

5 Staff's proposed code of conduct is found in Exhibit S - ____ (MRV- 5).

6 Q. Would you please explain Staff's recommendations regarding the structure of the
7 code of conduct?

8 A. As discussed in the "Staff Report on Code of Conduct Meetings," (S - ____, MRV-2),
9 one of the few areas of near agreement arising from the meetings with the various
10 interested parties was the structure of the code. Most parties agreed that the code
11 adopted in Michigan should contain broad statements of prohibited behavior with
12 specific examples illustrating, but not necessarily all-inclusive of, the prohibited
13 behaviors. Staff has used this format in its proposed code, Exhibit S- ____ (MRV- 5).

14 Q. What are the benefits of this type of code structure?

15 A. It would be difficult to anticipate all of the ways in which an incumbent utility could
16 abuse its market dominance. A code with only specific provisions risks omitting a
17 provision covering a potentially significant anticompetitive behavior. A code with
18 only broad provisions could resolve much of this concern, however those broad
19 provisions might be misunderstood or could be open to different interpretations by
20 different parties. By implementing a code with broad statements of prohibited or

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1 expected behavior followed by specific examples, a greater level of clarity can be
2 achieved. A common understanding of the meaning of code provisions benefits all
3 parties and should help to minimize the number of disputes.

4 Q. What are Staff's recommendations regarding the separation of regulated and
5 competitive activities?

6 A. Staff believes that competitive activities should be provided by affiliates that are
7 structurally and legally separate from the utility. Failure to require clear legal
8 separation between regulated and competitive activities presents several problems.
9 The utility will still be the monopoly provider of essential transmission and
10 distribution services. If the market is to succeed, all participants, including those not
11 affiliated with the utility, must have fair access to the utility's monopoly facilities.
12 An incumbent utility has every incentive to favor its affiliates by providing
13 preferential service to those customers choosing its affiliates for generation services
14 and by subsidizing the competitive activities of its affiliates at a cost to its regulated
15 customers. Structural separation provides clearer boundaries between regulated and
16 competitive activities which should enable more effective tracking of the transactions
17 between the two entities.

18 Q. Why does Staff believe that structural separation is a critical factor to the
19 development of a competitive generation market?

20 A. Neither revenues nor resources obtained in the course of providing regulated services
21 to captive customers of the regulated utility should subsidize competitive activities.

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1 The quality of regulated services should not be reduced because regulated revenues
2 are funding competitive activities. Structural separation occurs through the creation
3 of a separate corporation or corporations for competitive activities. If the affiliate
4 offering competitive services and products has an independent Board of Directors
5 and a separate corporate purpose from that of the utility, as well as separate facilities,
6 equipment, and employees, there is less opportunity for the utility to provide it with
7 financial, human and informational resources. It is also likely that there will be
8 clearer, formal documentation of transactions between the utility and the competitive
9 affiliate, allowing more effective oversight of the code.

10 Q. Won't an affiliate offering competitive services be put at a disadvantage if it is
11 unable to obtain financial support from its regulated affiliates?

12 A. Not necessarily. Staff should clarify that it has no objection to the competitive
13 affiliate receiving financial support from any of the many other nonregulated utility
14 affiliates. Staff does object, however, to the regulated utility subsidizing directly or
15 indirectly the activities of affiliates offering competitive services or products.

16 Q. Wouldn't functional separation provide the same degree of security from
17 anticompetitive behavior?

18 A. No, it would not. Functional separation may require that those employees providing
19 competitive services or products work in different facilities and use different
20 equipment than those employees providing regulated services. Functional separation

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1 also may require that the books and records for competitive activities be kept
2 separately from those of regulated activities. While helpful, this level of separation
3 alone is not sufficient to prevent potentially abusive behaviors. The closer the
4 regulated and competitive activities, both administratively and physically, the greater
5 opportunity to share financial, human, and informational resources, and the more
6 difficult it becomes to track the formal and informal transactions between regulated
7 and competitive activities. of conduct.

8 Q. Based on Staff's general position on separation, what types of provisions should be
9 included in a code of conduct?

10 A. Staff's proposed code of conduct (S - ___, MRV-5) offers several additional
11 provisions dealing with separation.

12 An effective code of conduct should include provisions to ensure that regulated
13 customers do not directly or indirectly subsidize competitive activities, including
14 pledging utility assets to support financing for such affiliates. In Exhibit S - ___
15 (MRV-5), Sections II - A, B, G, K, and L cover various aspects of subsidization.

16 Coupled with this should be a provision requiring separation of books and records.
17 This language is similar to the provision in both Consumers and Detroit Edison's
18 provisional standards of conduct. Section II - C deals with separation of books and
19 records. (S-___, MRV-5).

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1 Staff recommends a prohibition on sharing facilities, equipment, or services. Not
2 only can this type of sharing result in cost shifting or cross-subsidization, it can also
3 lead to sharing of proprietary information. Staff has included Section II-D (S-____,
4 MRV-5) to cover this issue. Again, this language is similar to, but more
5 comprehensive than, that found in the provisional standards of conduct.

6 Staff believes that people, whether members of the Board of Directors, officers, or
7 employees should not be shared by the utility and its affiliates providing competitive
8 services or products. Provision II-E and F of Staff's recommended code set limits on
9 sharing of employees (S-____, MRV-5). Staff also has included II-H, a provision
10 which would allow employee transfers between the utility and its affiliates offering
11 competitive services or products with appropriate documentation.

12 Staff has proposed several provisions, Section II-I through L, covering the separation
13 of regulated and competitive activities, including joint advertising and tying
14 arrangements (S-____, MRV-5).

15 Q. What does Staff believe needs to be added to the provisional standards of conduct to
16 help prevent discriminatory behavior by the utility in favor of its affiliates or against
17 non-affiliates?

18 A. Staff believes that, with the deletion of the "undue" language as previously discussed,

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1 the discrimination standards in the provisional standards of conduct are fairly
2 complete. Therefore, in Section III-A and D, Staff proposes language similar to the
3 language in Consumers and Detroit Edison's provisional standards of conduct
4 Sections B, C, E, and H as previously discussed (S-___, MRV-5). These provisions
5 alone, however, do not cover other issues which the Staff believes are necessary to
6 include in an effective code of conduct.

7 Q. What provisions would Staff recommend adding to the code of conduct?

8 A. Staff recommends adding provisions to the code which deal with specific types of
9 discriminatory behavior. The code should include language requiring that the utility
10 grant discounts and other types of special considerations on a nondiscriminatory
11 basis. Therefore, Staff recommends adding language the language found in Section
12 III-B of its recommended code (S -___, MRV-5).

13 As a step toward preventing the financial subsidization of competitive activities by
14 regulated customers, the code should contain language setting a standard for how the
15 utility's provision of services, products, and property to affiliates shall be
16 compensated. Staff has included language dealing with this concern in Section III-C
17 of its recommended code (S -___, MRV-5).

18 To help prevent indirect subsidization by means of technical assistance, the code
19 should include language prohibiting employees of the utility from providing

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1 information or consultation to affiliates offering competitive services or products.

2 Staff has included language regarding this issue in Section III- E of its recommended
3 code (S - ___, MRV-5).

4 To prevent the utility, especially acting in the role of transmission and distribution
5 provider, from pointing potential customers toward an affiliate or away from an
6 alternate provider, the Staff has included language prohibiting this type of
7 consultation in Section III-F of its recommended code (S - ___, MRV-5).

8 Q. What is Staff's position on the utility sharing information?

9 A. Information is a valuable commodity in a competitive market. The utility, either in
10 its role as a retail generation and distribution provider, a distribution provider for
11 other service providers, or as a transmission and distribution provider, possesses
12 information which could provide a significant competitive edge to the recipient. Staff
13 has identified at least five types of information that, if shared by the utility only with
14 an affiliate offering competitive services or products, provide the affiliate with a
15 significantly unfair advantage over non-affiliated competitors.

16 Q. What are these types of information and under what conditions should the utility
17 make it available?

18 A. First, there is the basic customer information, including the customers' names and
19 addresses. Staff believes that this information should not be shared with anyone
20 unless it is shared with all entities offering competitive retail services or products

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1 under the same terms and conditions, in the same format, and contemporaneously.
2 Staff recommends language dealing with this issue in Section IV-A of its
3 recommended code (S - ___, MRV-5).

4 Second, the utility possesses each individual customer's usage and billing data. This
5 information should not be shared with any individual or company unless the
6 customer specifically requests the data be released. The customer also should have
7 the opportunity to determine which, if any, providers receive the information. Staff
8 recommends language on this issue in Section IV- B (S - ___, MRV-5).

9 Third, there is aggregate, or non-specific, customer data. Staff believes that if this
10 data is made available to the affiliate, it should be made available to all competitive
11 providers authorized by the Commission to provide service in Michigan. Staff
12 recommends language covering this in Section IV-C of its recommended code (S -
13 ___, MRV-5).

14 Fourth, the utility possesses information about the transmission and distribution
15 system, including, for example, when and where upgrades are expected to be made.
16 This information could be valuable to both affiliates and alternate providers in
17 making business decisions. If this information is made available to one competitor,
18 it should be made available to all under the same terms and conditions, in the same

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1 form, and contemporaneously. Staff provides recommended language regarding this
2 issue in Section IV-D of its recommended code (S - ___, MRV-5).

3 Finally, there is information the utility obtains in its role as the transmission and
4 distribution provider to non-affiliated generators, marketers, brokers, and
5 aggregators. In this role, the utility obtains valuable information which could benefit
6 affiliated retail suppliers. For example, if an affiliate knew the identities of customers
7 switching to a non-affiliated supplier, the affiliate could interfere in the transaction
8 and convince the customer to instead deal with the affiliate. While competition can
9 result in lower costs for the customer, the utility affiliate should not gain an
10 advantage over non-affiliates by obtaining proprietary information from the
11 transmission/distribution provider. Staff includes proposed language on this issue in
12 Section IV-E of its recommended code (S - ___, MRV-5).

13 Q. What are Staff's recommendations regarding provisions governing the utility -
14 alternate supplier relationship?

15 A. First, the utility should not give the appearance that it speaks on behalf of any
16 alternate supplier. Second, the utility should be prohibited from interfering in the
17 contractual relationship between the alternate supplier and its customers. These
18 provisions are covered in Section V of Staff's recommended Code of conduct (S -
19 ___, MRV-5).

20 Q. To whom should the code of conduct be applied?

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1 A. Staff believes the code should apply to Consumers Energy and Detroit Edison in their
2 relationships and transactions with their affiliates as well as affiliates of their parent
3 companies. The code should be broad enough to include the utility's relationship
4 with all of its affiliates offering competitive services or products rather than narrowly
5 limiting it to the utility's relationship with just those affiliates offering retail
6 generation service. The risk of anticompetitive behavior and cross-subsidization
7 exists for all competitive services and products and is not limited just to retail
8 generation.

9 Q. Does Staff recommend the same code apply to other Michigan utilities as they begin
10 offering access to retail customers?

11 A. Perhaps. It appears to be most beneficial to promoting a competitive market if similar
12 codes are applied to similarly situated utilities. There may be a need for the
13 Commission to consider some minor modifications in this code for smaller utilities,
14 but Staff would suggest that modifications be the exception rather than the rule.

15 Q. Should this code apply to non-affiliated suppliers?

16 A. The Commission is in the process of determining licensing standard for non-affiliated
17 suppliers. One of the primary purposes of this code is to prevent the utility from
18 using the market power it has achieved as a regulated monopoly to subsidize or favor
19 in any way its affiliates, thus inhibiting the development of the competitive market.
20 Non-affiliated suppliers do not fit in this category.

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1 Staff, however, is concerned that affiliates of out-of-state utilities may have the same
2 ability to be subsidized by regulated customers as the affiliates of Consumers Energy
3 and Detroit Edison. Since the objective is to create a fair environment in which
4 competition can develop and flourish, out-of-state utility affiliates should have no
5 more an advantage than those of in-state utilities. Staff recommends the Commission
6 consider applying the code provisions dealing with cross-subsidization to out-of-state
7 utilities' affiliates serving retail customers in Michigan. To accomplish this, the
8 Commission could require as a part of the Act 69 approval process or any subsequent
9 licensing process, that each affiliate demonstrate it is already in compliance by virtue
10 of an applicable code of conduct in its home state, or sign a statement of compliance
11 stating that it will abide by the selected provisions.

12 Q. In your testimony you have offered both red-lined versions of the provisional codes
13 for Consumers Energy (S - ___, MRV- 3) and Detroit Edison (S - ___, MRV-4) and a
14 more complete code of conduct (S-___, MRV-5). Please summarize Staff's
15 recommendation regarding the Commission's adoption of changes to the provisional
16 codes versus adoption of the more comprehensive code.

17 A. If the Commission is only interested in adjustments to the codes currently in place,
18 Staff recommends the language in Exhibits S - ___ (MRV- 3) and S - ___, (MRV-4).
19 If the Commission is interested in a more comprehensive approach than exists in the
20 current codes, Staff recommends the presentation in S - ___ (MRV-5).

21 Q. Does this conclude your testimony?

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1 | A. Yes.

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

*** * * ***

**In the matter of the approval of a code of)
conduct for CONSUMERS ENERGY)
COMPANY AND DETROIT EDISON)
COMPANY.)**

Case No. U-12134

EXHIBITS OF
MARGARET ROBERTS VANHAFTEN
MICHIGAN PUBLIC SERVICE COMMISSION

January 11, 2000

MICHIGAN PUBLIC SERVICE COMMISSION

**Case No. U-11290
Electric Restructuring**

**DEVELOPING AND IMPLEMENTING CODES OF CONDUCT
FOR THE RETAIL ELECTRIC INDUSTRY**

Report filed by
The Michigan Public Service Commission Staff
December 23, 1998

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DEVELOPING AND IMPLEMENTING CODES OF CONDUCT FOR THE RETAIL ELECTRIC INDUSTRY

I. INTRODUCTION:

One major obstacle to the establishment of a successful competitive retail electricity market is an incumbent utility's opportunity to use market power to maintain its monopoly status. By exploiting its market power, the incumbent utility can limit market entry of potential competitors or gain an unfair market advantage over existing competitors. Lawmakers, regulatory agencies, and interested parties have acknowledged the concerns about market power and continue to investigate options for mitigating it. A variety of remedies have been considered, and several states involved in restructuring have implemented provisions to prevent or curb market power abuses. These mitigation techniques fall into two general categories: structural and behavioral remedies. One potential behavioral remedy is a Code or Standard of Conduct, rules of behavior by which each utility operating in the retail market would agree to abide.¹ Several states, as well as the Federal Energy Regulatory Commission (FERC), are employing codes of conduct as part of an overall strategy to dilute market power concerns. However, before a code is developed, there are a number of issues to be considered, including what provisions should be covered in the code, to whom should it apply, and how it should be enforced.

This paper examines the framework into which codes of conduct fit in a competitive electric generation market. It covers the advantages and disadvantages of structural and behavioral approaches to mitigation, discusses issues to be considered in developing a code of conduct including enforcement options, and provides examples of language used in codes that have been adopted by other state legislatures and commissions.

II. BACKGROUND:

The transition of the electric industry from one in which generation is a monopoly service

¹It should be noted that a Code of Conduct should not be confused with a Customer Bill of Rights. The primary purpose of a code of conduct is to prevent abuse of monopoly power.

provided under regulation to one in which generation is provided in the competitive market presents several problems which enhance the potential for abuse of market power. For example, in many instances competition is phased-in for retail customers. Thus some customers have the option to participate in the competitive generation market while others remain bundled customers of the regulated utility. The utility may be providing monopoly retail services at the same time that its marketing division and/or affiliate provides competitive retail services within the same service area. This hybrid structure, neither fully regulated nor fully competitive, can allow the utility to use its monopoly position to enhance its competitive position, for example by subsidizing competitive endeavors with ratepayer revenue or providing information on customers to marketing affiliates.² The utility also is generally the owner of the transmission and distribution systems, both of which will remain monopoly services and will continue, at least for the near future, to be regulated. This ownership enables the company to discriminate against its competitors and their customers in favor of its own affiliates and customers and to subsidize its own competitive activities with revenues from captive customers. These and other anticompetitive activities undermine the development of the competitive market and the benefits resulting from it. What can be left is an unregulated monopoly.

It is generally accepted that the most effective way to deal with the potential for market abuse is to build-in provisions prior to and during the restructuring process rather than waiting for the problems to develop and relying on after-the-fact adjustments or antitrust law to rectify the abuses.³ Antitrust cases are costly and time-consuming; generally, the damage to the competitive market is difficult to reverse. However, dealing with the issues up-front requires anticipating and understanding not only how the market will work but also in what ways market power abuse can occur.

There are two primary methods for handling market power abuse: structural remedies and

² While audits may in some instances uncover cross subsidization, without enforcement authority there is no opportunity to remedy the problem unless there is a rate case in which recovery of costs can be denied.

³ Refer to "The Michigan Public Service Staff Market Power Discussion Paper," filed June 5, 1998, p. 103, for additional discussion of this issue.

behavioral remedies.⁴ Structural remedies change the characteristics of the market to significantly reduce or eliminate an incumbent's incentive to use its market power, thus "maintaining an industry structure that is conducive to competition."⁵ Unlike the structural approach, behavioral remedies involve the establishment of rules governing conduct rather than removing the incentive to discriminate, cross-subsidize, or otherwise abuse market power.

Structural approaches focus on removing the utility's incentive to abuse market power.

Options include:

- The sale of generation facilities to reduce market concentration, or an equivalent activity -- For example, in California, Pacific Gas and Electric (PG & E) and Southern California Edison were encouraged to sell generation facilities as a way to reduce their market concentration.⁶ If it is believed that a utility's market power will exist only temporarily while the market develops, market power could be mitigated by requiring companies to enter long-term contracts to sell capacity or energy for the appropriate period of time.⁷
- The divestiture of generation or transmission facilities to eliminate the potential for affiliate transaction abuses -- A substitute for divestiture, although not without challenges, is the establishment of an Independent System Operator (ISO), an entity independent of the transmission owners organized to operate the transmission grid, minimizing the opportunity for affiliate discrimination.
- The structural separation of regulated and nonregulated services, both during a phase-in period and during full-scale retail competition -- This structural separation reduces, but does not necessarily prevent, the opportunity for cross-subsidization.

⁴ Baer, William J. "FTC Perspectives on Competition Policy and Enforcement Initiatives in Electric Power." Presented at "Antitrust and Anticompetitive Behavior" Conference, Sponsored by Infocast, Washington, D.C., December 4-5, 1997, p. 13.

⁵*id*, p. 13.

⁶ Binz, Ronald J. and Mark W. Frankena. "Addressing Market Power." A Policy Paper of the Competitive Policy Institute, Washington, D.C., p. 48.

⁷*id*, p. 48.

- Pricing transmission to broaden the geographic market and therefore, reducing concentration.⁸

Because of the legal and economic implications, structural remedies are complicated and time-consuming to carry out, have the potential to be contentious, and often require legislative authorization to implement. Additionally, these remedies may result in the loss of efficiencies gained through integration of generation and transmission. However, once the structural change has been accomplished, many of the incentives and opportunities to abuse market power are eliminated and there is little need for ongoing regulatory oversight.⁹

Behavioral remedies do not change the structure in which market power thrives, but rather attempt to prevent utilities from behaving in anticompetitive ways.¹⁰ Behavioral remedies require ongoing oversight and enforcement to ensure that there is compliance. Perhaps two of the more visible examples of a behavioral remedy are FERC's Open Access Orders 888 and 889, which require utilities to unbundle transmission and generation and to provide competitors with service comparable to that which the utility provides itself.¹¹ Behavioral remedies are generally rules and regulations, including:

- Dominant firm regulation, which can be used to limit prices charged by dominant firms even if nondominant firms are not bound by the same limitations.
- Restrictions on a utility's use of its transmission facilities to ensure competitors have access.

⁸*id*, p. 48.

⁹ Divestiture will not prevent the opportunity for cross subsidization between the regulated and nonregulated generation services during the phase-in of competition.

¹⁰ *id*, p. 50.

¹¹ Federal Energy Regulatory Commission. Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities. Order No. 888A, Docket Nos. RM95-8-001 and RM94-7-002; 78 FERC 61,220 (1997); issued March 4, 1997; and Open Access Same-Time Information System and Standards of Conduct. Order No. 889A; Docket No. RM95-9-001; 78 FERC 61,221 (1997) issued March 4, 1997.

- Codes of conduct or standards of behavior, which establish guidelines for the utility's activities and its relationship with its nonregulated affiliates. Codes of conduct "may restrict permissible organizational forms in order to separate monopoly and competitive activities; prohibit self-dealing; prescribe transfer pricing and other accounting methodologies to limit cross-subsidies; prohibit sharing of certain types of information; and mandate disclosure, reporting and equal access to information to facilitate oversight and prevent discrimination."¹²

Behavioral remedies are generally easier to implement than structural approaches, however they can be evaded. As previously mentioned, if they are to be effective, they require long-term oversight and enforcement.¹³ Thus, while costs are reduced on the front-end, oversight costs will continue until structural changes are made or the utility ceases all monopoly operations. Behavioral remedies, especially codes of conduct, present additional challenges: it is difficult to develop rules that include all potential contingencies; a significant amount of time must be spent initially to consider as many options as possible. Those developing the code must reach a balance between being overly broad and restrictive and being too narrow or lenient, and thus ineffective.¹⁴

The Federal Trade Commission (FTC) favors structural remedies as the most effective method of curbing market power abuses.¹⁵ The FERC, however, has declined to require structural changes in the bulk power market at this time. Instead, it is relying on open access tariffs, functional unbundling of generation and transmission operations from wholesale marketing functions of public utilities, a code of conduct, and encouraging

¹² Binz and Frankena, *supra*, p. 51.

¹³ Baer, *supra*, p. 14

¹⁴ *id*, p. 15. Baer cites the rules governing access to local exchange facilities in telecommunications as an example of rules that are complex and not necessarily effective.

¹⁵ In its "Comment of the Staff of the Bureau of Economics of the Federal Trade Commission Before the Michigan Public Service Commission, Case No. U-11290, Electric Restructuring," the FTC staff stated that "Affiliate codes of conduct, like functional separation, are likely to be a reasonable first step, but not necessarily a sufficient step toward effective competition. A variety of competitive concerns can arise in affiliate relationships. Favoritism toward affiliates in purchasing decisions and cross-subsidization of affiliates are among the most prominent." Also, see Baer, *supra*, p. 15.

establishment of ISOs.¹⁶ It should be noted that FERC Chairman James Hoecker has indicated his intention "to initiate and complete a generic proceeding that will vastly accelerate the establishment of ISOs or transcos, as appropriate, in every region of the country." ¹⁷ Binz and Frankena conclude that:

The choice between structural and behavioral remedies is not a pure one. The issue is largely the extent to which reliance is placed on behavioral remedies. Even if primary reliance is placed on structural remedies, there may be little alternative to reliance on behavioral remedies to deal with residual market power, including some problems that arise from monopolies over transmission and distribution.¹⁸

III. CODES OF CONDUCT:

Codes or standards of conduct have been developed and put in place in several industries.¹⁹ FERC has established codes of conduct in two applications: a code of conduct for affiliated power marketers and standards of conduct covering the interactions between employees of transmission utilities and their merchant employees. Several states have implemented codes of conduct in conjunction with the transition to a competitive retail electricity market and standards of conduct have been approved for several natural gas utilities in Michigan by the Michigan Public Service Commission (Michigan Commission or MPSC).

A. The Federal Energy Regulatory Commission

In "Heartland Energy Services," FERC adopted a code of conduct for affiliated power

¹⁶ FERC Order 889, *supra*, F(2), Section 37.5.

¹⁷ Hoecker, James J. "Electric Competition Revolution: The Sequel." Remarks presented at the Sixth DOE/NARUC National Electricity Forum, Houston, Texas, September 17, 1998, p. 17.

¹⁸ Binz and Frankena, *supra*, p. 51.

¹⁹ A code of conduct is one of many market power mitigation tools. Refer to the "Staff Market Power Discussion Paper," *supra*, for seven recommended mitigation measures, one of which is the establishment of a code of conduct, p. 127.

marketers seeking approval of market-based rates.²⁰ These standards covered:

- Generation dominance - The marketer must demonstrate that affiliates owning generating units have no generation dominance.
- Transmission market power - The marketer's affiliated public utility must have an open access transmission tariff on file with the FERC.
- Other barriers to entry - If the public utility affiliate also sells and transports natural gas, it is prohibited from refusing to provide service or providing it at unreasonable or discriminatory terms to the marketer's competitors.
- Affiliate abuse - An affiliated power marketer must agree not to sell power to or buy power from its affiliated public utility unless the FERC approves the transaction in a separate rate filing and it must obtain transmission services from its affiliated public utility under that utility's open access transmission tariff.
- Brokering to affiliates - The affiliated utility can only use its affiliate broker if there is no brokering fee.
- Reporting requirements - FERC established reporting requirements: quarterly reports detailing the purchase and sale transactions undertaken in the prior quarter and changes in status that would reflect a change in the characteristics on which the Commission depended in approving the market-based rates.²¹

In Order 889, FERC required transmission providers to establish or participate in an Open Access Same-Time Information System (OASIS).²² As part of the order, FERC established standards of conduct governing the behavior between the employees of a transmission utility and its merchant employees. These rules apply to all transmission services offered under the Open Access Tariff. While at times confused with the code of conduct established in "Heartland," the OASIS standards are less strict and not substitutable for

²⁰ "Heartland Energy Services, Inc." 68 FERC 61,223 (1994).

²¹ *id.*

²² Federal Energy Regulatory Commission. "Open Access Same-Time Information System and Standards of Conduct," *supra*.

those required in "Heartland."²³ Through implementation of these standards, FERC intended to accomplish four objectives:

- Prohibit Transmission Providers engaged in wholesale merchant functions "from giving preferential access to information related to transmission prices and availability to employees of the public utility or any affiliate engaged in wholesale merchant functions." FERC accomplishes this by: "(a) requiring that transmission-related information be made available to all customers (including employees of the public utility, and any affiliate, engaged in wholesale merchant functions) through OASIS postings available at the same time and on an equal basis and (b) prohibiting the employees of Transmission Providers and any affiliates from disclosing or obtaining non-public transmission-related information through communications not posted on the OASIS."²⁴
- Mandate that "employees engaged in system operations and reliability functions must treat all customers in a fair and impartial manner and may not give any preferential treatment to the company's (or its affiliate's) employees conducting wholesale merchant functions."²⁵
- Require "the functional unbundling of the transmission operations and wholesale merchant functions of public utilities and their affiliates so that those employees charged with system operations and reliability would be free to operate the system impartially for the benefit of all customers, including the Transmission Provider itself."²⁶
- Ensure that "the OASIS Final Rule would not compromise reliability,. . . by creating an exemption, in emergency circumstances affecting system reliability, that allows system operators to take whatever steps are necessary to keep the system in

²³ Quint, Arnold H. "Sharing of Information Among Affiliates." Presented at "Antitrust and Anticompetitive Behavior" Conference Sponsored by Infocast, Washington, D.C., December 4-5, 1997, p. 5.

²⁴ Federal Energy Regulatory Commission. "Open Access Same-Time Information System and Standards of Conduct, Part II," *supra*.

²⁵ *id.*

²⁶ *id.*

operation."²⁷

These FERC standards can, to some extent, be applied to the retail market since the focus on preventing discriminatory behavior is also relevant to the retail market. However, FERC codes do not go far enough to prevent some specific types of market power abuse characteristic of the retail market, including the numerous types of cross-subsidization and transfers of information that can occur in a hybrid regulated-competitive utility structure. **To be effective in the retail environment, FERC's code and standards must be expanded.**

In 1997, a subcommittee of the National Association of Regulatory Utility Commissioners (NARUC) issued a White Paper entitled "Tools and Conditions Needed to Prevent Cost Shifting and Cross Subsidies Between Regulated and Non-Regulated Affiliates." At its 1998 Winter Meetings, NARUC adopted a resolution urging that NARUC members:

[C]onsider implementing regulatory tools, such as those discussed in the white Paper (sic), that will allow for reasonable and appropriate continued regulation of monopoly utility services, including (1) policies to ensure non-discriminatory access to essential facilities, (2) financial controls to prevent cross-subsidies between regulated and competitive activities, and (3) policies to ensure non-discriminatory access to market information that are essential to the functioning of efficient markets.²⁸

B. Other States

Several states are employing behavioral methods to avoid the abuse of market power in retail markets. Some state commissions have developed codes of conduct, either at the explicit direction of the legislature or based on their existing authority. Other codes have been built into state restructuring legislation, either specifically identified as a code or built into other provisions of the legislation. For example, Illinois state restructuring legislation

²⁷ *id.*

²⁸ "Resolution Regarding Tools to Protect Pricing and Tools Needed to Prevent Cost Shifting and Cross Subsidies Between Regulated and Non-Regulated Affiliates." Adopted by the National Association of Regulatory Utility Commissioners at its 1998 Winter Committee Meetings. See Attachment A for White Paper.

directs the Illinois Commerce Commission to initiate a rulemaking establishing standards of conduct; in June 1998, the Commission issued an order in that proceeding.²⁹ Nevada Assembly Bill 366 requires that the Public Service Commission establish standards of conduct and penalties for violations.³⁰ In Maine, restructuring legislation contains specific provisions to govern the relationship and transactions between large investor-owned transmission and distribution utilities and their affiliates and requires the Commission to adopt rules to enforce the provisions and to determine the extent of separation necessary to avoid cross-subsidization and market power abuses. A Commission inquiry was initiated April 7, 1998.³¹ In Rhode Island, the restructuring legislation defines standards of conduct for affiliated generating and distribution companies.³² The California Commission conducted an extensive investigation into establishment of standards of conduct, resulting in an order issued in December, 1997 and a modifications order in August, 1998.³³ The Pennsylvania Public Utilities Commission has issued an interim code of conduct and is conducting a rulemaking into the development of an enduring code.³⁴ The Public Service Commission of Wisconsin is conducting an investigation into the development of standards of conduct.³⁵

C. The Michigan Public Service Commission:

Codes or standards of conduct monitoring affiliate transactions, a primary focus of a code

²⁹ "Illinois Commerce Commission On Its Own Motion, Implementation of Section 16-121 of the Public Utilities Act." 98-0035, June 12, 1998.

³⁰ "Nevada Assembly Bill No. 366 - Committee on Government Affairs," Approved July 16, 1997.

³¹ "Utility Requirements for Non-Core Activities and Transactions Between Affiliates." Chapter 820.

³² "An Act Relating to the Utility Restructuring Act of 1996." 96-H 8124B, Approved August 7, 1996.

³³ "Opinion Adopting Standards of Conduct Governing Relationships Between Utilities and Their Affiliates." D.97-12-088, December 16, 1997.

³⁴ "Application of Metropolitan Edison Company for Approval of Restructuring Plan Under Section 2806 of the Public Utility Code." R-00974008. R-00974008C001, June 30, 1998.

³⁵ "Investigation on the Commission's Own Motion Into Utility Business Activities and Into Transactions and Relationships of Utilities and Their Affiliates During the Transition to Restructured Electric and Gas Industries; Potential Effects of Increased Competition on Markets and Consumers." 05-BU-101, May 26, 1998.

of conduct, are not new issues to the Michigan Commission. As the result of a Commission approved settlement agreement in Case No. U-11220, SEMCO Energy Gas Company (SEMCO Energy) agreed to adhere to transportation standards of conduct.³⁶ Similar standards were also adopted by Wisconsin Public Service Corporation,³⁷ Consumers Energy,³⁸ and Michigan Consolidated Gas Company.³⁹ The provisions focus on preventing discrimination by the utility in favor of its affiliates and requiring separation of the utility's operating employees from those of its marketing affiliates:

Transportation Standards of Conduct (as adopted by the MPSC in U-11220):

This rule is intended to promote fair competition and a level playing field among all participants involved in transportation within SEMCO Energy Gas Company's ("SEMCO Energy") regulated service territory. SEMCO Energy will conduct its business to conform to the following standards of conduct:

- a. SEMCO Energy will apply any tariff provision relating to transportation service in the same manner without discrimination to all similarly situated persons.
- b. SEMCO Energy will not give its marketing affiliate or customers of its affiliate preference over non-affiliated gas marketers or their customers in matters relating to transportation service including, but not limited, nominating, balancing, metering, billing, storage, standby service, curtailment policy, or price discrimination.

³⁶ "In the matter of the application of Michigan Gas Company and Southeastern Michigan Gas Company for authority to merge and increase rates for the sale and transportation of natural gas and related approvals." Case No. U-11220, Opinion and Order, October 29, 1997.

³⁷ "In the matter of the application of Wisconsin Public Service Corporation for authority to revise its tariff rules and implement a new customer attachment program," Case No. U-11621, Order Approving Settlement Agreement, April 14, 1998.

³⁸ "In the matter of the application of Consumers Energy Company for approval of an experimental pilot program for expanded gas customer choice, including an expanded gas transportation program, a suspension of its gas cost recovery clause, a moratorium on non-GCR rate adjustment, an earnings sharing mechanism, and related relief," Case No. U-11599, Order Approving Application, December 19, 1997.

³⁹ "In the matter of the application of Michigan Consolidated Gas Company for approval of an experimental pilot program for expanded gas customer choice, including an expanded gas transportation program, a transportation aggregation tariff, an earnings sharing mechanism, a suspension of its gas cost recovery clause, a moratorium on non-GCR rate adjustments, and related relief," Case No. 11682, Order Approving Application, April 28, 1998.

- c. SEMCO Energy will not communicate to any customer, supplier or third parties that any advantage may accrue to such customer, supplier or third party in the use of SEMCO Energy's services as a result of that customer, supplier or other third party dealing with its marketing affiliate and shall refrain from giving any appearance that it speaks on behalf of its affiliate.
- d. SEMCO Energy will process all similar requests for transportation service in the same manner and within the same period of time.
- e. If a customer requests information about marketers, SEMCO Energy will provide a list of all marketers operating on its system, including its affiliate, but will not promote its affiliate.
- f. To the extent SEMCO Energy provides to its marketing affiliate a discount or information related to the transportation, sales or marketing of natural gas, including but not limited to SEMCO Energy's customer lists, that is not readily available or generally known to any other marketer or supplier, it will provide details of such discount or provide the information contemporaneously to all potential marketers on its system that have requested such information.
- g. SEMCO Energy will not condition or tie its agreement to release interstate pipeline capacity to any agreement by a gas marketer, customer or other third party relating to any service in which its marketing affiliate is involved.
- h. SEMCO Energy will not condition or tie an agreement to provide a transportation discount to any agreement by a marketer, customer or other third party relating to any service in which its marketing affiliate is involved.
- i. SEMCO Energy's operating employees and the operating employees of its marketing affiliates will function independently of each other, be employed by separate corporate entities, and reside in separate offices.
- j. SEMCO Energy will keep separate books of accounts

and records from those of its marketing affiliate.⁴⁰

Prior to approving these standards, the Commission had adopted guidelines covering affiliate transactions in several proceedings.⁴¹ In the December 7, 1989 order in Case Nos. U-8678, U-8924, and U-9197, a gas rate case, the Commission imposed several conditions on Consumers Power Company related to the provision of books and records. Included in the conditions were requirements that Consumers provide the Commission access to the books and records of its holding company, CMS Energy Corporation (CMS) and each of Consumers's corporate affiliates, subsidiaries, and joint ventures, including the Midland Cogeneration Venture Limited Partnership (MCV). The "Guidelines for Affiliate Transactions" focus on maintenance and provision of books and records, stating:

1. That the utility ensure that the Commission has access to books and records for the holding company and each of its affiliates and their joint ventures. Any objections to not (sic) providing all books and records must be raised before the Commission and the burden of showing that the request is unreasonable or unrelated to the proceeding is on the respondents.
2. Each utility, holding company, and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and to protect against cross-subsidization of non-utility activities by the utility's customers.
3. The holding company and each of its subsidiaries and the joint ventures of the holding company and/or its subsidiaries shall keep their books in a manner consistent with general accounting principles and, where applicable, consistent with the Uniform System of Accounts.
4. The utility shall furnish the Commission with:
 - The quarterly and annual financial statements of the

⁴⁰ U-11220, *supra*, Attachment D.

⁴¹ See, for example, U-8679, U-8924, and U-9197 regarding Consumers Power Company (December, 1989); U-9323 regarding Michigan Gas Company (June, 1990); and U-9346 regarding Consumers Power Company (May, 1991).

consolidated utility and/or its parent holding company;

- Annual statements concerning the nature of intercompany transactions concerning the utility and a description of the basis upon which cost allocations and transfer pricing have been established in these transactions;
 - Annual balance sheets and income statements of the non-regulated subsidiaries of the utility and/or the non-consolidated subsidiaries of the holding company;
 - An annual report of its transactions between the utility and its non-utility affiliates;
 - An annual report on its federal income tax on a consolidated or non-consolidated basis depending on filing.
5. The utility shall avoid a diversion of management talent that would adversely affect the utility. An annual report identifying personnel transferred from the utility to non-utility subsidiaries is required.
 6. The utility shall file an annual report regarding any transfer to non-utility affiliates of any utility assets or property exceeding a fair market value of \$100,000.
 7. Market, technological, or similar data transferred, directly or indirectly, from the utility to a non-utility affiliate shall be transferred at the higher of cost or fair market value.⁴²

In approving these measures, the Commission directed CMS and the Consumers affiliates and subsidiaries to use specific accounting methods and to keep the books in a manner consistent with general accounting procedures. MCV and Consumers appealed the Commission's decision on various points, including the requirements placed on the MCV by the Commission.⁴³

The Court of Appeals held that Section 5 of the Public Utilities Commission Act, MCL

⁴² "In the matter, on the Commission's own motion, of the rates and tariffs of Consumers Power Company regarding gas transportation service and related matters," U-8678, U8924, U9197. Opinion and Order Revision Depreciation Practices, December 7, 1989, p. 175.

⁴³ *Midland Cogeneration Venture Limited Partnership v Public Service Commission, and Consumers Power Company v Public Service Commission*. 199 Mich App 286 (April 1993).

460.55; MSA 22.5, authorizes the Commission to require a regulated utility to provide information on its parent company and nonregulated affiliates "where such information is reasonably necessary for the performance of the commission's regulatory duties."⁴⁴

Additionally, Section 6 of the Act authorizes the MPSC to "examine any books, accounts, and records kept on behalf of a utility subject to its jurisdiction and to require the production of any books, paper or records relating to the management or operation of the utility."⁴⁵ The Court also held that there exists statutory authority for the MPSC to require Consumers to:

[E]nsure that the PSC has access to the books and records of its parent company, affiliates, and joint ventures, to the extent Consumers has the ability to do so.⁴⁶

However, the Court was unable to find statutory authority enabling the MPSC to require specific accounting and bookkeeping requirements for the MCV, based, in part, on its status under the Public Utility Regulatory Policies Act of 1978 (PURPA).^{47,48} It appears this exception is limited, however, since the Court expressed "no opinion with respect to the validity of conditions 2 and 3 to the extent they apply to Consumers' other affiliates and joint ventures not represented in this appeal."⁴⁹

Section 5 of the Public Utilities Commission Act authorizes the MPSC to make rules and regulations binding on "all persons dealing with the commission or interested in any matter or proceeding pending before it."⁵⁰ The Court states that this provision:

⁴⁴ *id.*, p. 297.

⁴⁵ *id.*, p. 298, citing MCL 460.56, MSA 22.6.

⁴⁶ MCL 460.4; MSA 22.13(4).

⁴⁷ 199 Mich App 286 (300), *supra*.

⁴⁸ 16 USC 823a *et seq.*

⁴⁹ 199 Mich App 304 (footnote #5).

⁵⁰ MCL 460.55; MSA 22.5.

[A]rguably allows the PSC to impose conditions on nonregulated entities to facilitate relevant discovery in cases before it. However, in *Union Carbide*, . . . the Supreme Court indicated that this statute refers to rules and regulations that have been properly promulgated by the PSC, as opposed to conditions imposed in the final order of the PSC in a contested case.⁵¹

This raises two questions: (1) Does a code of conduct imposed by the Michigan Commission in an order also apply to the affiliates of the utility, or just the utility and, (2) in order to employ a code of conduct that applies to both the utility and its affiliates, is the Commission obligated to promulgate a rulemaking?

The "Guidelines for Affiliate Transactions" have been included in several MPSC orders, including Case Nos. U-10149 and 10150, Michigan Consolidated Gas Company proceedings.

Natural gas utilities in Michigan have agreed to standards that could serve as a foundation for developing a code of conduct for electric utilities as they enter the competitive era. However, because of differences in the two industries, gas standards do not include all of the provisions necessary to mitigate potential abuses in the electric industry. There are added historical incentives and structural opportunities for electric utilities to take advantage of their existing market power.

In the natural gas industry, producers, pipelines, and local distribution companies (LDCs) are separate companies. The electric utility is generally vertically integrated. The utility owns transmission, distribution, and generation facilities. Also, delivering reliable electricity requires tight coordination between generation and transmission/distribution services, even though these have begun to be functionally separated to ensure nondiscriminatory transmission service. Consequently, until a competitive electricity market matures and new systems and alternative suppliers have a reliable track record, there is an actual operational incentive for electric utilities to have less than an "arm's length" distance between the regulated and nonregulated activities to maintain previous levels of electricity reliability.

⁵¹ *Midland Cogeneration Venture Limited Partnership v Public Service Commission, and Consumers Power Company v Public Service Commission, supra*, p. 302.

Therefore, it is important to consider additional provisions for inclusion in a code of conduct for the electric industry.

IV. OPTIONS FOR CODES OF CONDUCT:

In this context, a code of conduct is written to establish guidelines governing the interactions between a utility and its affiliates marketing energy and energy-related products and services. Provisions of the code should, as completely as possible, prevent opportunities for the utility to abuse its market power especially by subsidizing affiliate activities with revenues from regulated services and engaging in self-dealing or discriminatory actions. Any code of conduct must be accompanied by an authority for ongoing oversight and enforcement. Suggested guidelines are outlined below.

A. Guidelines

1. Uniformity:

A code of conduct should be uniform and consistent for all of the state's electric utilities participating in the competitive retail market. Utilities should not be required to meet different standards of compliance. Affiliates of one utility should not have an unfair advantage over affiliates of another utility based upon application of different codes of conduct.

2. Applicability:

Generally, codes are applied to the activities of the regulated utility and its transactions with its affiliates. Provisions should include guidelines for maintenance and availability of records for affiliate transactions and access to relevant affiliate books and records.

3. Enforceability:

Codes of conduct serve little purpose if there are no commensurate provisions to effectively enforce compliance. The ability to enforce the code includes the appropriate authority to oversee and investigate potential violations, a complaint procedure, a hearing

process, and the funding and staffing to adequately carry out the responsibility. Enforcement also includes the authority to swiftly assess meaningful penalties for noncompliance.⁵² These provisions should be included in the code and clearly understood by all involved parties. Enforceability is one of the characteristics that highlights the differences between structural and behavioral approaches to mitigating market power, and it cannot be emphasized enough: behavioral remedies require on-going oversight and effective enforcement, including the assessment of meaningful penalties, if they are to ensure the development of the competitive market.

4. Fairness to Affiliates and Other Competitors:

The purpose of a code of conduct is to ensure that utility affiliates do not have an unfair advantage over nonaffiliate competitors. In the same manner, the code should not unfairly disadvantage utilities; it should establish as completely as possible a level playing field.

5. Definitions:

The code of conduct should include definitions of terms relevant to the code. The definitions should be consistent for all participants. Confusion develops when parties employ different meanings for common terms.

B. Basic Standards:

A code of conduct should contain provisions which clearly separate regulated and competitive activities and prevent discrimination and discriminatory sharing of certain types of information between the utility and its affiliates (or the regulated portion of the utility and the competitive portion of the utility). This section includes provisions which should be considered for inclusion in a code of conduct and examples of language from other codes in use by other states. The examples are offered for illustrative purposes only. **If considered for adoption, the provisions should be viewed in the context of the entire code from which**

⁵² For example, the California Public Utilities Commission (CPUC) recently fined the Pacific Gas and Electric Company (PG & E) \$1.68 million for violating the Affiliate Transaction rules. The CPUC found PG & E had allowed an affiliated electric service provider to misuse the parent company's name and logo in its marketing activities. California Public Utilities Commission Docket No. D98-11026, November 5, 1998.

they were drawn.

1. Separation Standards:

The code should contain provisions requiring separation of regulated monopoly services from the utility's nonregulated competitive operations and its affiliate's competitive activities.⁵³ Emphasis on establishing effective separation standards initially can reduce time spent tracking affiliate transactions. Without enforced separation standards, the opportunities for subsidization of competitive endeavors by monopoly ratepayers and the discriminatory transfer of restricted information increase. However, separation standards should not be confused with divestiture. Separation standards do not eliminate the incentive to use market power; rather they attempt to curb the utility's ability to do so and the affiliate's ability to benefit unfairly from it. Ideally, nonregulated competitive activities should be offered through affiliates, rather than separate utility divisions, to avoid some of the more subtle and difficult-to-track types of cross-subsidization and information sharing. Separation standards should be accompanied by associated guidelines for maintaining separate records of transactions between the utility and its affiliates and provide for Commission access to those documents. Several issues regarding separation should be considered for inclusion in the code:

Separation of Core and Non-Core Services:

When utilities offer both regulated and competitive services, the opportunities for abuse of market power, especially through cross subsidization and discriminatory transfer of restricted information, increase substantially. Consideration should be given to requiring the utility and its affiliates to function as separate corporate entities and to prohibit utilities from directly marketing energy and energy-related products and services in the competitive

⁵³ In its comments to the Commission in Case No. U-11290, *supra*, the Staff of the Bureau of Economics of the Federal Trade Commission stated that "Functional separation of the regulated from the competitive segments of traditionally vertically integrated utilities may be a plausible first step in introducing competition. . . however, functional separation may turn out not to be sufficient because it leaves in place the incentives to discriminate and cross-subsidize in an industry in which detection and documentation of violations may be difficult." p. 5.

market.⁵⁴

- Examples of language:

A utility may not offer core and non-core services through the same corporate entity. A utility must establish a separate corporate entity to offer non-core services. (Maine, Chapter 820, 3-A)

The Commission shall prohibit a provider of a noncompetitive service from providing a potentially competitive service, except through an affiliate of the provider. (State of Nevada, Assembly Bill 366, Section 41(1))

Sharing of Services and Facilities:

Affiliate use of utility assets, including plant, facilities, and office equipment should be restricted or prohibited in the code. Sharing of such resources can provide affiliates with access to otherwise protected information, giving them an unfair advantage over nonaffiliated competitors. Additionally, sharing of resources also can provide the affiliate with ratepayer subsidized benefits unavailable to nonaffiliated competitors. The trade-off for these restrictions is a loss of certain economic efficiencies. Limitations could include exceptions for affiliates established to provide corporate support rather than competitive services.

- Example of language:

Except in relation to corporate support and emergency support, electric utilities and affiliated interests in competition with [alternative retail electric suppliers] that provide services to customers within the utility's service territory shall function independently of each other and shall not share services or facilities. (Illinois, 98-0013, 11, Section 450.100)

Sharing Employees:

In establishing the code, consideration should be given to including limitations on employee sharing between the utility and its marketing affiliates. Employee sharing provides the opportunity for direct or indirect subsidization of competitive activities by ratepayers as well as the transfer of otherwise protected information.

⁵⁴ See the Michigan Public Service Commission "Transportation Standards of Conduct," *supra*, Section "I" for a similar provision.

- Examples of language:

Except in relation to corporate support and emergency support, electric utilities and their affiliated interests in competition with alternative retail electric suppliers shall not jointly employ or otherwise share the same employees. (Illinois, 98-0013, 12, Section 450.110 (a))

Electric utilities shall not jointly employ or otherwise share employees engaged in providing delivery services with their affiliated interests in competition with alternative retail electric suppliers. (Illinois, 98-0013, 12, Section 450.110 (b))

Employee Transfers:

Transferring employees from the utility to the competitive affiliate can result in ratepayer subsidization of the affiliate employees' training; employee transfers represent a loss to the utility and a gain to the affiliate. Codes can be written to limit the transfers or to establish a transfer fee.⁵⁵

- Examples of language:

Once an employee of a utility becomes an employee of an affiliate, the employee may not return to the utility for a period of one year. This Rule is inapplicable if the affiliate to which the employee transfers goes out of business during the one-year period. In the event that such an employee returns to the utility, such employee cannot be retransferred, reassigned, or otherwise employed by the affiliate for a period of two years. Employees transferring from the utility to the affiliate are expressly prohibited from using information gained from the utility in a discriminatory or exclusive fashion to the benefit of the affiliate or to the detriment of other unaffiliated service providers. (California D.97-12-088, V. Separation, G.2b)

A utility shall track and report to the Commission all employee movement between the utility and affiliates. The utility shall report this information annually. . . (California D.97-12-088, V. Separation, G.2(a))

Information Transfers:

A parallel to the transfer of employees is the transfer of otherwise restricted information

⁵⁵ See Michigan Public Service Commission "Guidelines for Affiliate Transactions," *supra*, Section 5 for a similar provision.

which can accompany the employee. This can be minimized by writing the code to contain provisions preventing a transferred employee from taking otherwise restricted information to the affiliate.

- Example of language:

Any employee hired by an affiliate shall not remove or otherwise provide information to the affiliate which the affiliate would otherwise be precluded from having pursuant to these Rules. (California D.97-12-088, V. Separation, G.2(d))

Joint Purchasing:

Utilities and their affiliates have traditionally made joint purchases to gain efficiencies. In writing a code, there should be consideration given to what extent, if at all, the utility and its competitive affiliates should be permitted to share costs savings from joint purchases and economies of scale. There is a need to prevent the utility from providing direct or indirect competitive advantages to the affiliate not available to other competitors, especially when those advantages are subsidized by ratepayers.

- Example of language:

To the extent not precluded by any other Rule, the utilities and their affiliates may make joint purchases of good (sic) and services, but not those associated with the traditional utility merchant function. For purpose of these Rules, to the extent that a utility is engaged in the marketing of the commodity of electricity or natural gas to customers, as opposed to the marketing of transmission and distribution services, it is engaging in merchant functions. Examples of permissible joint purchases include joint purchases of office supplies and telephone services. Examples of joint purchases not permitted include gas and electric purchasing for resale, purchasing of gas transportation and storage capacity, purchasing of electric transmission, systems operations, and marketing. The utility must insure that all joint purchases are priced, reported, and conducted in a manner that permits clear identification of the utility and affiliate portions of such purchases, and in accordance with applicable Commission allocation and reporting rules. (California D.97-12-088, V. Separation, A)

Corporate Support Services:

Permitting sharing of corporate support services, including payroll, legal services, insurance, and financial reporting provides the opportunity for cross subsidization. If such

sharing is permitted, the code should contain limitations on the types of services that can be shared and under what conditions. For example, it might be possible to limit shared services to those unrelated to marketing or regulatory issues to prevent the exchange of otherwise restricted information.

- Example of language:

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

As a general principle, such joint utilization shall not allow or provide a means for the transfer of confidential information from the utility to the affiliate, create the opportunity for preferential treatment or unfair competitive advantage, lead to customer confusion, or create significant opportunities for cross-subsidization of affiliates. In the compliance plan, a corporate officer from the utility and holding company shall verify the adequacy of the specific mechanisms and procedures in place to ensure the utility follows the mandates of this paragraph, and to ensure the utility is not utilizing joint corporate support services as a conduit to circumvent these Rules.

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

Examples of services that may not be shared include: employee recruiting, engineering, hedging and financial derivatives and arbitrage services, gas and electric purchasing for resale, purchasing of gas transportation and storage capacity, purchasing of electric transmission, system operations, and marketing. (California D.97-12-088, V. Separation, E)

Joint Marketing:

One of the most contentious issues in developing a code of conduct is to what degree, if at

all, should the utility and its competitive affiliate be permitted to jointly market their services. Objections are based on the concern that customer identification of the utility's name, and the associations made with the name, can provide an unfair advantage to the utility's marketing affiliate. Additionally, joint marketing can inaccurately convey a message that competitive services might be bundled to the utility's service or be more reliable because of the affiliate's tie to the regulated utility. This, of course, can work to the affiliate's disadvantage if the utility does not have a respectable reputation with customers. This issue can arise in a number of situations. For example, when the utility receives requests for information about competitive service providers, it is possible for the utility to respond with information favorable to the affiliate, giving preferential treatment and subsidizing the affiliate's marketing by a utility. The code should establish to what degree, if at all, the utility and its affiliates can jointly market services.⁵⁶

- Examples of language:

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.
(Massachusetts, D.P.U./D.T.E. 97-96, 12.03(12))

Except as otherwise provided by these Rules, a utility shall not . . . give the appearance that the utility speaks on behalf of its affiliates or that the customer will receive preferential treatment as a consequence of conducting business with the affiliates; or give any appearance that the affiliate speaks on behalf of the utility. (California D.97-12-088, III. Nondiscrimination E 6-7)

Use of Utility Name and Logo:

Closely tied to joint marketing is the degree to which the affiliate can draw on the utility name and logo, using the customers' familiarity with the name and logo to create an unfair

⁵⁶ See the Michigan Public Service Commission "Transportation Standards of Conduct," *supra*, Section "e" for a similar provision.

market advantage.⁵⁷ Unrestricted use of the logo presents opportunities for cross-subsidization.⁵⁸

- Examples of language:

. . .[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. (Massachusetts, D.P.U./D.T.E., 97-96, 12.03(13))

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

- the affiliate "is not the same company as. . .the utility,";
- the affiliate is not regulated by the California Public Utilities Commission; and
- "you do not have to buy [the affiliate's] products in order to continue to receive quality regulated services from the utility. (California D.97-12-088, V. Separation F(1))⁵⁹

Tying of Regulated and Unregulated Services:

Consideration should be given to including provisions preventing the utility from directly or

⁵⁷ In its comments to the Commission in Case No. U-11290, *supra*, the Staff of the Bureau of Economics of the Federal Trade Commission stated that "One example of improper cross-subsidization is the use of the logo of the regulated parent firm by unregulated affiliates. This novel form of cross-subsidization may create incentives for the regulated firm to overinvest in reputation-building activities. In addition, use of the regulated firm's logo by affiliates also may raise issues of deceptive advertising that the MPSC may wish to address." p. 14.

⁵⁸ See the Michigan Public Service Commission "Transportation Standards of Conduct," *supra*, Section "c" for a similar provision.

⁵⁹ As previously noted, the CPUC recently fined PG & E \$1.68 million for violating this provision.

indirectly tying the provision of a regulated service to the purchase of a nonregulated service, an anticompetitive practice. For example, tying distribution reliability to the purchase of the affiliate's energy, or to remaining a customer of the regulated utility, should be prohibited. While tying arrangements are a violation of Federal antitrust laws, relying on antitrust laws to provide relief may not be an efficient approach, and inclusion of anti-tying language may be useful.⁶⁰

- Example of language:

Except for services that have been declared competitive. . . electric utilities shall not tie or otherwise condition the provision of any services, discounts, rebates, fee waivers, or waivers of the electric utilities' ordinary terms and conditions of service, including but not limited to tariff provisions, to the taking of any goods and services from the electric utilities' affiliated interests. (Illinois, 98-0013, 4, Section 450.40)

Transfer of Goods and Services:

The code should contain provisions covering the transfer of goods and services between the utility and its affiliates to prevent subsidization of the affiliate by the utility's ratepayers. For example, guidelines could include provisions that goods and services provided by the utility to its affiliates be priced at the fair market value when the goods and services are offered for sale and available to all on a nondiscriminatory basis, and otherwise as a fully loaded cost plus an adder to labor costs. Goods and services offered by the affiliate to the utility not offered for sale to others should be priced at the lower of fair market value or fully loaded cost. These provisions will assist in preventing cross subsidization.

- Examples of language:

Transactions between an electric utility and its affiliated interests shall not be allowed to subsidize the affiliated interests. (Illinois, 98-0013, 13 Section 450.120(a))

Transactions between a utility and its affiliates shall be limited to tariffed products and services, the sale or purchase of goods, property, products or services made generally available by the utility or affiliate to all market participants through an

⁶⁰ See the Michigan Public Service Commission "Transportation Standards of Conduct," *supra*, Sections "g" and "h" for similar provisions.

open, competitive bidding process . . . (California D.97-12-088, III Nondiscrimination, B.)

Costs associated with the transfer of goods and services between an electric utility and its affiliated interests, including affiliated interests in competition with alternative retail electric suppliers, shall be priced as specified in, and allocated pursuant to the Commission approved services and facilities agreement or affiliated interests agreement presented in the affiliated [alternative retail electric supplier] certification proceeding. Any transfer of goods and services between an electric utility and its affiliated interests, including affiliated interests in competition with alternative retail electric suppliers, that is not explicitly addressed in a Commission approved services and facilities or affiliated interests agreement is prohibited unless the transfer has been otherwise specifically approved by the Commission. . . . (Illinois, 98-0013, 13, Section 450.120(c))

Access to Books and Records:

To effectively monitor compliance with the code, the Commission must have access to the books and records not only of the utility, but also the relevant books and records of its parent company, affiliates, and subsidiaries. It is also helpful if the Commission has access to company personnel knowledgeable about the books and records. In turn, the Commission should agree not to disclose sensitive competitive information to the public. The "Guidelines for Affiliate Transactions" adopted by the Commission in U-8678, et al., mentioned previously, can serve as a model. Additional language specific to the electric industry adds specificity.⁶¹

- Examples of language:

In connection with an application for a certificate of service authority filed by an affiliated interest of an electric utility. . . the affiliated interest shall provide a copy of a Commission approved services and facilities or affiliated interest agreement that explicitly addresses the cost allocation and valuation methodology to be applied to any transfer of goods and services: between the electric utility and its affiliated interests in competition with [alternative retail electricity suppliers]; between the utility and its other affiliated interests; and between the utility's other affiliated interests and its affiliated

⁶¹ See the Michigan Public Service Commission "Transportation Standards of Conduct," *supra*, Section "j" and the "Guidelines for Affiliate Transactions," Sections 1-4 for similar provisions.

interests in competition with [alternative retail electricity suppliers]. In the event that there is no Commission approved agreement addressing these issues, the applicant shall submit such an agreement for approval as part of its application. (Illinois, 98-0013,13, Section 450.120 (b))

An electric utility shall maintain books, accounts, and records separate from those of its affiliated interest." (Illinois, 98-0013, 15, Section 450.140 (a))

In connection with an application for a certificate of service authority filed by an affiliated interest of an electric utility. . . the affiliated interest shall provide a copy of a Commission approved services and facilities or affiliated interest agreement that explicitly sets forth both the cost allocation guidelines and the accounting conventions to be applied to any transactions: between the electric utility and its affiliated interests in competition with [an alternative retail electric supplier]; between the utility and its other affiliated interest and; between the utility's affiliated interests in competition with [an alternative retail electric supplier] and its other affiliated interests. In the event that there is no Commission approved agreement addressing cost allocation and accounting conventions, the applicant shall submit such an agreement for approval as part of its application. (Illinois, 98-0013,15, Section 450.140 (b))

Upon the request of the Commission, electric utilities shall make personnel available who are competent to respond to the Commission's inquiries regarding the nature of any transactions that have taken place between the electric utility and its affiliated interests, including but not limited to the goods and services provided, the prices, terms and conditions, and other considerations given for the goods and services provided." (Illinois, 98-0013, 15, Section 450.140(c))

Each electric utility shall maintain a log detailing: (i) each instance in which it exercised discretion in the application of tariff provisions; (ii) each instance in which it offered affiliated interests or customers of affiliated interests services not governed by tariffs, except for corporate support transactions and services which have been declared competitive pursuant to . . . the Act; and (iii) each instance in which it offered affiliated interest or customers of affiliated interests a discount, rebate, fee waiver or waivers of the electric utility's ordinary terms and conditions in connection with services provided under tariffs on file with the Commission. The electric utility shall

make such log available to the Commission upon request. The log shall contain the following information:

- the names of the affiliated interests and unaffiliated entities involved in the transaction;
- a description of the transaction;
- the time period over which the transaction applies; and
- the quantities and locations involved in the transaction. (Illinois, 98-0013, 15, Section 450.140 (d))

A utility shall maintain contemporaneous records documenting all tariffed and nontariffed transactions with its affiliates, including but not limited to, all waivers of tariff or contract provisions and all discounts. A utility shall maintain such records for a minimum of three years and longer if this Commission or another government agency so requires. The utility shall make such records available for third party review upon 72 hours' notice, or at a time mutually agreeable to the utility and third party. (California D.97-12-088, IV. Disclosure and Information F)

2. Provisions to Prevent Discrimination:

Market power can be abused if the utility shows preference to its affiliates or its affiliates' customers over its competitors or the customers of competitors. The vertically integrated nature of the electricity industry, with the utility providing regulated generation, transmission, and distribution services along with a host of other nonregulated products and services, lends itself to discriminatory practices. In some instances, the utility also provides nonregulated retail generation services in the competitive market. Utility affiliates generally provide retail generation services within and outside of the utility's service territory. This structure provides an open invitation for discriminatory behavior. If transmission and distribution services are not separated structurally from generation services, as would occur with divestiture, there is an incentive to favor affiliate customers. For example, a utility can process service requests for customers of its affiliates before those of the competitors. An effective code of conduct should contain provisions prohibiting discriminatory behavior and establishing safeguards supporting the prohibition.⁶²

⁶² See the Michigan Public Service Commission "Transportation Standards of Conduct," *supra*, Sections "a" and "b" for similar provisions.

Comparable Access to Distribution Services:

Utilities should be prohibited from discriminating in the provision of monopoly services. For example, distribution services should be required to be provided to nonaffiliated marketers' customers under the same terms and conditions as they are provided to customers of affiliated marketers. The code should require the utility to process requests for distribution service for a competitor's customers with a timeliness equal to that of customers of affiliates.⁶³

- Examples of Language:

Electric utilities shall not provide affiliated interests or customers of affiliated interests preferential treatment or advantages relative to unaffiliated entities or their customers in connection with services provided under tariffs on file with the Illinois Commerce Commission. . . . This provision applies broadly to all aspects of service, including but not limited to, responsiveness to requests for service, the availability of firm versus interruptible services, the imposition of special metering requirements, and all terms and conditions and charges specified in the tariff. (Illinois, 98-0013, 2, 450.20(a))

A utility shall process requests for similar services provided by the utility in the same manner and within the same time period for its affiliated interests in competition with alternative retail electric suppliers and for all similarly situated unaffiliated alternative retail electric suppliers and their respective customers. (Illinois, 98-0013, 2, 450.20(d))

Comparable Access to Non-Tariffed Utility Services:

Utility provision of nontariffed services to affiliates or affiliates' customers allows the utility to subsidize the transactions with ratepayer funds, giving the affiliate a market advantage. In a code, it is possible to establish parameters aimed at preventing these transactions altogether, or to establish conditions to prevent or minimize the potential abuse. For example, utilities can be permitted to offer services or goods to the affiliate or the affiliate's customers if the goods or services are also offered to all "similarly situated" companies or customers simultaneously and on the same terms. The code can require that documentation of these transactions be available to the commission for compliance review,

⁶³ See the Michigan Public Service Commission "Transportation Standards of Conduct," *supra*, Section "d" for similar provision.

and can require that, if two different prices are provided to two different entities, the cost differential be documented and justified.⁶⁴

- Example of language:

(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." (Massachusetts, D.P.U./D.T.E. 97-96, 12.03 (6)(a))

Comparable Access to Discounts:

Utilities should not be permitted to provide discounts to affiliates or customers of affiliates that are not provided to similarly situated nonaffiliates or their customers. In addition to being discriminatory, the discounts can be subsidized by ratepayers, compounding the anticompetitive impact of the transaction.

- Example of language:

If an electric utility offers affiliated interests or customers of affiliated interests a discount, rebate, fee waiver or waivers of its ordinary terms and conditions for services provided under tariffs on file with the Commission, it shall contemporaneously offer the same discount, rebate, fee waiver or waivers of its ordinary terms and conditions to all unaffiliated entities and customers of unaffiliated entities, to the extent consistent with the tariffs. If an electric utility offers affiliated interests or customers of affiliated interests services that are not governed by tariff sheets, except for corporate support transactions and services that have been declared competitive . . . it shall contemporaneously offer such services to all unaffiliated entities and customers of unaffiliated entities. Electric utilities shall maintain a log of such instance. (Illinois, 98-0013, 2, Section 450.140(f))

⁶⁴ See the Michigan Public Service Commission "Transportation Standards of Conduct," *supra*, Section "f" for similar provisions.

3. Disclosure and Information Standards:

The monopoly status of the regulated utility provides it with significant opportunity to use information to its own or its affiliates' advantage in a competitive market. For example, utilities possess data on customer usage which, if made available to marketing affiliates (or internal competitive marketing divisions) would provide a competitive edge over its competitors. Additionally, in carrying out its monopoly transmission and distribution responsibilities, the utility holds information on the transactions of nonaffiliated suppliers, which, if made available, could also benefit marketing affiliates. If the market is to be competitive, information obtained by the utility in its monopoly role should not be used to benefit the utility's affiliates in the competitive market unless the same information is shared with all competitors on the same basis. The code should include provisions covering what types of information are not to be shared and/or standards covering under what conditions information can be shared.

Customer Information:

Customer information should not be provided to marketing affiliates for use in marketing their services unless it is provided to competitors on the same basis. Individual customer load profiles, billing histories, and other related information can benefit marketers. Codes should contain language prohibiting the exchange of this information with affiliates or internal competitive marketing divisions without appropriate customer authorization. The code should also establish guidelines governing how customer information will be provided at the request of the customer on equal terms to affiliates and nonaffiliates. The code can also contain standards for the release of generic data on load shapes, usage, or other aggregated customer data, on equal terms to affiliates and nonaffiliates.

- Examples of language:

A Distribution Company shall not release any proprietary customer information to an Affiliate without the prior written authorization of the customer. (Massachusetts, D.P.U./D.T.E. 97-96, 12.03(9))

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. (Massachusetts, D.P.U./D.T.E. 97-96, 12.03 (10))

Except as otherwise provided by these Rules, a utility shall not . . . request authorization from its customers to pass on customer information exclusively to its affiliates. (California D.97-12-088, Ill. Nondiscrimination E 5)

Transmission and Distribution Information:

Transmission and distribution information can provide the recipients with a competitive edge. Employees of the affiliated marketer or other involved affiliates should not have preferential access to information about the transmission and distribution system that is not available at the same time and in the same manner to nonaffiliated service providers.

- Examples of Language:

Employees of the electric utility's affiliated interests shall not have preferential access to any information about the electric utility's transmission or distribution systems that is not contemporaneously and in the same form and manner available to an unaffiliated alternative retail electric supplier that has submitted a request pursuant to subsection (a) of this section. (Illinois, 98-0013, 6, Section 450.60(b))

An electric distribution company is responsible for ensuring that any employee of the electric distribution company may not disclose to employees of any affiliate engaged in a nonregulated power producer function any information concerning the distribution system of the electric distribution company or the distribution system of another (including information received from non-affiliated or information about distribution system operations, capability, price, curtailments, auxiliary services, and the like) through non-public communications that is not at the same time available to all nonregulated power producers without restriction. If an employee of the electric distribution company engaged in distribution system operations or reliability functions discloses information in a manner contrary to the requirements of the standards of conduct, the electric distribution company must immediately report such information to the commission. An electric distribution company may not share any market

information, acquired from nonaffiliated, nonregulated power producers or developed in the course of responding to requests for distribution service, with any employee of an affiliate engaged in a nonregulated power producer function. (Rhode Island, Chapter 316, 96-H 8124B, 39-1-27.6, c(iv))

Information on Alternate Suppliers:

Utilities providing transmission and/or distribution services should be required to treat all information obtained from alternate suppliers as confidential, and should be prohibited from providing any information of that type to affiliated entities without the alternate supplier's authorization.

- Example of language:

Electric utilities shall treat all information obtained from an alternative retail electric supplier as confidential information, and shall not provide such information to its affiliated interests or to unaffiliated entities unless the alternative retail electric supplier provides authorization to do so. (Illinois, 98-0013, 10, Section 450.90))

4. Procedural Issues:

In a code of conduct, it is beneficial to include provisions dealing with how it will be implemented, including application, compliance, and enforcement.

Applicability:

The code should clearly indicate to whom the code applies. Unless there is a specific reason to do otherwise, the same code should apply to all electric utilities regulated by the Commission.

- Example of language:

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

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

affiliates engaging in the provision of a product that uses electricity or the provision of services that relate to the use of electricity. . . . (California, D.97-12-088, II. Applicability. A-B)

Compliance Plans:

The FERC and some states require the utility to file a compliance plan, demonstrating that they understand the code and have procedures in place to comply with its provisions.

- Example of language:
 - A. Compliance Plans: No later than December 31, 1997, each utility shall file a compliance plan demonstrating to the Commission that there are adequate procedures in place that will preclude the sharing of information with its affiliates that is prohibited by these Rules
 - B. New Affiliate Compliance Plans: Upon the creation of a new affiliate which is addressed by these Rules, the utility shall immediately notify the Commission of the creation of the new affiliate, as well as posting notice on its electronic bulletin board. No later than 60 days after the creation of this affiliate, the utility shall file an advice letter with the Energy Division of the Commission, served on the parties to this proceeding. The advice letter shall demonstrate how the utility will implement these Rules with respect to the new affiliate. (California, D.97-12-088, VI, Regulatory Oversight)

Enforcement and Penalties:

The code should also contain provisions covering how possible code violations will be handled. It cannot be overemphasized that oversight and enforcement coupled with the ability to assess meaningful penalties when there are violations is essential to an effective code of conduct. A review process can be initiated by a complaint filed with the commission by a customer or nonaffiliated supplier. There have been indications that nonaffiliated suppliers may be hesitant to file complaints fearing retaliation by the utilities, given the fact that those with complaints are generally dependent upon the utility for transmission and distribution services. Therefore, Commission oversight can be considered a primary enforcement tool. The manner in which nonaffiliated supplier complaints are handled should take this concern into consideration.

- Example of language:
[A]fter notice and hearing held on complaint or on the Commission's own motion, the Commission may:

- 1) Order the affiliated alternative retail electric supplier to cease and desist, or correct, any violation of or nonconformance with the provisions
- 2) Impose financial penalties for violations of or nonconformance with the provisions . . . not to exceed (i) \$10,000 per occurrence or (ii) \$30,000 per day for those violations or nonconformance which continue after the Commission issues a cease-and-desist order; and
- 3) Alter, modify or suspend the certificate of service authority of an electric utility's affiliated alternative retail electric supplier for substantial or repeated violations of or nonconformance with the provisions (Illinois, 98-0013, 17, Section 450.160 (b))

5. Additional Consideration:

There is one issue not specifically mentioned in these codes that should be considered for inclusion in any code adopted: there have been instances in the natural gas industry in which the local distribution company (LDC) has, without proper authorization, canceled contracts between customers and nonaffiliated providers upon customer complaint to the LDC. Distribution companies, whether gas or electric, should be prohibited from using control of the distribution system to interfere in the contractual relationship between a customer and its nonaffiliated provider.

V CONCLUSION:

In the absence of structural remedies, an enforceable code of conduct is a critical behavioral tool to prevent abuse of the utility-affiliate relationship, thus curbing the opportunity to abuse market power. Mitigation of market power is a critical factor in the establishment of a working competitive market. To be effective, the code should be carefully crafted, comprehensive, and consistent for all of the state's electric utilities participating in the competitive retail market. The code should also be enforceable and strictly enforced on an ongoing basis with commensurate provisions to assess penalties as necessary and appropriate.

Since this application of codes is relatively new, there should be a procedure to evaluate

the effectiveness of the code, performed separately from the ongoing enforcement process. This evaluation or audit would focus on examining to what extent the adopted code has been followed, if code provisions have been successful in preventing abusive affiliate transactions or relationships or if modifications are needed. Through an actual examination of the application of the code, and with the adoption of appropriate modifications, there is a greater possibility that the code will become an effective tool in curbing market power abuses.

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ATTACHMENT A

**TOOLS AND CONDITIONS NEEDED TO PREVENT COST SHIFTING AND CROSS
SUBSIDIZATION BETWEEN REGULATED AND NON-REGULATED AFFILIATES**

**Adopted by the National Association of Regulatory Utility Commissioners
at its 1998 Winter Committee Meetings**

TOOLS AND CONDITIONS NEEDED TO PREVENT COST SHIFTING AND CROSS SUBSIDIZATION BETWEEN REGULATED AND NON-REGULATED AFFILIATES:

Purpose: A utility may wish to provide competitive services through the regulated utility as either a regulated or non-regulated service or through a non-regulated subsidiary or affiliate. It is important that the law allow the Federal and State Commissions to employ the tools necessary to prevent cost shifting and to ensure the competitiveness in unregulated markets is not adversely affected by interactions with regulated markets. This cannot be guaranteed if the Commission must seek an agreement from a non-regulated subsidiary or affiliate in order to employ such tools.

- A). Cost shifting between regulated and non-regulated affiliates shall be prevented through the following means:
- 1). Federal Access to Books and Records
The appropriate Federal Commission shall have access to all books, accounts and records of all non-regulated affiliates of a public utility.
 - 2). State Access to Books and Records and Personnel capable of responding to inquiry from regulators
A State Commission may examine the books, accounts, memoranda, contracts and records and have access to personnel capable of responding to inquiries of:
 - a). a public utility subject to its regulatory authority under state law;
 - b). any non-regulated company, which is an affiliate, parent or subsidiary of the state-regulated public utility company selling or receiving products or services to and/or from the state-regulated public utility;
 - c). any non-regulated company which is an affiliate, parent or subsidiary of the state-regulated public utility company to determine if direct or indirect transactions have taken place between the non-regulated company and the state-regulated

public utility. Where a State Commission accesses the books and records of a non-regulated affiliate company, the State Commission shall not publicly disclose trade secrets or sensitive commercial information;

d). any Service Companies selling or receiving products or services to and/or from the state-regulated public utility;

e). any Service Companies to determine if direct or indirect transactions have taken place between the Service Company and the state-regulated public utility. Where a State Commission accesses the books and records of a non-regulated affiliate company, the State Commission shall not publicly disclose trade secrets or sensitive commercial information.

3). "Ordinary Course of Business" Contracts

The term "ordinary course of business", as it applies to contracts between affiliates that need not be approved by the Federal and State Commissions, should be clarified. It should be clarified that the transactions between the utility and the affiliate are for transactions which are customary for conducting regular utility business and that the goods or services being sold are typical for business transactions between a utility and another entity.

4). Separation plans or operating agreements

a). A separation plan or operating agreement shall be filed with and approved by the Federal and State Commissions which ensures, to the maximum extent practicable, the operations, resources, and employees involved in the provision or marketing of non-regulated services, and the books and records associated with those services shall be separate from the operations, resources, and employees involved in the provision of state-regulated services and the books and records associated with the state-regulated services.

b). Item 4).a). will apply even if the public utility company demonstrates a structural or physical separation of the

regulated and non-regulated services.

c). Transactions between regulated and non-regulated service providers within the public utility company should be recorded in separate subaccounts to facilitate auditing by Federal and State Commission Staff.

5). Allocation of Costs

a). Public Utility companies should develop and maintain written guidelines for the methods used to allocate the costs of conducting and charging for or allocating transactions between regulated and non-regulated service providers within the public utility company. Such guidelines should be filed with and approved by the Federal and State Commissions.

b). Revenues received by state-regulated companies for services provided to non-regulated affiliates shall be recorded in "operating revenue" accounts, if corresponding costs were recorded in "operating expense" accounts.

c). Costs charged by regulated sectors to non-regulated sectors as affiliate transactions should be at fully allocated costs. In the case of a charge for facilities, the fully allocated costs should include at a minimum property taxes, depreciation expenses, maintenance expenses and a rate of return on the investment in the asset. In the case of personnel, the fully allocated costs should include all employee benefits, payroll taxes, insurance, pension and post retirement benefits other than pension.

d). In cases where costs cannot be charged directly and it is necessary to use an allocation formula, revenues should not be a factor in the formula unless the utility can prove a direct cause causation with the revenues. Generally, revenue based allocations are not based on cost causation or utilization of resources.

6). Audit Authority for State Commissions

The State Commission may order an audit to be performed no more frequently than on an annual basis, of all matters deemed relevant by the selected auditor that reasonably relate to retail rates.

a). The public utility company and the affiliated or associated companies involved in non-regulated services shall cooperate fully with all requests necessary to perform the audit.

b). In the event the State ordered audit is performed by an independent auditor, the public utility company and its affiliates shall bear all costs of having the audit performed.

c). The audit report shall be provided to the State Commission not later than 6 months after the onset of the audit, and provided to the public utility company not later than 60 days thereafter.

d). Transactions between regulated and non-regulated sectors should be subjected to regular internal audits by the utility. These audits should test compliance with all Commission Orders, compliance with proper accounting procedures and compliance with the written guidelines. The audits should included written reports of conclusions which, along with associated workpapers, are to be made available to the Commission Staff for review.

B). Tools to protect competitiveness and avoid subsidized or predatory pricing in unregulated markets:

Purpose:

The same tools that the Federal and State Commissions need to prevent cost shifting also protect competitiveness of unregulated markets because they also prevent the non-regulated sectors from benefiting from lower costs than their competitors that result from shifting costs to regulated sectors.

In addition, non-regulated sectors or the regulated utility providing competitive

services can benefit unfairly from free access to customer records of the regulated sectors. The non-regulated sectors, as well as the regulated public utility company, should be prohibited from unfair practices.

1). The regulated public utility company and its affiliates shall follow a code of conduct, filed with Federal and State Commissions, which governs the company's activities in a competitive market and the sharing of information, data bases and resources between its employees involved in the marketing or provision of non-regulated services and those employees involved in the provision of regulated services.

2). The public utility company and its affiliates shall maintain records subject to Federal and State Commission review, which document compliance with the code of conduct.

3). The Code of Conduct shall include, at a minimum, the following for any affiliate, including Service Companies engaged in competitive services:

a). affiliate shall operate independently from the Utility company;

b). affiliate shall maintain books, records, and accounts in the manner prescribed by the appropriate Federal and State Commissions which shall be separate from the books, records, and accounts maintained by the Utility company;

c). affiliate shall have separate officers, directors, and employees from the Utility company;

d). affiliate may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Utility company; and

e). affiliate shall conduct all transactions with the Utility on an arm's length basis with any such transactions reduced to writing and available for public inspection.

4). The Code of Conduct should include, at a minimum, the following for the Utility who has an affiliate engaged in competitive services:

- a). Utility may not discriminate between an affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards;
- b). Utility shall account for all transactions with an affiliate in accordance with generally accepted accounting principles or accounting principles approved by the appropriate Federal and State Commissions; and
- c). Utility shall not carry out any promotion, marketing, sales, advertising or research and development for or in conjunction with an affiliate.

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter, on the Commission's own motion,
to consider the restructuring of the electric
utility industry.)
)
)
) Case No. U-11290

In the matter of the application of
THE DETROIT EDISON COMPANY for authority
to suspend implementation of its power supply cost
recovery clause and related relief.)
)
)
) Case No. U-11449

In the matter of the request of
CONSUMERS ENERGY COMPANY for
approval of a retail open access tariff.)
)
)
) Case No. U-11451

In the matter of the request of
THE DETROIT EDISON COMPANY for approval
of a direct access tariff.)
)
)
) Case No. U-11452

In the matter of the request of
CONSUMERS ENERGY COMPANY for authority
to suspend its power supply cost recovery clause
and related relief.)
)
)
) Case No. U-11453

In the matter of the request of
CONSUMERS ENERGY COMPANY and
THE DETROIT EDISON COMPANY for
approval of a true-up mechanism in connection
with the recovery of stranded costs.)
)
)
) Case No. U-11454

**STAFF REPORT ON CODE OF CONDUCT MEETINGS
CASE NO. U-11290
JUNE 4, 1999**

In its order in Case No. U-11290, issued March 8, 1999, the Michigan Public Service Commission directed Staff to meet with Consumers Energy, Detroit Edison and other interested parties to discuss codes of conduct.¹ In particular, the Commission asked whether there are "specific issues in the electric market that would warrant modifications" to the code applied to Michigan's natural gas companies. Additionally, using the Staff's discussion paper entitled "Developing and Implementing Codes of Conduct for the Retail Electric Industry (Staff code paper)," the Commission requested that Staff "... attempt to develop a consensus on what additional actions, if any, are needed. ..." and identify "... any remaining issues that need be addressed by the Commission."² Staff held a series of meetings, initially with small groups and later with all of the groups together, to discern areas of agreement and disagreement.³ Included in the discussions were representatives of Michigan's investor-owned utilities, small and large customers, alternate suppliers, heating and cooling contractors and qualifying facilities. Staff files this report based on these discussions.

¹ "In the Matter, on the Commission's own motion, to consider the restructuring of the electric utility industry," Case No. U-11290, et. al.; March 8, 1999.

² id. p. 38.

³ A list of those attending the small group meetings and the large meeting is included in the Appendix.

These meetings did not produce an agreement on a code of conduct. Staff, however, gained a clearer understanding of the positions of the various groups, where parties perceived voids in the existing codes and issues the Commission may wish to consider in determining the need for future action. The only code issue all participants agreed on was that a code of conduct is necessary to govern an electric utility's relationships with its marketing affiliates. There is near consensus on the code structure, with preference for, or tolerance of, broad provisions with specific illustrative examples. There is no consensus on code application, provisions and enforcement.⁴ For example, while there is agreement that discrimination by the utility in favor of its marketing affiliates should be prohibited, there is no consensus on what behaviors should be considered discriminatory. Nor is there agreement on whether the Commission could rely on existing antitrust laws to prevent discrimination instead of implementing a code. Some believe that an unenforced or weak code might provide a shield for anticompetitive behavior. This could serve as the basis for protections under the State Action Doctrine.⁵ Utilities generally support a less stringent code with minimal Commission oversight and the retention of economies associated with vertical integration. Customer groups and alternate suppliers support more specific code provisions, active Commission enforcement and structural separation of regulated and nonregulated activities.

⁴ As used in this paper, "consensus" refers to a unanimous agreement.

⁵ For additional discussion of the State Action Doctrine, see the "Michigan Public Service Commission Staff Market Power Discussion Paper;" June, 1998, p. 49.

BACKGROUND

Codes of conduct can be a method to reduce the market power available to an incumbent electric utility in an emerging competitive market. Codes govern the utility's relationship with any marketing affiliates and, to an extent, with alternate suppliers. In contrast to mitigation methods which eliminate the incentive to use market power, codes establish rules to prevent anticompetitive conduct.⁶ During the past several years, the Commission has adopted Transportation Standards of Conduct for several natural gas utilities (natural gas code), including Consumers Energy.⁷ In its implementation filing in Case No. U-11290, Consumers Energy included a proposed code of conduct for its electric operations, covering its relationship with its marketing affiliates.⁸

In its March 8, 1999 order, the Commission found the natural gas code and Consumers Energy's proposed electric code were similar, with a few exceptions.⁹

⁶ Divestiture, for example, changes the framework of the market, eliminating the incentive to use market power. Behavioral remedies, like codes, do not eliminate the incentive to abuse market power, but rather establish rules to prevent the abuse. For an additional discussion of codes of conduct, see "Developing and Implementing Codes of Conduct for the Retail Electric Industry;" filed by the Michigan Public Service Commission Staff on December 23, 1998 in Case No. U-11290.

⁷ As a result of a Commission approved settlement in Case No. U-11220, "In the matter of the application of Michigan Gas Company and Southeastern Michigan Gas Company for authority to merge and increased rates for the sale and transportation of natural gas and related approvals." October 29, 1997. Later, similar codes were adopted by Wisconsin Public Service Corporation (U-11621), Consumers Energy (U-11599), and Michigan Consolidated Gas Company (U-11682).

⁸ "Consumers Energy Company's Electric Restructuring Implementation Plan;" filed in Case No. U-11290, et.al, June 30, 1998.

⁹ 1) The electric code identifies two classes of affiliates, contrary to the natural gas code. 2) The natural gas code requires operating employees of Consumers Energy and its marketing affiliates to function independently, be employed by separate corporate entities, and maintain separate business offices; the electric code does not. 3) The natural gas code has

The Commission modified the proposed electric code to require Consumers Energy's affiliates to maintain separate business offices, a similar provision to the language in the natural gas code. In this Order, the Commission clarified that the code applies to Consumers Energy irrespective of whether Consumers Energy's first tier affiliates are selling power in the competitive market within Consumers Energy's service territory or not.¹⁰ In light of the Commission's directive to Staff to initiate these discussions, Staff views the code proposed by Consumers Energy and modified by the Commission as an interim code.

On April 12, 1999, Detroit Edison filed an electric code of conduct similar to the one approved for Consumers Energy in Case No. U-11290. Detroit Edison, however, did not include the designation of first and second tier affiliates. The Commission has not yet acted on this filing.

SUMMARY OF POSITIONS

Based on the discussions during the small group and combined meetings, Staff found that, in general, alternate suppliers and customers share similar positions. With some exceptions, they favor a stronger code with specific provisions, clear

provisions relating to discounts offered to affiliates and nonaffiliates; the electric code does not. 4) The proposed electric code of conduct has a provision indicating that there is no intent to relieve Consumers Energy of its responsibility to comply with the Standards of Conduct established by the Federal Energy Regulatory Commission.

¹⁰ Consumers Energy's code defines first tier affiliates as "divisions of, departments within or wholly-owned subsidiaries of Consumers" and second tier affiliates as "separately organized affiliated companies or joint ventures."

separation of regulated and nonregulated activities and proactive Commission oversight. The utilities, in general, favor a less stringent code, retention of the economies associated with vertical integration, and less intrusive Commission oversight.

RESULTS

The participants in the code of conduct discussion meetings reached agreement on a limited number of issues:

- There should be a code and the preferred format is broad provisions with specific clarifying examples;
- Discrimination should be prohibited;
- If customer names and addresses or system operation information is provided to anyone, it must be contemporaneously provided to all marketing affiliates and alternate suppliers under the same terms and conditions;
- Information on alternate suppliers held by the utility will not be shared with utility affiliates; and
- A speedy complaint or dispute resolution process should be adopted.

Most of the other issues discussed produced differing opinions, which in some cases were expressed quite vehemently. While there are exceptions, in general the utilities share similar perspectives. Customer and alternate supplier perspectives are opposite to those of the utilities. Based on what Staff believes are strongly held positions presented by the participants in the meetings, Staff does not foresee the

opportunity to reach a consensus on a code of conduct or even code components in the near future.

Staff has identified three issues which it believes require further Commission guidance prior to the finalization of a code of conduct:

1. To what extent should the utility have the option of retaining the economies of scale and scope inherent in the monopoly structure? The utilities argue that these economies are a critical factor in their ability to compete in the electric market. Customers and alternate suppliers believe that allowing the utilities to retain these economies will result in subsidization of competitive activities by non-competitors or monopoly customers, inhibiting the development of a competitive market. The degree of separation between the regulated activities of the utility and the competitive activities of the utility and/or its marketing affiliates appears to be a fundamental issue on which the code should be based.
2. How does the Commission plan to oversee and enforce the code of conduct? How will it impose penalties? The participants in the discussions are again polarized on the role of the Commission. Utilities support oversight through a complaint and mediation process. Customers and alternate suppliers not only support establishment of a speedy complaint process, but also strongly believe the Commission should take an active role through the application of

code compliance audits and other monitoring mechanisms.

3. There is a lack of understanding on which companies will be covered by the code. While all agree that Consumers Energy and Detroit Edison would be subject to the code, it is unclear whether the other investor-owned utilities, cooperatives and alternate suppliers operating within the state would be subject to the same code. It is also unclear how the Commission anticipates the code will interact with Act 69 and the alternative licensing process. Finally, the Commission should consider whether it would grant exemptions to the code.

While the code of conduct discussion meetings did not produce consensus on a code of conduct, Staff believes the information presented in Appendix A should assist the Commission in evaluating the need for change to the interim Consumers Energy Electric Code and the applicability of those concepts to Detroit Edison in Case No. U-11290.

**STAFF REPORT ON CODE OF CONDUCT MEETINGS
U-11290
APPENDIX A**

SUMMARY OF CODE OF CONDUCT MEETINGS

Most customers and alternate suppliers agree that the existing natural gas code contains elements appropriate for an electric code but the gas code is insufficient to deal with the potential market power problems likely to occur in the electric industry. The vertically integrated nature of the electric industry - both economically and technically - provides the opportunity for cross-subsidization and discrimination which they believe will inhibit the development of a competitive market. Alternate suppliers indicate that a weak code will favor the utilities and their affiliates, deterring competitors from entering the market.¹ Participants in the meetings identified concerns with the existing code language and proposed additional provisions which they feel the Commission should consider.

¹ The Federal Energy Regulatory Commission (FERC), in reviewing its standards of conduct for wholesale transactions, has found that codes of conduct do not necessarily produce confidence in the market: "It appears, based upon our experience thus far, that no matter how detailed the standards of conduct and how intensive our enforcement, competitors will continue to be suspicious that the wall between transmission operations and power sales is being breached in subtle and hard to detect ways. The perception that many entities that operate the transmission system cannot be trusted is not a good foundation on which to build a competitive power market." FERC, "Regional Transmission Organization: Notice of Proposed Rulemaking," Docket No. RM99-2-000, 18 CFR Part 35, May 13, 1999, (p. 85)

Existing Code:

- Most customers and alternate suppliers find the natural gas code insufficient for preventing market power abuses in the competitive electric industry. They argue that the vertically integrated nature of the electric utility industry, coupled with the significant market power possessed by the state's two largest electric utilities, requires additional provisions. These parties also state that oversight, enforcement, and penalty provisions should be included in the code. Since Consumers Energy's interim code mirrors the natural gas code, it is found by the non-utility participants to lack the breadth necessary to prevent anticompetitive behaviors. For example, the Consumers Energy interim code includes only limited provisions on separation of regulated and competitive activities which can result in cross-subsidization.
- Many customers and alternate suppliers state that some of the provisions in Consumers Energy's interim code lacked clarity, leaving the provisions open to interpretation. Code language needs to be clear to prevent confusion of those subject to it as well as those seeking its protection.
- Consumers Energy's interim code conditions many provisions with language such as "undue discrimination," "to the extent practicable" and "undue preference", a deviation from its natural gas code. Customers and alternate suppliers believe this language weakens the code and opens the door to abuses. They assert this conditioning language should be deleted.

Conclusions Related to the Existing Code:

Customer groups and alternate suppliers:

The customer groups and alternate suppliers believe that additional provisions are necessary to prevent anticompetitive behavior. Without such protections, they believe incumbent utilities will be able to abuse their market position and inhibit the development of competition.

Incumbent Utilities:

Consumers Energy believes that its approved code should be given a chance to work. If deficiencies in the existing code are identified during the transition to retail access, the code can be modified to correct the problem at that time.

Discussion of Code Topics:

In conducting the small group meetings and the larger meeting, the Staff addressed code of conduct issues by exploring specific topics. These topics were:

- Separation
- Discrimination
- Sharing Information
- Utility - Alternate Supplier Relationship
- Compliance Plans
- Oversight and Enforcement
- Penalties
- Applicability
- Code Format

The following sections discuss these topics presenting the general positions of the participants and recommendations related to the topics.

Separation:

The most contentious issue discussed during each meeting was the degree of separation that should exist between the utility and its competitive suppliers.

Theoretically, the greater the degree of separation, the less opportunity there is for anticompetitive behavior. Whereas divestiture removes the incentive to abuse market power, separation standards attempt to curb the utility's ability to do so.²

With functional separation, the utility is able to conduct competitive businesses through separate divisions or departments. This allows the utility to retain existing efficiencies, benefitting customers and enhancing the utility's position in the competitive market. The incumbent utilities take a strong position that they will not be able to compete with large, out-of-state suppliers without the opportunity to use existing economies associated with vertical integration. While they might share employees, purchases, and/or equipment, they do expect to employ appropriate accounting procedures to allocate costs. If they lose this opportunity, they argue that their competitive business will be inhibited and bundled ratepayers will pay higher rates to compensate for lost economies in competitive ventures.

² Several customers and alternate providers supported divestiture as their first option, eliminating the need for many provisions in the code. However, since ordering divestiture may not be within existing Commission authority, Staff has not discussed it in depth in this report.

Structural separation standards require competitive activities to be offered through a legally established corporate affiliate. Customers and alternate suppliers strongly support a code requiring structural separation. They argue that the incumbent utilities want to provide competitive services on an incremental rather than fully allocated cost basis. They add that a requirement for structural separation would restrict a utility's ability to easily transfer valuable customer and alternate supplier information. It would also limit the opportunity to subsidize competitive activities with ratepayer funds. Both customers and alternate suppliers state their belief that equivalent economies will be available to the utilities and their marketing affiliates through participation in a truly competitive market. Alternate suppliers believe that relying on existing economies became a moot point once the decision was made to move to a competitive market: monopoly protections and competition cannot co-exist in a competitive or emerging competitive market.

Consumers Energy's interim code allows competitive activities to take place within the utility.³ To some degree, the code limits interaction between regulated and competitive activities:

- Employees of its first and second tier affiliates must function independently of the transmission and distribution employees,⁴

³ While the focus of the meetings was codes of conduct covering the provision of generation services, the heating, cooling, and air conditioning contractors attended the meeting and expressed their position that the code should cover the provision of all competitive services offered by the utility and its affiliates.

⁴ Consumers Energy Retail Open Access Program Standards of Conduct, (I)

- Consumers Energy must maintain separate business offices from its wholly-owned subsidiaries and second-tier affiliates involved in retail open access⁵ and
- The books and records of the regulated utility must be maintained separately from marketing affiliates.⁶

Most non-utility participants believe that these provisions are inadequate to prevent cross-subsidization and other market abuses. They assert that in the absence of divestiture there needs to be a legal structural separation to ensure a clear audit trail, limit cross-subsidization and prevent the abuse of market power. In light of this, they urge the inclusion of additional separation provisions, including:

- legal separation of regulated and nonregulated business functions;
- prohibition against ratepayer subsidization of nonregulated business activities;
- prohibition against, or conditioning of, affiliate use of the utility logo;
- prohibition against the utility sharing employees with the affiliates and restrictions on employee transfers between the utility and its affiliates;
- prohibition against joint marketing with affiliates and
- prohibition against or limitations on joint purchases.

Some parties suggest it may be appropriate to allow the utility to share some joint corporate functions with its affiliates, including corporate oversight, payroll related

⁵ Consumers Energy Retail Open Access Program Standards of Conduct, (I).

⁶ Consumers Energy Retail Open Access Program Standards of Conduct, (J).

tasks, and financial analysis. These joint functions, if allowed in the code of conduct, must be clearly identified and there must be active Commission oversight to ensure the costs are properly allocated.

Customers and alternate suppliers point to the Staff's Code of Conduct paper for examples of provision language adopted in other states that should be included in Michigan's code.

Several parties also express concern that allowing the utility to carry out competitive activities will provide the utility with antitrust protections under the State Action Doctrine. The State Action Doctrine provides immunity to a regulated business for actions which might be considered anticompetitive, but have been "clearly articulated and affirmatively expressed as state policy" and "actively supervised by the State itself."⁷

Discrimination:

All participants agree that the utility should not discriminate in favor of its affiliates or customers of its affiliates. However, there is disagreement on what constitutes discrimination. As noted previously, several of the provisions in Consumers Energy's interim code are conditioned by terms such as "undue discrimination."

⁷ California Retail Liquor Dealers Assoc. v Midcal Aluminum, Inc., 445 US 97, 105; 100 S Ct 937; 63 L Ed 2d 233 (1980).

This hedge is not in Consumers Energy's natural gas code. Consumers Energy explains that it is virtually impossible to prevent all incidents of discrimination. Conditioning language provides the utility with protection from potential penalties resulting from unintentional violations. Customers and alternate suppliers contend that the use of conditioning terms such as "undue" provides the utility an opportunity to discriminate, adds unnecessary complexity to the complaint and litigation process and should be eliminated.

In addition to the elimination of all "undue" language, non-utility discussion participants recommend the addition or clarification of several provisions relating to discrimination:

- an unconditional prohibition against any discriminatory treatment in favor of affiliates, including the provision of tariffed and nontariffed services or products, hook-ups, transmission and distribution maintenance and repairs;
- prohibition against tying arrangements;
- prohibition against the utility suggesting to customers that use of its affiliate services could result in more favorable treatment by the utility;
- prohibition against the utility steering customers to its affiliates and
- prohibitions against, or limitations on, utility purchases from the affiliate and affiliate purchases from the utility.

Several participants representing utilities, customers and alternate suppliers point out that discriminatory behavior is prohibited under existing State and Federal

antitrust laws.

Sharing information:

The information possessed by a utility is a valuable commodity to its marketing affiliates and alternate suppliers. The utility has information on:

- individual customers including names, addresses, phone numbers and usage and billing data;
- aggregate customer data;
- information on utility operations and
- information on alternate suppliers obtained through the provision of transmission and distribution services.

Any sharing of this information by utilities with an affiliate can provide the affiliate with a competitive advantage. All participants agree that customer lists and aggregate customer data should be provided to affiliates and alternate suppliers on the same terms and conditions and contemporaneously, or not at all.⁸ Customer usage and billing data should only be provided upon customer request to the customer or the customer's designee only. Any data on an alternate supplier should only be provided at the request of that alternate supplier. To some extent, the information on utility operations is covered by Federal Energy Regulatory Commission (FERC) guidelines. However, those guidelines deal predominantly with wholesale transactions and should be re-examined if they are to be relied upon for

⁸ There was concern raised about sharing phone numbers, since some customers have unlisted phone numbers the privacy of which should be protected. There was little disagreement that phone numbers should not be distributed.

retail use.⁹

Consumers Energy and Detroit Edison suggest they will not provide information to anyone unless the customer requests usage data be provided to a utility affiliate or alternate supplier. Nonetheless, alternate suppliers are less assured that information has not been and will not be transferred indirectly or inadvertently, by means of shared or transferred employees or shared equipment. Since this information is a critical component of any marketing effort, alternate suppliers favor the sharing of customer names and addresses with all suppliers as a means to jump-start the market. They support detailed provisions in the code prohibiting situations which could reasonably result in the inappropriate transfer of information, including:

- the utility will not provide information on its transmission and distribution system to its affiliates unless the same information is provided contemporaneously to every alternate supplier licensed or certified to provide service within that service area, on the same terms and conditions and in the same form;
- the utility will not provide customer credit information to its affiliates unless the same information is provided contemporaneously to all alternate suppliers licensed or certified to provide service within that service area, on the same terms and conditions and in the same form; and
- the utility will not provide to anyone any information received from an alternate supplier in the course of providing transmission and distribution services without written approval of the alternate supplier.

⁹ See The Federal Energy Regulatory Commission; *Heartland Energy Services, Inc.*, 68 FERC 61,223 (1994) and The Federal Energy Regulatory Commission; *Open Access Same-Time Information System and Standards of Conduct*; 78 FERC 61,221 (1997).

Utility - Alternate Supplier Relationship:

All parties agree that the utility should not interfere in the relationship between the alternate supplier and its customers. However, there is some disagreement as to what this would actually mean. Consumers Energy and Detroit Edison indicate that they would allow a customer under contract to an alternate supplier to return to the utility's bundled service if the customer is dissatisfied with the alternate supplier regardless of the terms of the customer's contract with the alternate supplier.

Other utilities are concerned that such a provision would require them to maintain enough capacity to allow switchbacks, which could be detrimental to their position in the market. Alternate suppliers would like provisions added that would support the contractual relationship they will have with their customers. Interested parties recommend adding provisions to the code, including:

- prohibiting the utility from giving the appearance it speaks on behalf of the alternate supplier unless there is a signed agreement allowing it; and
- prohibiting the utility, acting in its role as transmission and distribution provider, from interfering in the contractual relationship between the alternate supplier and its customers.

Compliance Plans:

Most parties believe it would be useful to include a provision requiring utilities to file a code of conduct compliance plan with the Commission. The plan would provide details on how the utility anticipates meeting the requirements in the code and would be signed by a designated corporate officer. The Commission would

review the plan, and approve it or modify it as required.

Oversight and Enforcement:

Commission oversight can include active methods, such as compliance audits, or reactive methods, such as responding to complaints. The utilities generally argue against active oversight. They reason that a transition to deregulation should not include additional regulation. They claim that compliance audits will result in higher rates for ratepayers. Finally, active oversight is unnecessary as long as those aggrieved have the opportunity to file complaints.

Customer groups and alternate suppliers argue a complaint process alone is inadequate to deal with anticompetitive behavior.¹⁰ They strongly state that active Commission oversight is necessary to the development of the market. The additional costs associated with staff oversight will be offset by reductions in other staff costs. Further, there will be benefits to ratepayers if active oversight results in a reduction of cross-subsidization. While they support a complaint process, some stated reluctance to file a complaint against the utility on which they depend to provide transmission and distribution services.¹¹ Some refer to Staff's code of

¹⁰ In its Notice of Proposed Rulemaking (*supra*), the FERC stated that "... a system that attempts to control behavior that is motivated by economic self-interest through the use of standards of conduct will require constant and extensive policing. This kind of regulation goes beyond traditional price regulation and forces us to regulate very detailed aspects of internal company policy and communication ... Functional unbundling does not necessarily promote light-handed regulation." (p. 84).

¹¹ The FERC, in its Notice of Proposed Rulemaking, stated, "However, we also believe that there is a great potential for standards of conduct violations that will never even be reported or detected." (p. 79).

conduct paper: that behavioral remedies for market power such as codes of conduct are more staff-intensive than divestiture.¹²

The discussion of oversight did produce one area of agreement by all parties: the need for timely resolutions to violations. Some parties find complaint processes in other states to be cumbersome and time-consuming, a situation which only magnifies the abuse. They request the Commission adopt an expedited time frame for resolving complaints.

Penalties:

Most participants agree that the Commission, under current statutory authority, is limited in its ability to assess penalties for code violations. Currently, the most reasonable options available to the Commission include cease and desist orders; a reduction in stranded cost recovery through the true-up proceeding and a reduction in rate of return. For marketing affiliates benefitting from the utility's code violations, some suggest revocation of Act 69 or alternative licensing approval for either all customers or, in order to protect existing customers, from contracting with new customers. As an alternative, the Commission could revoke the affiliates' approval to compete in the affiliated utility's service territory.

¹² "Developing and Implementing Codes of Conduct for the Retail Electric Industry," December 23, 1998, p. 5.

Utilities tend to support less stringent penalties, preferring to rely on complaints and mediation. Customers and alternate suppliers, perhaps anticipating more code violations, want stronger penalties as a deterrent to anticompetitive behavior. Most agreed the ultimate penalty, divestiture, which is an option in several states, falls outside of the Commission's existing jurisdiction.

Applicability:

There is some disagreement regarding to whom the code should apply. All agree the code should apply to investor-owned utilities. Some suggest that the same code or a similar one should apply to electric cooperatives. While some suggest that the code should apply to alternate suppliers and affiliates, others point out that they should be covered under the Act 69/alternative licensing provisions.¹³

The Michigan Electric and Gas Association (MEGA) utilities make a case for a different code for small utilities and those operating in more than one state. In the absence of that, they request the opportunity to seek Commission approved exemptions from specific provisions. They cite two primary reasons: 1) Some MEGA companies are small, pose little or no risk of abusing market power, and would be harmed especially by stringent separation requirements. For example, one employee of a small utility may currently carry out several different regulated and

¹³ Consumers Energy's code states that "These standards of conduct shall apply as follows to affiliates of Consumers Energy." However, Consumers Energy stated during its small group meeting that it cannot commit on behalf of its affiliates.

competitive functions; requiring structural separation would result in the need to hire an additional person, a problem for a small company. 2) Some Michigan utilities operate in two or more states. They state that it would be administratively difficult to comply with different codes in each state. Thus, they would like the opportunity to use the code from one state in all other states. Based on these two reasons, they believe an exemption process would be appropriate.

Small qualifying facilities anticipate problems if their contracts are bought out, yet some of their facilities remain under joint venture agreements with a utility. It appears the qualifying facility would then be considered an affiliate of the utility and bound by the same restrictions as marketing affiliates. They believe this situation would restrict their opportunity to participate in the market, even though they would not be functioning in the same role as the utility's marketing affiliates. Therefore, they requested a blanket exemption for small qualifying facilities (80 mW or less), or alternatively, the opportunity to seek code exemptions from the Commission.

Code Format:

There was significant discussion about the format of the code. Codes adopted in other states have two basic formats, broadly stated provisions and specific provisions. A broad provision encompasses a wide range of related prohibitions

within one statement. For example, "The utility will not discriminate in favor of its marketing affiliates." Such broad language makes it possible to argue that any discriminatory behavior would be prohibited by this provision, making it less likely that an anticompetitive behavior would be inadvertently left out of the code. On the other hand, broad provisions can be vague, open to interpretation and, therefore, more difficult to litigate. Two participants favor general provisions, suggesting they will be easier for smaller utilities to implement and would provide more appropriate guidance to the state legislature if it takes up codes of conduct in electric industry restructuring legislation.

Specific provisions provide more detail and thus clearer direction regarding prohibited behaviors. For example, a section on discrimination might include several provisions prohibiting different types of discriminatory behavior. While specific provisions are clearer and, according to several participants, easier to litigate, there is a greater risk that an unanticipated discriminatory behavior will be omitted from inclusion in the code. Even with this concern, most participants believe that specific provisions would be more effective in prohibiting market power abuses than general provisions.

During the discussions, however, a third option was recommended: a code comprised of broad provisions followed by specific examples. For example, "The

utility will not discriminate in favor of its marketing affiliates. Discriminatory behaviors include, but are not limited to, . . .” This format combines the strengths of broad and specific provisions. Virtually all participants indicated they favored or would accept this hybrid code format.

CONCLUSION

The meetings demonstrated that there is little consensus on what should be included in a code of conduct for the electric industry. Most parties are grouped into one of two polar positions: Consumers Energy and Detroit Edison are satisfied with the the codes they have filed as part of their retail access implementation plans, although they remain open to a limited number of adjustments. The large and small customers and alternate suppliers believe there need to be significant changes and additions to ensure a competitive market and prevent anticompetitive behavior. The MEGA utilities are positioned at various places along this continuum.

Alternate suppliers indicate that it is not only anticompetitive behavior that damages the market, it is also the perception that there is an environment that allows anticompetitive behavior. If competitors believe the playing field is tilted in the utility's favor, they are less likely to put forward the investment to enter the market, especially if there are other states with a more competitor-friendly

environment. They argue that a strong code, including legal separation of the utility and its affiliates, with active oversight and enforcement, will help convey the message that Michigan is an attractive place for them to do business.

**CODE OF CONDUCT MEETINGS
U-11290
MEETING ATTENDANCE
APPENDIX B**

Individual Meetings:*

Michigan Alliance for Fair Competition

Michigan Chamber of Commerce

Alternate Suppliers:

Energy Michigan

Enron Corporation

Michigan Independent Power Producers Association

Business Customers:

ABATE

Competitive Utility Tariffs

Michigan Manufacturers Association

Michigan Retailers Association

Small Business Association of Michigan

Residential Customers:

American Association of Retired Persons

Attorney General

Michigan Consumer Federation

Residential Ratepayers Consortium

Small Qualifying Facilities:

Landfill Energy

Primary Power Management

Detroit Edison

Consumers Energy

Michigan Electric and Gas Association

PG & E Energy Services

* Meetings are listed in chronological order. They were held From February through May, 1999.

Large Group Meeting:

Consumers Energy

Detroit Edison

Michigan Electric and Gas Association:

- Alpena Power Company
- American Electric Power
- Northern States Power Company - Wisconsin
- Upper Peninsula Power Company
- Wisconsin Electric Power Company
- Wisconsin Public Service Company

Alternate Suppliers

- Energy Michigan
- Engage Energy
- Enron Corporation
- EnStar Energy Group
- Greater Detroit Resource Recovery Authority
- Kimball Power Company
- Primary Power, Inc.
- Russell and Russell, P.C.
- WPS Energy Services, Inc.

Customer Groups

- ABATE
- American Association of Retired Persons
- Attorney General
- Competitive Utility Tariffs
- Michigan Manufacturers Association
- Perrigo

Michigan Alliance for Fair Competition / ACCA / SMACNA

Others:

- Jonathon Washington
- Karoub and Associates

CONSUMERS' PROVISIONAL ELECTRIC CODE OF CONDUCT

This rule is intended to promote fair competition and a level playing field among all participants involved in the Retail Open Access Service program within Consumers Energy Company's ("Consumers") regulated electric service territory. All affiliates of **CMS Energy and Consumers Energy (Consumers)**, whether divisions of, departments within or wholly-owned subsidiaries of Consumers (collectively described herein as first tier affiliates) or separately organized affiliated companies or joint ventures (collectively described herein as second tier affiliates), will be allowed to participate in every aspect of such program **as approved by the Commission in Consumers' restructuring plan** on an equal basis to non-affiliates because of Consumers' decision to adopt these standards of conduct. Accordingly, once the MPSC approves such a scope of participation by Consumers' first and second tier affiliates and agrees that Consumers' program and obligations thereunder should be no different because of participation by such affiliates, Consumers agrees to apply the following standards of conduct to the Retail Open Access Service program in its regulated electric service territory:

- A. These standards of conduct shall apply as follows to affiliates of Consumers: **in its relationships with affiliates of CMS Energy and Consumers participating in the Retail Open Access Service Program.**
- (1) ~~The standards of conduct apply to second tier affiliates when they participate in the Retail Open Access Service program within Consumers' regulated electric service territory by offering retail customers power supplies at market prices. Such affiliates can begin to participate immediately in the program.~~
 - (2) ~~The standards of conduct will only apply to Consumers or its first tier affiliates if and when they participate in the Retail Open Access Service program within Consumers' regulated electric service territory by offering retail customers power supplies at market prices. The standards of conduct do not apply to Consumers or its first tier affiliates if the power supply is offered as part of a bundled service or if the price of the power supply to the customer remains regulated in any respect by the MPSC.~~

~~(3) Within its regulated electric service territory, Consumers and its first tier affiliates will not commence offering retail customers power supplies at market prices pursuant to the Retail Open Access Service program any earlier than January 1, 2002.~~

- B. Consumers will apply any tariff provision relating to Retail Open Access Service in the same manner without undue discrimination to all similarly situated persons.
- C. Consumers will not give any Aggregator, Broker, Marketer or Retailer or their customers undue preference over any other Aggregator, Broker, Marketer or Retailer and their customers in matters relating to bidding, scheduling of power, provision of ancillary services, billing, metering, curtailment policy or access to customer information pursuant to the Retail Open Access Rate Schedules approved by the MPSC. Affiliated Aggregators, Brokers, Marketers, Retailers and their customers shall neither receive undue preferences nor be discriminated against, but simply be treated by Consumers like all other Aggregators, Brokers, Marketers, Retailers and their customers.
- D. Consumers will not communicate to any of its retail electric customers, or to any Aggregator, Broker, Marketer or Retailer or any of their customers that any advantage may accrue to such customers, Aggregators, Brokers, Marketers or Retailers in the use of Consumers' regulated services as a result of that customer, Aggregator, Broker, Marketer or Retailer dealing with any particular Aggregator, Broker, Marketer or Retailer, including an affiliated Aggregator, Broker, Marketer or Retailer.
- E. ~~To the extent practicable,~~ Consumers will process all similar requests for Retail Open Access Service in the same manner and within the same period of time.
- F. If a Customer requests information about Aggregators, Brokers, Marketers or Retailers, Consumers will provide a list of all Aggregators, Brokers, Marketers or Retailers known to be operating on its system, including **CMS Energy and Consumers' its affiliates authorized by the Michigan Public Service Commission to provide service in Michigan**, and in response to such a request will not promote any specific Aggregators, Brokers, Marketers or Retailers including **CMS Energy and Consumers its affiliates participating in the Retail Open Access Service program.**

- G. Consumers shall not provide customer lists, ~~customer-specific sales volume and customer-specific patterns of usage~~ to any Aggregator, Broker, Marketer or Retailer, including affiliated Aggregators, Brokers, Marketers or Retailers offering retail customers power supplies at market prices. Once a calendar year a Customer can request in writing that up to 12 months of historic **usage or billing** volumetric sales data be provided **directly to the customer, or, in writing**, to a particular Aggregator, Broker, Marketer or Retailer or to all Aggregators, Brokers, Marketers or Retailers, and that request will be honored by Consumers without charge until revoked by the Customer. Additionally, once a calendar year an particular Aggregator, Broker, Marketer or Retailer can request and receive up to 12 months of historic **usage or billing** volumetric sales data for one of its current customers and Consumers **shall** may without charge provide only that Aggregator, Broker, Marketer or Retailer with such data. Consumers **must supply data more frequently or more than 12 months old, but it may** can levy a reasonable fee to fill **those** requests for data that is more than 12 months old or to respond to requests made more frequently than once a calendar year.
- H. Consumers **shall** will implement its Retail Open Access Service program on a nondiscriminatory basis, and **Consumers** will not engage in any practice which unduly conditions transactions between any Customer, Aggregator, Broker, Marketer or Retailer **or the Aggregator, Broker, Marketer or Retailer's customers and CMS Energy or Consumers' affiliated Aggregators, Brokers, Marketers or Retailers on the existence of any other relationship with CMS Energy, Consumers Energy or affiliated Aggregators, Brokers, Marketers, or Retailers.** Notwithstanding the above, **affiliated and non-affiliated Customers, Aggregators, Brokers, Marketers or Retailers and their customers** are not relieved of complying with the requirements to execute or complete the contracts, agreements or other forms required by the terms of the Retail Open Access Service program **as approved by the Michigan Public Service Commission.**
- I. Except as permitted by these standards of conduct, **employees of Consumers' regulated business** transmission and distribution employees and the employees of **CMS Energy and Consumers** its first and second tier affiliates that act as Aggregators, Brokers, Marketers and Retailers offering retail customers power supplies at market prices will function independently of each other, **be employed by separate corporate entities, and Consumers will maintain separate business offices from its wholly-owned subsidiaries and**

~~second-tier affiliates engaged in the Retail Open Access Service program.~~

- J. The books of accounts and records for the regulated utility services provided by Consumers to its retail electric customers will be maintained separately from the books of accounts and records kept by any affiliated Aggregator, Broker, Marketer or Retailer.
- K. Nothing in these retail standards of conduct is intended to supplant or relieve Consumers of its duty to comply with the Standards of Conduct for Public Utilities established by the Federal Energy Regulatory Commission in Order Nos. 889 and 889-A. as codified at 18 CFR §§37.1-37.4.
- L. **Consumers Energy shall maintain the documentation demonstrating compliance with this code of conduct. All documentation shall be kept at a designated company office in Michigan. Consumers shall provide this information for Commission review upon a request by the Commission or its Staff. The designated officer will either be available or make personnel available who are knowledgeable to respond to the Commission's inquiries regarding compliance with the provisions of this code of conduct.**

Consumers shall use a dispute resolution process separate from any process that might be available by the Commission. Consumers' dispute resolution process shall address complaints arising from application of this code of conduct. Within five business days of receipt by Consumers of a notice of dispute or violation of the code of conduct, each party shall identify an employee, agent, or representative to deal with the dispute. These persons shall have fifteen business days to resolve the dispute. If no resolution is achieved, but the promise of resolution seems forthcoming in the judgement of the complaining party, that party may extend this informal process an additional fifteen days. If a complaint is not resolved, the complaining party may file a formal complaint pursuant to the existing procedures in place before the Commission. Consumers shall keep a log of all complaints, including 1) the name of the person or entity filing the complaint, 2) the date the complaint was filed, 3) a written statement of the nature of the complaint, and 4) the results of the resolution process.

Violations of the Code of Conduct will be presumed to impede the vitality of the competitive market. The result of this impediment will be presumed

to lessen the risk to Consumers, and through Consumers, to its parent and affiliates. Therefore, penalties for violation of the code will take the form of a reduction in Consumers' authorized rate of return on common equity, with a concomitant reduction in rates. The more flagrant or repetitive the violations, the more severe the adjustment to the authorized rate of return on common equity. Rate reductions will be implemented through existing Commission authority and processes.

THE DETROIT EDISON COMPANY PROVISIONAL STANDARDS OF CONDUCT

This rule is intended to promote fair competition and a level playing field among all participants involved in the Retail Open Access Service program within ~~The Detroit Edison Company's ("Detroit Edison") regulated electric service territory.~~ All affiliates of DTE Energy and **The Detroit Edison Company (Detroit Edison)** will be allowed to participate in ~~every aspect of such program as approved by the Commission in Detroit Edison's restructuring plan on an equal basis to non-affiliates because of Detroit Edison's decision to adopt these standards of conduct.~~ Accordingly, Detroit Edison agrees to apply the following standards of conduct to the Retail Open Access Service program in its regulated electric service territory:

- A. These Standards of Conduct shall apply to Detroit Edison **in its relationships with** and the affiliates of DTE Energy and **Detroit Edison** participating in the Retail Open Access Service program.
- B. Detroit Edison will apply any tariff provision relating to Retail Open Access Service in the same manner without undue discrimination to all similarly situated persons.
- C. Detroit Edison will not give any Aggregator, Broker, Marketer or Retailer or their customers undue preference over any other Aggregator, Broker, Marketer or Retailer and their customers in ~~matters relating to bidding, scheduling of power, provision of ancillary services, billing, metering, curtailment policy or access to customer information pursuant to the Retail Open Access Rate Schedules approved by the MPSC.~~ Affiliated Aggregators, Brokers, Marketers, Retailers and their customers shall neither receive undue preferences nor be discriminated against, but simply be treated by Detroit Edison like all other Aggregators, Brokers, Marketers, Retailers and their customers.
- D. Detroit Edison will not communicate to any of its retail electric customers, or to any Aggregator, Broker, Marketer or Retailer **or any of their customers** that any advantage may accrue to such customers, Aggregators, Brokers, Marketers or Retailers in the use of Detroit Edison's regulated services as a result of that customer, Aggregator, Broker, Marketer or Retailer dealing with any particular Aggregator, Broker, Marketer or Retailer, including an affiliated Aggregator, Broker, Marketer or Retailer.

- E. ~~To the extent practicable,~~ Detroit Edison will process all similar requests for Retail Open Access Service in the same manner and within the same period of time.
- F. If a Customer requests information about Aggregators Brokers, Marketers or Retailers, Detroit Edison will provide a list of all Aggregators, Brokers, Marketers or Retailers ~~known to be operating on its system,~~ including DTE Energy and **Detroit Edison's affiliates authorized by the Michigan Public Service Commission to provide service in Michigan,** and in response to such a request will not promote any specific Aggregators, Brokers, Marketers or Retailers including DTE Energy and **Detroit Edison** affiliates participating in the Retail Open Access Service program.
- G. Detroit Edison shall not provide customer lists, ~~customer-specific sales volumes and customer-specific patterns of usage~~ to any Aggregator, Broker, Marketer or Retailer, including affiliated Aggregators, Brokers, Marketers or Retailers offering retail customers power supplies at market prices. Once a calendar year a Customer can request in writing that up to 12 months of historic **usage or billing** volumetric sales data be provided **directly to the customer or, in writing,** to a particular Aggregator, Broker, Marketer or Retailer or to all Aggregators, Brokers, Marketers or Retailers, and that request will be honored by Detroit Edison without charge until revoked by the Customer. Additionally, once a calendar year ~~an~~ particular Aggregator, Broker, Marketer or Retailer can request and receive up to 12 months of historic **usage or billing** volumetric sales data for one of its current customers and Detroit Edison ~~shall~~ may without charge provide only that Aggregator, Broker, Marketer or Retailer with such data. Detroit Edison **must supply data more frequently or more than 12 months old, but it may** can levy a reasonable fee to fill ~~those~~ requests for data that is more than 12 months old ~~or to respond to requests made more frequently than once a calendar year.~~
- H. Detroit Edison **shall** will implement its Retail Open Access Service program on a nondiscriminatory basis, ~~and~~ **Detroit Edison** will not engage in any practice which unduly conditions transactions between any Customer, Aggregator, Broker, Marketer or Retailer **or the Aggregator, Broker, Marketer or Retailer's customers and DTE Energy or** Detroit Edison's affiliated Aggregators, Brokers, Marketers or Retailers **on the existence of any other relationship with DTE Energy, Detroit Edison or affiliated Aggregators, Brokers, Marketers, or Retailers.** Notwithstanding the above, **affiliated and non-affiliated Customers,**

Aggregators, Brokers, Marketers or Retailers **and their customers** are not relieved of complying with the requirements to execute or complete the contracts, agreements or other forms required by the terms of the Retail Open Access Service program **as approved by the Michigan Public Service Commission.**

- I. Except as permitted by these standards of conduct, **employees of Detroit Edison's regulated business** ~~transmission and distribution employees~~ and the employees of DTE Energy **and Detroit Edison** affiliates that act as Aggregators, Brokers, Marketers and Retailers offering retail customers power supplies at market prices will function independently of each other, **be employed by separate corporate entities, and** ~~Detroit Edison will maintain separate business offices from any DTE Energy affiliate engaged in the Retail Open Access Service program.~~
- J. The books of accounts and records for the regulated utility services provided by Detroit Edison ~~to its retail electric customers~~ will be maintained separately from the books of accounts and records kept by any affiliated Aggregator, Broker, Marketer or Retailer.
- K. Nothing in these retail standards of conduct is intended to supplant or relieve Detroit Edison of its duty to comply with the Standards of Conduct for Public Utilities established by the Federal Energy Regulatory Commission in Order Nos. 889 and 889-A, as codified at 18 CFR §§ 37.1-37.4.
- L. **Detroit Edison shall maintain the documentation demonstrating compliance with this code of conduct. All documentation shall be kept at a designated company office in Michigan. Detroit Edison shall provide this information for Commission review upon a request by the Commission or its Staff. The designated officer will either be available or make personnel available who are knowledgeable to respond to the Commission's inquiries regarding compliance with the provisions of this code of conduct.**

Detroit Edison shall use a dispute resolution process separate from any process that might be available by the Commission. Detroit Edison's dispute resolution process shall address complaints arising from application of this code of conduct. Within five business days of receipt by Detroit Edison of a notice of dispute or violation of the code of conduct,

each party shall identify an employee, agent, or representative to deal with the dispute. These persons shall have fifteen business days to resolve the dispute. If no resolution is achieved, but the promise of resolution seems forthcoming in the judgement of the complaining party, that party may extend this informal process an additional fifteen days. If a complaint is not resolved, the complaining party may file a formal complaint pursuant to the existing procedures in place before the Commission. Detroit Edison shall keep a log of all complaints, including 1) the name of the person or entity filing the complaint, 2) the date the complaint was filed, 3) a written statement of the nature of the complaint, and 4) the results of the resolution process.

Violations of the Code of Conduct will be presumed to impede the vitality of the competitive market. The result of this impediment will be presumed to lessen the risk to Detroit Edison, and through Detroit Edison, to its parent and affiliates. Therefore, penalties for violation of the code will take the form of a reduction in Detroit Edison's authorized rate of return on common equity, with a concomitant reduction in rates. The more flagrant or repetitive the violations, the more severe the adjustment to the authorized rate of return on common equity. Rate reductions will be implemented through existing Commission authority and processes.

**MICHIGAN PUBLIC SERVICE COMMISSION STAFF
PROPOSED CODE OF CONDUCT**

This code of conduct is intended to promote fair competition by establishing precepts for the relationship between regulated utilities and their affiliates offering competitive services or products. To accomplish this objective, this code contains provisions to deter anticompetitive behavior and create an environment in which the market for retail generation service can flourish. The provisions in this code separate monopoly and competitive activities, limit the opportunity for subsidization of competitive activities by regulated ratepayers, establish standards for nondiscriminatory behavior, set guidelines for the transfer of proprietary information and remove barriers to entry. To this end, the utility is prohibited from taking punitive action against any individual (including a utility employee) or other entity who files a complaint with the utility or the Commission or otherwise causes an alleged violation of this code of conduct to come to the attention of the Commission.

I. Applicability:

This code applies to The Consumers Energy Company and the Detroit Edison Company in their relationships with their affiliates and affiliates of their parent

companies, referred to in this document as "covered electric utility." This code becomes effective upon approval of the Michigan Public Service Commission.

II. Separation

A covered electric utility shall be a legally separate corporate entity from its affiliates offering competitive services or products. The covered electric utility shall function in such a manner so as 1) not to interfere with the development of competition for generation and competitive retail services and products, 2) to inhibit the opportunity for anticompetitive behavior, and 3) to minimize regulatory expense to prevent anticompetitive behavior. This separation standard includes, but is not limited to, the following:

- A. The covered electric utility shall not offer competitive services or products. All competitive services or products must be offered through legally separate corporate affiliates.
- B. The covered electric utility shall not subsidize in any manner, directly or indirectly, the business of its affiliates offering competitive services or products.
- C. The covered electric utility shall maintain its books and records separately

from those of affiliates offering competitive services or products.

- D. The covered electric utility and its affiliates offering competitive services or products shall not share facilities, equipment, or services, including computer hardware and software.
- E. The covered electric utility shall not jointly employ officers and/or directors with any affiliate offering competitive services or products.
- F. The covered electric utility's operating employees and the operating employees of its affiliates offering competitive services or products shall function independently of each other, be employed by separate corporate entities, and maintain separate offices.
- G. The covered electric utility shall not finance or co-sign loans for affiliates offering competitive services or products, nor shall it pledge utility assets to support financing for such affiliates.
- H. Employees may transfer between the covered electric utility and any of its affiliates offering competitive services or products as long as the covered electric utility shall document and file quarterly with the Commission each occasion that an employee of the utility becomes an employee of the affiliate and/or an employee of an affiliate becomes an employee of the

utility.

- I. A covered electric utility and its affiliates offering competitive services or products shall not engage in joint advertising, marketing, or other promotional activities related to the provision of competitive services, nor shall they jointly sell competitive services. The utility shall not give the appearance in any way that it speaks on behalf of its affiliates offering competitive services or products nor shall the utility permit an affiliate offering competitive services or products to give the appearance that it speaks on behalf of the utility.
- J. The covered electric utility shall not suggest that it will provide any customer with preferential treatment or service by doing business with an affiliate offering competitive electric services or products, nor shall the utility suggest that any customer will receive inferior treatment or service by doing business with an alternate supplier.
- K. The covered electric utility shall not condition or otherwise tie the provision of a utility service or the availability of discounts, rates, other charges, fees, rebates or waivers of terms and conditions to the taking of any goods or services from the affiliate offering competitive services or

products.

- L. The covered utility shall not allow its affiliates offering competitive services or products to use its logo unless the affiliate includes, in a clearly visible position and easily readable by the customers, the following statement:

(Affiliate name) is not regulated by the Michigan Public Service Commission.

III. Discrimination

A covered electric utility shall not discriminate in favor of or against any party, including its affiliates offering competitive services or products. This includes, but is not limited to, the following:

- A. An electric public utility shall not provide any affiliate offering competitive services or products, or to any customer of such affiliate, with preferential treatment or any other advantages that are not offered under the same terms and conditions and contemporaneously to alternate suppliers offering competitive services or products within the utility's service territory or to customers of those alternate suppliers. This provision includes, but is

not limited to, all aspects of the utility's service, including pricing, responsiveness to requests for service or repair, the availability of firm and interruptible service, and metering requirements.

- B. If a covered electric utility provides to any affiliate offering competitive services or products, or such affiliate's customers, a discount, rebate, fee waiver, or waiver of its ordinary terms and conditions for services or products, it shall contemporaneously offer the same discount, rebate, fee waiver, or waivers to all alternate suppliers operating within the electric public utility's service territory or such alternate supplier's customers.
- C. If a covered electric utility provides services, products, or property to any affiliate offering competitive services or products, compensation shall be based upon the higher of fully allocated cost or market price.
- D. If a covered electric utility provides a customer or potential customer with the names of its affiliates offering competitive electric services or products, it shall do so only by distributing their names along with all others on the most recent list of all alternative electric suppliers authorized by the Michigan Public Service Commission to offer service within the utility's service territory.

- E. The covered electric utility shall not provide information or consultation to an affiliate offering competitive services or products regarding a potential business arrangement between that affiliate and a potential customer.
- F. The covered utility shall not refer a customer or potential customer to an affiliate offering competitive services or products nor steer a potential customer away from an alternate supplier, nor shall the utility provide a customer or potential customer with advice or assistance regarding the selection of or relationship with an affiliate or other service provider.

IV. Disclosure of Information

Information obtained by the covered electric utility in the course of conducting its regulated business shall not be shared directly or indirectly with its affiliates offering competitive services or products unless that same information is provided to alternate suppliers operating in the State on the same terms and conditions and contemporaneously. This provision includes, but is not limited to:

- A. Customer specific names and addresses shall not be provided to an affiliate offering competitive services or products unless the same information is provided on the same terms and conditions, and

contemporaneously to all alternate providers approved to operate within the State.

- B. Customer specific consumption or billing data shall not be provided to any affiliate or alternate supplier without prior approval of the customer according to the process approved by the Commission. Once a calendar year a customer can request up to 12 months of historic usage or billing data be provided directly to the customer or, when requested in writing, to designated alternate electric supplier(s) or affiliated supplier(s) offering service in that utility's distribution service territory and the request will be honored by the electric utility without charge until revoked by the customer. Additionally, once a calendar year, an alternate supplier or affiliate supplier can request and receive up to 12 months of historic usage or billing data for current customers of the alternate or affiliate supplier and the utility may without charge provide that supplier with such data. The utility can charge a reasonable fee to cover the costs of filling requests for data that is more than 12 months old or to respond to requests made more frequently than once a calendar year. A covered electric utility shall not request approval from a customer to provide

information to an affiliated electric supplier without requesting in the same manner and at the same time approval to provide the same information to all alternate suppliers operating within the utility's service territory.

- C. If a covered electric utility provides non-customer specific, or aggregated, customer information to its affiliate offering competitive retail services or products, it must offer the same information on the same terms and conditions, in the same form and manner, and contemporaneously to all alternate electric suppliers.
- D. A covered electric utility shall not provide its affiliates offering competitive services or products with information about the distribution system, including operation and expansion, without providing the same information under the same terms and conditions, in the same form and manner, and contemporaneously to every alternate supplier operating in the state.
- E. A covered electric utility shall not provide any information received from or as a result of doing business with an alternate electric supplier to the utility's affiliate offering competitive services or products without the written approval of the alternate electric supplier.

V. Utility - Alternate Supplier Relationship

Except in instances approved by the Commission, the covered electric utility shall not in any way interfere in the business operations of an alternate supplier.

This provision includes, but is not limited to, the following:

- A. A covered electric utility shall not give the appearance in any way that it speaks on behalf of any alternate supplier.
- B. A covered electric utility shall not interfere in any manner in the contractual relationship between the alternate supplier and its customer unless such involvement is clearly permitted in the contract between the customer and the alternate supplier.

VI. Compliance Plans

Each covered electric utility shall file a code of conduct compliance plan within 30 days of the approval of this code of conduct by the Commission. The compliance plan shall:

- A. Identify a designated corporate officer of the utility who will oversee compliance with the code of conduct and be available to serve as the Commission's primary contact regarding compliance with the code.

- B. Include an affidavit signed by the designated corporate officer certifying that the utility will comply fully with this code of conduct.
- C. Describe to the Commission the procedures in place to comply with all provisions of the code of conduct.
- D. Include an organizational chart of the parent or holding company showing all regulated entities and affiliates and a description of all services and products provided between the regulated entity and its affiliates.

In this filing, the utility may request a waiver from one or more provisions of this code of conduct. The utility carries the burden of demonstrating that such a waiver will not inhibit the development or functioning of the competitive market. This compliance plan shall be updated annually.

VII. Oversight, Enforcement, and Penalties:

- A. A covered electric utility shall maintain the documentation demonstrating compliance with this code of conduct. All documentation shall be kept at a designated company office in Michigan. The utility shall provide this information for Commission review upon a request by the Commission or its Staff. The designated officer will either be available or make personnel

available who are knowledgeable to respond to the Commission's inquiries regarding compliance with the provisions of this code of conduct.

- B. The covered electric utility shall use a dispute resolution process separate from any process that might be available by the Commission. The utility's dispute resolution process shall address complaints arising from application of this code of conduct. Within five business days of receipt by the utility of a notice of dispute or violation of the code of conduct, each party shall identify an employee, agent, or representative to deal with the dispute. These persons shall have fifteen business days to resolve the dispute. If no resolution is achieved, but the promise of resolution seems forthcoming in the judgement of the complaining party, that party may extend this informal process an additional fifteen days. If a complaint is not resolved, the complaining party may file a formal complaint pursuant to the existing procedures in place before the Commission. The covered electric utility shall keep a log of all complaints, including 1) the name of the person or entity filing the complaint, 2) the date the complaint was filed, 3) a written statement of the nature of the complaint, and 4) the results of the resolution process.

- C. Violations of the Code of Conduct will be presumed to impede the vitality of the competitive market. The result of this impediment will be presumed to lessen the risk to the incumbent utility, and through the utility, to its parent and affiliates. Therefore, penalties for violation of the code will take the form of a reduction in the utility's authorized rate of return on common equity, with a concomitant reduction in rates. The more flagrant or repetitive the violations, the more severe the adjustment to the authorized rate of return on common equity. Rate reductions will be implemented through existing Commission authority and processes.

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PROOF OF SERVICE

MICHIGAN PUBLIC SERVICE
COMMISSION

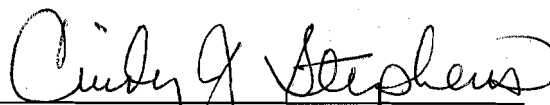
JAN 11 2000

FILED

STATE OF MICHIGAN)
)
County of Ingham)

Case No. U-12134

Cindy Stephens, being duly sworn, deposes and says that on January 11, 2000, A.D. she served a copy of the attached Testimony, by mailing copies thereof by first class mail, postage prepaid, or by inter-departmental mail, to the persons as shown on the attached service list.



Subscribed and sworn to before me
this 11th day of January, A.D., 2000.



Notary Public Ingham County, Michigan
My Commission expires August 16, 2000

SERVICE LIST FOR DOCKET # U - 12134-
DATE OF PREPARATION: 01/11/2000

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