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June 30, 1999

<u>**VIA FEDERAL EXPRESS MAIL**</u>

FILED
JUL 1 1999
Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
P.O. Box 360
Jefferson City, MO 65102

Re: <u>MPSC Case No. EX-99-442</u>

Dear Mr. Roberts:

Enclosed for filing on behalf of Union Electric Company, d/b/a AmerenUE, are an original and fourteen (14) copies of its Comments in the above proceeding.

Kindly acknowledge receipt of this filing by stamping as filed a copy of this letter and returning it to me in the enclosed, self-addressed stamped envelope.

Sincerely,

William J. Niehoff
Attorney

Enclosure
cc: Service List

EX-99-442

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

FILED
JUL 1 1999
Missouri Public
Service Commission

PROPOSED RULE 4 CSR 240-20.015
Affiliate Transactions
Electric Utilities

Comments of
Ameren Corporation and Union Electric Company

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INTRODUCTION

Consumer welfare. Low prices. High quality. The Missouri Public Service Commission should use these guideposts to decide whether to adopt the proposed affiliate rule.

The stated purpose of the proposed affiliate rule is "to prevent regulated utilities from subsidizing their nonregulated operations." Circumstances differ across utilities in Missouri with regard to the current affiliate regulations.

With respect to Ameren Corporation (Ameren), Union Electric Company (UE), and their affiliates, however, there already are numerous mechanisms in place that effectively guarantee proper cost allocation and the prevention of improper cross subsidies. These mechanisms include extensive federal regulation, existing scrutiny of Ameren-related affiliate transactions through Ameren's service agreement (SA) and cost allocation manual (CAM), and other mechanisms. This regulatory framework, uniquely applicable in Missouri to Ameren, operates to prohibit undesirable aspects of utility-affiliate transactions while preserving and encouraging the desirable aspects that enhance consumer welfare.

In all events, the Commission should adopt a regulatory approach that is narrowly tailored to specific issues of concern yet flexible enough to apply properly to both Ameren and other utilities in Missouri. Consumer welfare will be advanced by affiliate-transactions regulations that target remaining potential abuses of the utility-affiliate relationship but go no further. Over-regulation, by adding cost with no actual benefit, will actually frustrate the rule's ultimate goal of "provid[ing] the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities."

The proposed rule is unnecessarily broad, inflexible, and heavy-handed, especially in light of the existing regulatory mechanisms applicable to Ameren. Though

the rule currently proposed by the Commission is intended to benefit consumers, it actually imposes onerous burdens and, particularly as applied to Ameren, destroys many of the consumer-benefiting efficiencies that arise from the relationship between a utility and its affiliates. Ironically, this result is exactly contrary to the Commission's purpose of assuring that ratepayers are not adversely impacted by the utilities' nonregulated activities.

A flexible and narrowly tailored approach to the problem of cross-subsidization will best serve ratepayers in Missouri. Strict regulation always is an option, and should be considered if, and only if, a more light-handed approach proves unworkable.

These comments begin by briefly reviewing the procedural history of the proposed rule. We next discuss the goals of regulation generally and of the affiliate rule in particular. Then, we consider the extent to which those goals are addressed and satisfied, either completely or partially, by existing laws, regulations, or other regulatory mechanisms, particularly with respect to Ameren and UE. Finally, we review the proposed rule in light of the existing legal background and the Commission's goals.

As an alternative to the proposed rule, Ameren proposes a rule that recognizes existing legal protections. This rule would be part of a sensible regulatory framework that effectively prohibits potential abuses, allows pro-consumer efficiencies and maximizes consumer welfare. Thus, Ameren rejects a heavy-handed "one-size-fits-all" approach to prohibiting affiliate transactions in favor of an approach that is more flexible, more narrow and far more consumer friendly.

PROCEDURAL HISTORY

On April 3, 1996, the Commission established Case No. OO-96-329, entitled "In the Matter of the Development of an Affiliated Transaction Rule for Gas, Electric, Water and Sewer Companies," and provided a draft rule for purposes of comment. Various parties supplied suggestions and comments regarding the draft rule.

On November 5, 1997, the Commission closed Case No. OO-96-329, and established Case No. OX-98-183, a rulemaking docket intended to investigate the need for rules governing interaffiliate transactions among electric, gas, heating, sewer, and water companies. The Commission incorporated all of the contents of Case No. OO-96-329 into OX-98-183. On January 6, 1998, the Staff of the Commission circulated a revised version of the rule. On February 20, 1998, the Staff recommended that "development of standards of conduct [for affiliate-utility transactions] be continued, but in the context of the specific utility segment that will be affected rather than in a generic docket."

On an informal basis, the Commission followed the Staff's recommendation. Throughout the latter half of 1998, the Staff informally circulated draft interaffiliate transaction rules applicable to each industry.

On June 1, 1999, the Commission published an official Notice of Proposed Rulemaking in the Missouri Register, thereby initiating the formal rulemaking process. These comments are submitted in response to that Notice.

COMMENTS

I. The Commission Should Seek To Improve Consumer Welfare Through Light-Handed And Flexible Regulation.

Consumer Welfare and Utility-affiliate Transactions. Consumer welfare -- low prices, high quality service, and broad service offerings -- should be the ultimate goal of the Commission in considering which, if any, interaffiliate transaction rules to promulgate. In the context of a regulated industry, consumer welfare is maximized by regulations that lead to low prices, high quality, and a diversity of service offerings.

Here, the general goal of consumer welfare sees specific form in the Commission's stated goal of ensuring low prices for ratepayers: "The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities." The Commission recognizes that consumers would suffer if a utility could subsidize nonregulated activities by collecting inflated rates for regulated services from ratepayers. Thus, the Commission states the proposed rule's purpose as "prevent[ing] regulated utilities from subsidizing their nonregulated operations."

Issues of cross-subsidization are intrinsic to the operation of an entity in both regulated and unregulated industries. As Dr. John H. Landon, Ph.D., recognizes in his attached comments, cross-subsidization takes place when a regulated utility overcharges consumers in regulated markets in order to subsidize its unregulated or competitive products or services.[1] (*See* Comments of Dr. John H. Landon, attached hereto as Exhibit A, at 7).

---

[1] Dr. John H. Landon is a Ph.D. in Economics who has focused his studies on regulated industries. He is a Principal and Director of the Energy and Telecommunications Practice of the Analysis Group.

Cross-subsidization forces the ratepayer to pay more than he or she should for regulated service from the utility. Left unchecked, cross-subsidization may also tend to reduce the alternatives available to consumers, reduce allocative efficiency, and retard the development of new products and services. (*Id.*).

Utility-affiliate transactions can impact consumer welfare through a variety of means other than cross-subsidization. These impacts can be both negative and positive. With respect to the negative impacts, Dr. Landon describes how discrimination in essential services and improper sharing of essential information both threaten consumer welfare.[2] (*See* Comments of Dr. Landon, Exhibit A, at 7-10).

Discrimination takes place when the utility provides preferential treatment to its affiliate over competitors with regard to essential services that are unique to the utility. (*See* Comments of Dr. Landon, Exhibit A, at 7-8). A utility is regulated largely because it maintains exclusive control over facilities and services (*e.g.*, electric or gas transmission and distribution facilities) that cannot be practicably or efficiently developed by other firms. When a utility discriminates in favor of its affiliates (or against the affiliates' competitors) with respect to those essential facilities or essential services, the utility's competitive affiliates gain an unfair advantage over competitors, who must rely upon the utility for those same services. (*See* Comments of Dr. Landon, Exhibit A, at 8).

As Dr. Landon notes, however, concerns regarding a utility's discriminatory conduct are limited to *essential* services and facilities. (*See* Comments of Dr. Landon, Exhibit A, at 7-10). A utility cannot unfairly discriminate with respect to non-essential services or facilities. By definition, non-essential services and facilities may be practicably

[2] Though neither of these two concerns is expressly identified in the Commission's statement of purpose, several sections of the proposed rule appear designed to deal with these concerns.

duplicated by the affiliates' competitors. (*See id.* at 8). When a utility offers a non-essential service on a favorable basis to its affiliate (*e.g.*, legal services or accounting), thereby providing that affiliate with an advantage against its competitors, those competitors will make use of their own resources or be encouraged to develop that non-essential service otherwise, perhaps by partnering with another firm in the marketplace. The result is that both the affiliate and its competitors operate more efficiently. In contrast, when a utility offers an essential service on a favorable basis to its affiliates (*e.g.*, access to the transmission and distribution facilities), those affiliates obtain a competitive advantage, but the affiliates' competitors cannot match or duplicate that competitive advantage because it is under the unique control of the utility.

The second additional concern about utility-affiliate transactions relates to information sharing among utilities and their affiliates. (*See* Comments of Dr. Landon, Exhibit A at 8-10). Information related to essential facilities or services, much like the essential facilities or services themselves, would, if provided by the utility to its affiliates on a preferential basis, provide the affiliates with an illegitimate competitive advantage. Nevertheless, as Dr. Landon describes, concerns about information sharing, much like concerns about discrimination, are limited to *essential* services. (*See id.* at 9-10). A utility cannot harm consumer welfare by preferentially sharing information about non-essential services such as corporate support, human resources, internal policies of the utility and marketing of the utility's competitive services. (*See id.*).

In spite of the risks posed by cross-subsidization, discrimination, and information sharing, utility-affiliate transactions are by no means anti-consumer. In fact, and as the above discussion of discrimination intimates, utility-affiliate transactions can have

powerful pro-consumer effects by allowing the utility and/or its affiliates to exploit legitimate competitive advantages and efficiencies for the benefit of the consumer.

Legitimate competitive advantages and efficiencies allow firms, including utilities and their affiliates, to lower prices, maintain high quality service, and introduce diverse service offerings. Legitimate competitive advantages come from improvement in all phases of business, including production, distribution, management, service, marketing, and product selection. Efficiencies result as firms develop lower-cost methods of doing business.

With respect to utility-affiliate transactions, legitimate competitive advantages include, among other things, both economies of scale and economies of scope. Economies of scale occur when the average cost of production falls with increases in the quantity of items produced. Such cost reductions are achieved through a variety of means, including spreading fixed costs over greater volume of sales, and ultimately improve consumer welfare through lower-cost products that better fit consumer preferences. In the context of utility-affiliate transactions, economies of scale are accomplished when a utility is able to properly and accurately share its fixed costs with its affiliates. Similarly, economies of scale are realized when two utilities are able to coordinate their operations and act as a single integrated firm.

Economies of scope occur when a single firm lowers per-unit costs by producing or marketing a variety of goods rather than each good being made and sold by a separate firm. This type of integration can lower average costs by allowing a firm to use the production factors or knowledge of one product to produce another. In the context of utility-affiliate transactions, the integration across utilities and their affiliates of corporate support services

such as accounting, human resources, and legal services can achieve economies of scope that lower average costs and therefore benefit consumers.

At bottom, and as Dr. Landon describes in more detail in his attached comments, a utility's provision of non-essential services, facilities, or information to its affiliates on a preferential basis will improve consumer welfare through the development of economies of scale and scope. (*See* Comments of Dr. Landon, Exhibit A, at 9-10). For example, when a utility shares its accounting services with its affiliate (and charges the affiliate the appropriate price for those services), the affiliate is able to operate at a lower cost. Consumers benefit from the affiliate's lower cost of production. Competitors of the affiliate will respond by improving the efficiency of their accounting departments or by partnering with another firm that can offer the same lower-cost accounting services that the utility can to its affiliate. And the competitors' response again improves consumer welfare.

When promulgating a rule governing utility-affiliate transactions, the Commission should recognize that such transactions both benefit consumer welfare and present some risks. Cross-subsidization is the most obvious risk. With respect to discrimination and information sharing, the distinction between essential services, facilities, and information, on the one hand, and non-essential services, facilities, and information, on the other hand, is critical. Whereas preferential treatment of the affiliate with respect to essential services and information destroys consumer welfare, preferential treatment with respect to non-essential services and information promises tremendous benefits.

Light-handed regulation. In its efforts to eliminate potential problems with utility-affiliate transactions, the Commission should adopt a light-handed and flexible regulatory approach. A light-handed, narrowly tailored approach would effectively prohibit all anti-

consumer-welfare aspects of interaffiliate transactions but would allow and encourage the pro-consumer aspects of interaffiliate transactions. A light-handed approach stands in contrast to a heavy-handed or prophylactic approach in which the Commission's regulations would not be tailored to the potential problems but would instead go far beyond what is necessary. A light-handed approach offers many benefits over a heavy-handed approach.

First, the light-handed approach would allow maximization of consumer welfare. Much like a heavy-handed approach, the light-handed approach would accomplish the Commission's goals of eliminating cross-subsidization, discrimination with respect to essential services, and information-sharing with respect to essential services. Unlike a heavy-handed approach, light-handed regulations would maximize consumer welfare by allowing legitimate competitive advantages that benefit consumers. By promulgating a light-handed and narrowly tailored rule, the Commission would both eliminate the negative aspects of utility-affiliate transactions and encourage the positive aspects. Light-handed regulation stands in stark contrast to prophylactic rules that are broader than necessary, which may significantly retard existing legitimate competitive advantages and impede the development of new legitimate competitive advantages.

The second advantage of light-handed regulation is that it offers the advantage of allowing regulators to revisit the need for heavier regulation. In contrast, the imposition of heavy-handed or prophylactic regulations is often a one-way street. Once restrictive rules are put in place, it is very difficult to remove them – even if they accomplish no good or affirmatively cause harm. Inefficiencies caused by the rules are difficult to observe or

quantify. And it is virtually impossible to determine whether the rules are necessary or whether their goals are already accomplished by some other means.

The third advantage of light-handed regulation is that it is consistent with the current trend toward deregulation. Though the electricity industry in Missouri has not been deregulated, numerous states have moved to deregulate utility industries, and both the Missouri legislature and the Commission have closely studied the possibility of deregulation here. A light-handed approach to regulating utility-affiliate transactions would facilitate a later shift toward deregulation.

In sum, the goal of this rule-making should be the maximization of consumer welfare, primarily by ensuring that consumer rates for regulated service are not "adversely impacted by the utilities' nonregulated activities." With respect to affiliate-utility transactions, the Commission has expressed that its primary concern is with cross-subsidization; discrimination with respect to essential goods, essential services, and essential information is also a legitimate concern. Light-handed regulations – which effectively prohibit this anti-consumer conduct but do no more – are best for consumer welfare. They allow legitimate competitive advantages to develop and they encourage utilities and their affiliates to pass on those advantages to consumers. Ironically, heavy-handed or prophylactic regulations harm consumer welfare in the name of helping it. The Commission should seek to maximize consumer welfare in this rulemaking proceeding by adopting light-handed regulations that prohibit anti-competitive conduct but go no further.

II. Existing Regulatory Mechanisms Operate Effectively To Prohibit Cross-Subsidization Involving Ameren Or UE.

In order to promulgate a light-handed regulatory regime, it is first necessary to investigate whether existing regulatory mechanisms address the perceived problem. As is

further described below, Ameren and its affiliates occupy a singular position among utilities in Missouri. Ameren's unique position means that several sets of regulations already operate to prevent abuse of Ameren's interactions with its affiliates but allow exploitation of the pro-consumer aspects of those interactions.[3]

A. Ameren's Unique Status As A Registered Holding Company.

Ameren is a publicly owned Missouri corporation that was formed on January 1, 1998, upon completion of the merger between Union Electric Company (UE) and Central Illinois Public Service Company (CIPS). Ameren is the parent holding company of both UE and CIPS. UE is a Missouri Electric, Gas and Steam Corporation regulated by the Commission. UE also has electric and gas operations in Illinois. UE and CIPS are regulated utilities in Illinois and are regulated by the Illinois Commerce Commission. In addition to UE and CIPS, Ameren has a number of other non-utility subsidiaries. These include Ameren Services Company (Ameren Services), which provides centralized administrative services to Ameren' other subsidiaries.

As a result of its unique (in Missouri) status as a registered holding company with subsidiary utilities operating in two states, Ameren is subject to a host of regulations that do not apply to other Missouri utilities. These regulatory mechanisms include the federal Public Utilities Holding Company Act of 1935 (PUHCA), Ameren's Service Agreement and a comprehensive Cost Allocation Manual, and the oversight of the Illinois Commerce

[3] The Missouri Commission has recognized and relied upon the benefits of federal regulation of affiliate transactions in other contexts. For example, in telecommunications, the Commission has, at least in part, relied on Federal Communications Commission affiliate transaction rules in order to govern these relationships. (*See, e.g., In the Matter of Investigation into Southwestern Bell Telephone Company's Affiliate Transactions*, Case No. TO-94-184).

Commission. Together, this scrutiny provides very effective protection against the possibility of cross-subsidization through interaffiliate transactions.

B. PUHCA's Prohibitions Against Cross-Subsidization.

Ameren is a public utility holding company registered with the Securities and Exchange Commission (SEC) under the Public Utilities Holding Company Act of 1935 ("PUHCA"), 15 U.S.C. § 79, *et seq.* As Mr. William T. Baker describes in his attached comments, PUHCA is an SEC-administered federal statute that governs holding companies that own regulated utilities.[4] (*See* Comments of Mr. William T. Baker, Esq., attached hereto as Exhibit B, at 2-5). Under PUHCA, Ameren and its subsidiaries are subject to comprehensive regulation with respect to a wide variety of matters including financing and capital structure, intercompany extensions of credit, service company arrangements, and other affiliate transactions involving the sale of goods, services, assets and other property. In most cases, SEC approval of specific corporate transactions is required. (*See id.*).

For the companies that are registered under PUHCA, that law plays an important role in prohibiting abuses of the utility-affiliate relationship and ensuring realization of the consumer benefits inherent in that relationship. PUHCA does this through three means: first, PUHCA governs and regulates the "integration" of multiple utilities owned by the same holding company; second, PUHCA regulates the organization of and conduct of service companies such as Ameren Services; and finally, PUHCA applies a "cost" standard to all utility-affiliate transactions involving transfers of goods, services, assets, or other property, in order to prevent cross-subsidization.

[4] Mr. Baker is an attorney with over 30 years of experience representing gas and electric companies registered under PUHCA in proceedings before the SEC. (*See* Comments of Mr. William T. Baker, Esq., attached hereto as Exhibit B, at 1).

Integration. The "integration" standard of PUHCA prohibits a registered holding company from holding more than a single integrated public-utility system and businesses that are incidental thereto. A holding company such as Ameren is allowed to retain an additional public utility system only if the SEC finds that its retention "will serve the public interest by tending towards the economical and efficient development of an integrated public-utility system." 15 U.S.C. § 79j(c)(2). An integrated public-utility system is defined to mean "a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities [which are] physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system ...." 15 U.S.C. § 79b(a)(29)(A). Thus, a holding company registered under PUHCA may own two or more utilities only if the SEC has found that the facilities of the separate companies will be operated as if they are part of a single enterprise, in a manner that is both efficient and conducive to consumer welfare. (*See* Comments of Mr. Baker, Exhibit B, at 3-5). Furthermore, a registered electric utility company must also adopt operating agreements approved by the Federal Energy Regulatory Commission (FERC) that govern operations of the generation facilities of the utilities and cost allocation among them. (*See id.*).

As the Commission is aware, Ameren owns two utilities, UE, in Missouri and Illinois, and CIPS in Illinois. The SEC specifically reviewed the merger of these regulated industries into Ameren and concluded that they met the standard for an integrated public-utility system. (*See* Comments of Mr. Baker, Exhibit B, at 3-4). A central part of the SEC's decision was Ameren's showing that integrated operation of the two utilities would result in savings of over $700 million during the 10-year period following the merger.

These projected savings resulted largely from economies of scale and scope arising from operating efficiencies, reductions in personnel, elimination of duplicative corporate functions, and economies in purchasing materials and supplies. (*See id.*). Thus, as applied to Ameren, the "integrated system" standard of the SEC ensures that the relationship between CIPS and UE will realize considerable competitive advantages which ultimately benefit consumers. Thus, the "integrated system" standard of the SEC ensures that transactions between UE and its affiliate, CIPS, will accomplish considerable pro-consumer benefits.

The "integrated system" standard also works to prohibit cross-subsidization. In the course of becoming an "integrated system," UE and CIPS adopted a Joint Dispatch Agreement, approved by FERC, that governs the allocation of the costs of certain facilities. (*See* Comments of Mr. Baker, Exhibit B, at 4). Furthermore, the SEC allows (and in fact encourages) the provision of goods and services between affiliated utilities provided that such transactions take place at the seller's cost. Indeed, the SEC order approving the merger of UE and CIPS specifically contemplated that they would provide a variety of services (*e.g.*, meter reading, materials management, line services) to each other at cost. (*See id.* at 3-5).

Service Companies. Under PUHCA, a registered holding company is authorized to set up a "service company." A "service company" is a holding company subsidiary that is formed in order to provide centralized managerial, technical, legal, and other corporate support services to its affiliated companies. (*See* Comments of Mr. Baker, Exhibit B, at 5). The SEC requires that a "service company" provide these corporate support services *at cost*. Thus, the SEC prohibits service companies from realizing a profit on their activities

and requires that they be organized as non-profit companies. With a few minor exceptions, the SEC requires that service companies engage in transactions only with affiliated companies. (*See id.*).

The use of service companies allows a registered holding company to realize economies of scale and other efficiencies that reduce the costs of doing business and therefore benefit consumers. Specifically, through service companies, PUHCA-registered entities are able to avoid duplication of corporate support functions, and thereby to avoid duplicative costs. Furthermore, by requiring that the service company provide service at cost, the SEC effectively prohibits cross-subsidization from the utility to the service company.

Ameren Services operates as Ameren's SEC-approved service company. The existence of Ameren Services allows Ameren and its affiliates to recognize considerable economies of scale and efficiencies. For the various companies affiliated under the Ameren umbrella, Ameren Services operates as the central payroll department, personnel department, accounts payable department, etc. (*See* Comments of Mr. Baker, Exhibit B, at 6). Thus, Ameren's affiliates (and their customers) avoid the costs associated with several duplicative and redundant corporate service departments. Similarly, Ameren Services allows the various Ameren affiliates to achieve more efficient operation by sharing non-essential business information, experience and knowledge. (*Id.*).

The SEC specifically reviewed the operations of Ameren Services and approved them. One requirement of the approval was that Ameren adopt a general services agreement (GSA). That GSA sets forth the types and categories of services that Ameren Services has agreed to provide and the methods of cost allocation that it must use.

Furthermore, the GSA contains comprehensive and detailed cost allocation methodologies that are designed to ensure that non-regulated businesses are charged properly for the services that they receive from Ameren Services. (*See id.*). The GSA effectively prevents any cross-subsidization by UE and CIPS of Ameren's unregulated subsidiaries. In addition, the SEC has prohibited Ameren Services from changing its organization, the type and character of the companies it serves, its methods of cost allocation, or the scope or character of the services it provides without first notifying the SEC.

In order to ensure effective adherence to the SEC's rules governing Service Companies and the Ameren GSA, the SEC requires Ameren and its affiliates to comply with extensive reporting requirements. Thus, a Service Company must maintain comprehensive records regarding its costs, its financial status, its transactions with all affiliated entities, its cost-accounting procedures, etc. Furthermore, each Service Company is required to file an annual report with the SEC regarding its operations. This report contains a broad range of specific information and allows the SEC to determine whether the service company is providing services "economically and efficiently for the benefit of [affiliated companies] at cost, fairly, and equitably allocated among such companies." 15 U.S.C. § 79m(b). Finally, as part of its ongoing oversight, the SEC conducts periodic service company audits that sometimes result in SEC recommendations for improving service company functions.

"At cost" interaffiliate transactions. PUHCA requires that all transactions between companies affiliated with a PUHCA-registered holding company be performed "*at cost*." (*See* Comments of Mr. Baker, Exhibit B, at 9-10). The "at cost" rule ensures that no PUHCA-regulated company realizes a profit on any sale to any affiliate. The rule is

designed to capture all of the costs of a service company and to assign those costs to affiliated client companies based on the amount and type of services performed. (*See id.*).

The SEC has promulgated a comprehensive set of federal regulations that prescribes exactly how "cost" is to be determined. These regulations are codified at 17 C.F.R. § 250.91. They require fair and equitable allocation of the cost among the affiliates receiving services from the service company, govern the type and amount of various cost inputs, and provide a framework used by the SEC to monitor the cost of inter-affiliate transactions. (*See id.*).

Through these means, the SEC ensures that transactions among members of an integrated system are not priced to produce a profit for the seller or a subsidy or windfall for the buyer. (*Id.*). Thus, the SEC ensures that no company affiliated with a PUHCA-registered holding company is able to engage in improper cross-subsidization. The "at cost" standard, much like the "integrated company" regulations and the "service company" rules, operates to prohibit many of the problems associated with utility-affiliate transactions while protecting and encouraging the consumer benefits that may be realized.

C. Ameren's Service Agreement And Cost Allocation Manual

Ameren's service agreement (SA) and its cost allocation manual (CAM), each operate to help eliminate or limit potential negative consequences of transactions between Ameren and its affiliates. Through the SA, the Commission is provided some guarantee against the possibilities of cross-subsidization, discrimination with respect to essential services, and discriminatory information-sharing. And through the CAM, the Commission is able to effectively ensure that neither Ameren nor any of its affiliates is able to cross-subsidize by inaccurately reflecting the cost of a major item.

D. Ameren's General Service Agreement

In addition to the SEC and this Commission, another state regulatory agency has also conducted a rigorous review of Ameren's structure and is satisfied that cost allocation issues and cross-subsidy issues are adequately addressed. Though this decision is not binding on the Missouri Commission, it is further evidence that existing regulatory mechanisms operate to prevent the possibility of cross-subsidization.

The Illinois Commerce Commission considered and approved the merger of UE and CIPS in September 1997. *See Joint Application for Approval of Merger and Reorganization*, Illinois Commerce Commission, Docket No. 95-0551). The Commission explicitly considered and found that the merger, reorganization and procedures adopted at that time provided for appropriate cost allocation and protected against cross-subsidization. The Commission found as follows:

> VIII. NO UNJUSTIFIED SUBSIDIZATION OF NON-UTILITY ACTIVITIES
> Section 7-204 of the [Illinois Public Utilities Act] provides that before the Commission can approve any proposed reorganization, it must find that the reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers.
>
> ****
>
> The organizational structure proposed by Applicants consists of the holding company, Ameren, as the parent company with UE, CIPS, and CIC as its three subsidiaries. Prior to consummation of the merger, Ameren Services Corporation ("Ameren Services") will be incorporated in Missouri to serve as the service company for the Ameren System.
>
> ****
>
> The Commission concludes that the evidence establishes that the proposed merger and reorganization will not result in the unjustified subsidization of non-utility activities by UE and CIPS or their Illinois ratepayers.

(*Id.*, at 59-60).

The Merger Order further considered the extent to which the General Services Agreement (GSA) addressed issues concerning allocation of costs and facilities among utility and non-utility operations, stating:

> IX. ALLOCATION OF COSTS AND FACILITIES BETWEEN UTILITY AND NON-UTILITY OPERATIONS
> Section 7-204 also requires that before the Commission can approve any proposed reorganization, it must find that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are included by the utility for ratemaking purposes.
>
> ****
>
> The Commission concludes that the revised GSA is reasonable and in the public interest and should be approved ....

(*Id.* at 60-64).

Thus, the Ameren corporate structure, including formation of a services company, was reviewed by the SEC and one state regulatory commission which concluded that cost allocation and cross-subsidy issues were fully addressed. This review provides additional comfort that potential problems with utility-affiliate transactions are adequately handled.

III. With Respect To Ameren, The Proposed Affiliate-Transactions Rules Provide Little Additional Protection And Threaten Consumer Welfare.

The proposed rule should be evaluated in light of the Commission's goals, consumer welfare, and existing regulatory protections against abuse of the affiliate-utility relationship. The affiliate transaction rule currently proposed by the Commission, at least as applied to Ameren, duplicates existing regulatory protections and protects against problems that are already effectively prevented. Many of the regulations eliminate Ameren's consumer-welfare-enhancing efficiencies, structures and transactions that benefit ratepayers and are allowed even under PUHCA's established scheme of comprehensive

regulation. Several of the regulations directly conflict with the operating structure and scheme set up by PUHCA and could require a costly restructuring of Ameren and its affiliates. Finally, a number of the regulations impose costs and burdens that are inconsistent with the potential benefits or suffer from significant legal infirmities.

A. Section 2: Standards.

Section 2 of the Proposed Rule is entitled "Standards." In many important ways, it is this section that contains most of the substance of the Commission's rule. It is also this section that is most problematic.

From a broad perspective, Section 2 is inconsistent with the regulatory philosophy and scheme established by PUHCA. PUHCA recognizes that interaffiliate transactions offer significant benefits as well as potential problems. PUHCA seeks to eliminate only the latter. PUHCA specifically encourages (but closely monitors) interaffiliate cooperation through the "integrated system" and through "service companies." The proposed rule, in contrast, is hostile to any interaffiliate transactions and prohibits both those that are desirable and those that are undesirable. Effectively, Section 2 conflicts with PUHCA without accomplishing any greater consumer protection.

Section 2(A). Section 2(A) prohibits a regulated electrical corporation from providing "a financial advantage to an affiliated entity." A "financial advantage" is defined as the transfer of goods, services, information or assets at greater than the lesser of (a) the fair market price; or (b) the fully distributed cost (FDC) to the regulated electrical corporation for the good, service, information or asset in question.

The first problem with Section 2(A) is the breadth of the definition of "financial advantage." The rule defines "financial advantage" to mean "information, assets, goods or

services of any kind (including but not limited to, land, patents, trained employees, research, employee training, etc.)." Under this definition, virtually any contact at all between the utility and the affiliate runs the risk of being characterized as a "financial advantage" unless stringent guidelines are satisfied.

Application of "financial advantage" to a transferred employee is particularly problematic. An employee's skills are owned solely by him or her. Neither the utility nor its affiliate "own" the employee's skills. Similarly, it is virtually impossible to value an employee's skills. (*See* Comments of Dr. Landon, Exhibit A, at 14).

The second problem with Section 2(A) is that it goes far beyond its intended purpose. Section 2(A) is designed to prevent cross-subsidization. In fact, it accomplishes far more than that, effectively prohibiting a utility and its affiliates from realizing any efficiencies and benefits from interaffiliate transactions. Section 2(A) confuses the undesirable effects of interaffiliate transactions (cross-subsidization) with the desirable effects (efficient transactions that will lower costs and therefore benefit ratepayers through lower rates). Section 2(A) effectively eliminates all consumer benefits of interaffiliate transactions. (*See* Comments of Dr. Landon, Exhibit A, at 14-15).

Section 2(A) also is problematic because it directly conflicts with the standards of PUHCA. (*See* Comments of Mr. Baker, Exhibit B, at 11-12). PUHCA requires that utilities price their transactions "at cost." In enforcing PUHCA, the SEC relies upon its regulations. These regulations effectively prohibit cross-subsidization while allowing the desirable benefits of interaffiliate transactions. The SEC regulations provide formulae for determining "cost" in different circumstances and many of these formulae are inconsistent with both market value and fully distributed cost, the two benchmarks established by

Section 2(A).[5] It would be impossible for a utility or its affiliates to both comply with PUHCA and with the Commission's proposed rule. (*See id.*).

An example specific to Ameren's situation makes clear both the proposed rules' conflict with PUHCA and its negative effect on consumer welfare. Under existing law, Ameren Services provides accounting services to the various members of Ameren's corporate family. Under strict SEC guidelines, these services are provided "at cost." Thus, the possibility of cross-subsidization is eliminated. Nevertheless, because Ameren Services is able to share its fixed costs among Ameren's corporate family and realize other economies of scope and scale, its "cost" of providing those accounting services to each member of the family are considerably lower than either the fair market price of those services or the fully distributed cost to UE of providing that service for itself. As a result, the utility incurs a lower cost for the accounting services that it receives. These cost savings are passed on to consumers in lower rates.

The Commission's proposed rule would eliminate this benefit and would require Ameren Services to price its accounting services at either the fair market price of those services or at the fully distributed cost of the utility providing those services for itself. In either circumstance, the cost to UE could be higher than under current regulation. The efficiencies of the service company structure would be lost. As a result, ratepayers would pay a higher price for their regulated service.

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[5] The proposed rule defines "fully distributed cost" to mean "a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. FDC required recognition of all costs incurred directly or indirectly used to produce a good or service. Costs are assigned either through a direct or allocated approach. Costs that cannot be directly assigned or indirectly allocated (e.g., general and administrative) must also be included the FDC calculation through a general allocation."

Under both current regulation and under the Commission's proposed rule Section 2(A), it is impossible for cross-subsidization to occur. The only difference between the two regulations is that PUHCA allows realization of beneficial efficiencies while Section 2(A) adopts a more heavy-handed approach that ultimately harms consumers. Section 2(A) directly conflicts with the Commission's goal to ensure that "rates are not adversely impacted by the utilities' nonregulated activities."

Finally, though Section 2(A) provides no recognizable benefit to Ameren (and in fact will cause rates to go up), it still imposes significant regulatory costs and burdens. Section 2(A) requires Ameren to determine the fair market price for every utility-affiliate transaction. Quite often, it will be difficult or impossible to determine a fair market price for many goods and services. As an example, when a utility employee transfers to an affiliated entity, it may be virtually impossible to determine the fair market value or fully distributed cost of that employee. Furthermore, the collection and analysis of market value and FDC information will be costly – and these costs will be passed on to ratepayers. The exercise of determining FDC for services that could have been provided by the regulated entity would require subjective assumptions and hypotheticals that would be both costly and of no real benefit to the ratepayers.

Section 2(A) goes far further than is necessary to accomplish the Commission's goal of preventing cross-subsidization and actually works to the detriment of consumers.

Section 2(B). Section 2(B) of the Proposed Rule provides that: "The regulated electrical corporation shall conduct its business in such a way as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time." The Proposed Rule defines "Preferential Service" to mean "information or

treatment or actions by the regulated electrical corporation which places the affiliated entity at an unfair advantage over its competitors."

Section 2(B) is the most troublesome of all of the proposed rule sections for a variety of reasons. First, and most fundamentally, the rule is very vague. The term "unfair advantage" is left undefined. It is impossible to know what constitutes an "unfair advantage." For this reason, Section 2(B) will have a powerful chilling effect on utility-affiliate transactions far beyond its intended consequences.[6]

Conceivably, "unfair advantage" could include any advantage not actually enjoyed by any one competitor. Because the mere existence of a relationship between a utility and its affiliate is in fact an "advantage," Section 2(B) could be read to require the dismantling of Ameren's holding company structure and to prohibit any Missouri utility from having any affiliates. Though some might object that this interpretation of the rule is nonsensical and not what the Commission intended, it is impossible to determine how far the rule is meant to stretch. The ambiguity may cause risk-averse utilities and their affiliates to operate under the assumption that the rule has the broadest possible meaning. Furthermore, it will cause competitors of the utility's affiliates to invoke the rule and use litigation to gain a competitive advantage over those affiliates.

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[6] Furthermore, as currently drafted Section 2(B) is grammatically problematic in a manner that causes the rule to make no sense. The rule provides as follows: "The regulated corporation shall conduct its business in such a way as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time." Because "preferential service" is a defined term, the term "preferential" cannot be read to define information or treatment. Hence, as currently drafted, Section 2(B) effectively prohibits a regulated utility from providing *any* information or treatment to an affiliated entity.

The second problem with Section 2(B) is similar to the problem with Section 2(A). Though it is impossible to determine the scope or effect of Section 2(B), even if the rule is interpreted narrowly, it will reach far more broadly than is necessary to accomplish the Commission's goals. With respect to the Commission's sole professed goal of eliminating cross-subsidization, Section 2(B) will operate to prevent interaffiliate transactions that are both desirable and undesirable. From the perspective of cross-subsidization, Section 2(B) is unnecessary. As has been extensively described above, PUHCA operates to effectively prevent cross-subsidization. Section 2(B)'s broad and vague prohibition can only cause uncertainty and promote litigation.

With respect to discrimination in essential services and facilities and the related problem of information-sharing (though the Commission has not actually cited these justifications for the rule), Section 2(B) probably goes much further than is necessary. Section 2(B) could be read to apply to all services, goods, and information, whether essential or non-essential. Where competition exists, it is only with respect to essential services that consumers face any potential harm from the discriminatory provision of goods, services, or information by the utility. With respect to non-essential services, consumers actually benefit when goods, services, or information are provided from the utility to its affiliates on a preferential basis. Such preferential treatment actually allows the utility and the affiliate to realize cost savings, often resulting from economies of scale or scope, that benefit consumers.

Section 2(B) is a vague and misguided attempt to solve an ill-defined problem that is already largely solved.

Section 2(D). Section 2(D) requires a utility to provide information regarding its affiliates' competitors to any customer who requests information from the utility about goods or services provided by an affiliated entity.

This rule does nothing to further the Commission's stated goal of preventing cross-subsidization. Instead, it can only be understood as a misguided and ineffective attempt to "level the playing field" between the utility's affiliates and competitors with those affiliates. It effectively places a utility's affiliates at a disadvantage vis-à-vis their competitors, as those competitors are not required to respond to requests for information by producing a list of companies that seek to take its business. Section 2(D) serves only to harm consumer welfare by providing an artificial competitive advantage to any non-affiliated competitor, regardless whether that non-affiliated competitor may be less efficient than the utility-affiliated competitor. Section 2(D) also harms consumer welfare by discouraging any affiliation between non-regulated companies and regulated utilities. Section 2(D) bears no rational relationship to the prevention of cross-subsidization and actively harms consumer welfare.

Section 2(D) also suffers a constitutional problem. The proposed regulation would compel the utility to send a message (*i.e.*, an implied warranty of competitors' services) with which it may not agree and to associate with entities (*i.e.*, competitors) to whom it certainly is adverse. The First Amendment of the United States Constitution and the free speech protections of the Missouri Constitution protect against such dangers and, accordingly, render the proposed regulations unconstitutional.

Ameren's Proposed Section 2. As an alternative to Section 2 of the currently proposed rule, Ameren proposes the following rule:

(2) Standards.

(A) A regulated electrical corporation 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 Missouri Public Service Commission.

(B) A regulated electric corporation and its affiliated interests shall not notify potential or actual customers, either directly or indirectly, that the electric corporation provides any advantages relating to the scheduling , transmission or distribution of electricity to affiliated interests or their customers relative to unaffiliated entities and their customers.

(C) A regulated electrical corporation shall not tie, as defined by State and federal anti-trust laws, the provision of any tariffed services to the taking of any goods and services from the electric utility's affiliated interests.

(D) Specific customer information shall be made available to affiliated or unaffiliated companies only upon consent of the customer or as otherwise provided by law or Commission Rule and upon payment of reasonable charges incurred in producing such information. General or aggregated customer information may be made available to affiliated or unaffiliated companies or persons alike upon payment of reasonable charges incurred in producing such information.

(E) A regulated electrical corporation shall treat as confidential all information related to the transmission or distribution of electric energy received from unaffiliated energy marketers and shall not share such information with its affiliates.

(F) Transactions between an electrical corporation and its affiliated interests shall not be allowed to subsidize the affiliated interests.

(G) Costs associated with the transfer of goods and services between an electric utility and its affiliated interests shall be priced either at cost or at fair market value, as specified in, and allocated pursuant to a Commission approved services agreement. For purposes of this section, a services agreement that has been approved by the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935, or any successor legislation or rules, will be deemed to satisfy this provision. The existence of an SEC-approved or Commission-approved Services Agreement under this provision shall not be a binding determination on the Commission regarding the reasonableness of charges in a subsequent Commission rate proceeding.

(H) A regulated electrical corporation shall maintain books, accounts, and records separate from those of its affiliated interests.

(I) Upon request of the Commission, electrical corporations 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 consideration given for the goods and services provided.

(J) The regulated electrical corporation shall not participate in any affiliate transactions which are not in compliance with this rule except as otherwise provided in section (9) of this rule.

(*See* Ameren's Proposed Rule, attached hereto as Exhibit C, at 2-3).

Ameren's proposed Section 2 is more light-handed, more flexible, and more narrowly tailored than Section 2 of the currently proposed rule.[7] Parts (A) & (C) effectively prohibit improper discrimination with respect to essential services, *i.e.*, services provided under tariffs, and Part (B) prohibits the utility from informing consumers that it may discriminate with respect to essential services. All three sections leave the utility free to offer its affiliate non-essential services on a preferential basis, thereby preserving the pro-consumer aspects of interaffiliate transactions.

Parts (D) and (E) of the proposed Section 2 effectively deal with concerns related to information sharing. Part (D) protects customer confidentiality while allowing the utility to share non-essential information. Part (E) prohibits the utility from sharing with its affiliates information related to essential services.

Parts (F), (G), and (H) are primarily concerned with cross-subsidization. Part (F) expressly and directly prohibits cross-subsidization, and Part (H) requires complete separation between the utility and its affiliate. Part (G) requires that interaffiliate pricing take place either at cost or at fair market value pursuant to a Commission-approved services agreement. It further provides that a services agreement approved by the SEC under PUHCA is deemed to be satisfactory. Part (G) resolves the conflict between PUHCA and the Commission's currently proposed rule. Furthermore, in comparison to the

[7] The rule proposed by Ameren effectively incorporates agreements reached in its merger stipulation and order preserving the Commission's jurisdiction over retail rates. For example, Section 2(G) above establishes the need to follow an SA but reserves rate authority to the Commission.

broad and vague ban of the current proposed rule, Part (G) allows for flexibility in the administration of the rules without sacrificing any effectiveness.[8]

B. Section 3: "Evidentiary Standards for Affiliate Transactions"

Though Section 3 of the proposed rule is entitled "Evidentiary Standards for Affiliate Transactions," the regulation reaches far more broadly than its title would suggest, and actually imposes significant substantive burdens upon utilities. These burdens fail to take PUHCA or Ameren's structure as a holding company into consideration. In fact, many of these burdens specifically and directly contradict provisions of PUHCA without achieving any other benefits.

Section 3(A). Section 3(A) requires a utility to either "obtain competitive bids ... or demonstrate why competitive bids [are] neither necessary nor appropriate" every time that the utility purchases information, assets, goods, or services from an affiliated entity. In essence, Section 3(A) requires that every utility-affiliate transaction take place within the framework of a competitive bidding process.

The requirements of Section 3(A) are inconsistent with PUHCA. Applied to Ameren, Section 3(A) would require a competitive bidding process every time that UE purchased any good or service from Ameren Services. This would defeat the whole purpose of a services company, which is to ensure realization of efficiencies.

Moreover, Section 3(A)'s bidding process would inevitably cause an increase in the rates paid by consumers. A bidding process would accomplish little if any benefit but would impose tremendous costs. The harms potentially addressed by the bidding requirement are already addressed by PUHCA. As detailed above, PUHCA effectively

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[8] Parts (I) and (J) facilitate the Commission's administration of the rules.

prohibits cross subsidization. Because Ameren Services, as a service company, is prohibited from making a profit, it has no incentive to raise or inflate its cost-based prices. And SEC regulation and monitoring of the prices charged by Service Companies ensures that those prices are competitive with the marketplace. Finally, state regulation of retail prices in Missouri effectively prohibits pass-through of important expenses.

In contrast to the lack of benefits from the bidding process, there are significant costs. The costs of conducting such a process; of ensuring that the process is fair and comprehensive; and of ensuring compliance with the process are very real. These costs will necessarily be passed on to consumers and ratepayers.

Sections 3(B) –3(D). Sections 3(B) – 3(D) are sections that support the more substantive requirements of Section 2 and Section 3(A). Section 3(B) requires a utility to document the fair market price and FDC of any good, service, asset, or information involved in a utility-affiliate transaction. Section 3(C) requires the utility to demonstrate, in connection with the provision of any information, assets, goods, or services to affiliated entities, that it considered various cost measurements related to the transaction and adequately determined the fair market price of the information, assets, goods or services involved. Section 3(D) requires the utility to use a Commission-approved CAM to determine cost allocation, market valuation, and internal cost methods related to any transaction involving the purchase of goods or services by the utility from the affiliate.

All three of these sections threaten to impose onerous burdens without any real benefit. Each may require extensive investigative and administrative work by the utility. As described above, the collection and development of hypothetical cost information and of

information related to fair market value is both time-consuming and expensive. Sections 3(B)-3(D) impose considerable costs without any benefit.

Ameren's Proposed Section 3: As an alternative to Section 3 of the currently proposed rule, Ameren proposes the following rule:

> (3) Evidentiary Standards for Affiliate Transactions.
>
> In transactions involving the purchase of goods or services by the regulated electrical corporation from an affiliated entity, the regulated electrical corporation will use a commission-approved Cost Allocation Manual (CAM) and Service Agreement, as described in Section 2(G), above, which sets forth cost allocation, market valuation and internal cost methods. This CAM can use benchmarking practices that can constitute compliance with the market value requirement of this section.

(*See* Ameren's Proposed Rule, Exhibit C, at 3).

Ameren's proposed Section 3 abandons the competitive bidding process that is flatly inconsistent with PUHCA. It protects against cross-subsidization and discrimination by referencing proposed Section 2(G) and the requirement that interaffiliate transactions take place pursuant to a Commission-approved CAM and SA. It offers the advantages of consistency with federal law, simplicity, efficiency, and effectiveness over the currently proposed Section 3.

C. Sections 4-5: Record-Keeping Requirements

Sections 4-5. Sections 4 and 5 of the proposed rule contain extensive and detailed record-keeping requirements. Section 4 requires the utility to keep extensive and detailed records of information related to its own costs. Section 5 requires the utility to ensure that its parent and each affiliated entity maintain books and records that contain extensive information regarding the affiliate's costs, cost allocation, employee information, and other materials.

Sections 4 and 5 of the proposed rule are largely redundant with the existing record-keeping requirements under Missouri law and the record requirements of PUHCA. To the

extent that they are redundant, the sections do not impose any real cost and therefore are unobjectionable. To the extent that the record-keeping requirements go beyond current requirements of Missouri law or PUHCA, they impose significant costs without any real benefit.

***Ameren's Proposed Sections 4 & 5*:** As an alternative to Sections 4 & 5 of the currently proposed rule, Ameren proposes the following rule:

(4) Record-Keeping Requirements.

(A) Each regulated electrical corporation shall maintain the following information in a mutually agreed-to electronic format (i.e., agreement between the staff, Office of the Public Counsel and the regulated electrical corporation) regarding affiliate transactions on a calendar year basis and shall provide such information to the commission staff and the Office of the Public Counsel on, or before, May 15 of the succeeding year:

1. A full and complete list of all affiliated entities as defined by this rule;
2. A full and complete list of all goods and services provided to or received from affiliated entities;
3. A full and complete list of all contracts entered with affiliated entities;
4. A full and complete list of all affiliate transactions undertaken with affiliated entities without a written contract together with a brief explanation of why there was no contract;
5. The amount of all affiliate transactions by affiliated entity and account charged; and
6. The basis used (e.g., fair market price, FDC, etc.) to record each type of affiliate transaction.

(B) In addition, each regulated electrical corporation shall maintain the following information regarding affiliate transactions on a calendar year basis:

1. Records identifying the basis used (e.g., fair market price, FDC, etc.) to record all affiliate transactions; and
2. Books of accounts and supporting records in sufficient detail to permit verification of compliance with this rule.

(C) For purposes of this Rule, reports made on Form U-5-S and U-13-60 pursuant to the Public Utility Holding Company Act of 1935, or any successor legislation or rules, will be deemed to satisfy this provision.

(5) Records of Affiliated Entities.

(A) Each regulated electrical corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliated entity and charged to the regulated electrical corporation;

2. Documentation of the methods used to allocate and/or share costs between affiliated entities including other jurisdictions and/or corporate divisions;

3. Description of costs that are not subject to allocation to affiliate transactions and documentation supporting the nonassignment of these costs to affiliate transactions; and

4. Policies regarding the availability of customer information and the access to services available to nonregulated affiliated entities desiring use of the regulated electrical corporation's contracts and facilities.

(*See* Ameren's Proposed Rules, Exhibit C, at 3-4).

With regard to Section 4, Ameren's proposed rule has only one change from the currently proposed rule. Ameren's proposed rule adds Section 4(C), which allows the extensive reporting required under PUHCA to satisfy the requirements of the rule.

With regard to Section 5, Ameren's proposed rule eliminates several of the more costly, vague and burdensome record-keeping requirements that bear little relationship to the problems of interaffiliate transactions. Section 2(J) of Ameren's proposed rule supplements the record-keeping and disclosure requirements of the interaffiliate transaction rule, by requiring each utility to make personnel available to answer specific questions of the Commission.

D. The Collective Effect of the Proposed Rule

In summary, several sections of the proposed rule impose significant costs without achieving any real benefits. The proposed rule would largely eliminate the pro-consumer benefits of integration and the service company. Rules that create the need for functional or structural separation create the need for duplication of resources and inputs and should

be considered only if no more costly alternatives exist. The conflict between the proposed rule and Ameren's current operating structure under PUHCA could force the restructuring of Ameren. Furthermore, by imposing broad heavy-handed regulation at this point, the Commission fails to give a chance to the possibility that light regulation might do the job.

The proposed rule will necessarily impose costs resulting from compliance with the rule's various requirements. These costs will inevitably harm the consumer. Furthermore, as Ameren has utilities operating in multiple states, the proposed affiliate transaction rule takes on a higher degree of complexity and cost as applied to Ameren.

IV. The Need for a Contested Case Proceeding

The Commission's proposed rule was published in the Missouri Register only 30-days ago. The Commission has decided to allow only two sets of written comments on the proposed rule and has required that those comments be filed pursuant to a short timetable. Furthermore, the Commission has stated that there will be only a single day of hearings on each proposed rule and the comments that certainly will be submitted.

In light of the complexity and importance of the issues to be addressed by the proposed rule, the current procedures do not appear to be the most effective or desirable manner of proceeding. In lieu of the current proceeding, the Commission should move forward with a "contested case" proceeding pursuant to Missouri law. Such a proceeding would allow full consideration of the various issues related to interaffiliate transactions and would allow development of a record. Given the importance of the issue, its complexity and the requirements of Missouri administrative law, a contested case proceeding, in which each party will be allowed to fully explore the relevant issues, is the only prudent choice. A "contested case" proceeding would allow examination and cross-examination of the

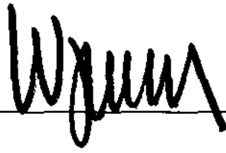
various interested parties, and respected experts in the field, in order to assist the Commission in a complete understanding of the issues at hand. Furthermore, a "contested case" proceeding is probably required under Missouri law. *See* RSMo §§ 386.250; 393.140; and 536.010. A "contested case" proceeding would not cause any significant delay in light of the importance of the issues to be considered and the potential effect of the proposed rule.

CONCLUSION

The Commission has an opportunity to genuinely achieve consumer welfare in the current rulemaking proceeding. There is an undeniable temptation to over-regulate in this area or to apply a simplistic "one-size-fits-all" approach to the potential problem of cross-subsidization. As the foregoing comments demonstrate, however, the approach currently proposed promises to harm consumer welfare far more than it will actually help it.

The Commission should abandon the currently proposed rule in favor of a light-handed approach, such as that proposed by Ameren, that will achieve the ultimate goal of protecting consumer welfare, both by prohibiting undesirable aspects of interaffiliate transactions not already prohibited by existing law, and by allowing realization of the considerable benefits available from interaffiliate transactions. Ameren's proposed rules are consistent with the current trend toward deregulation of regulated utilities and would facilitate a shift to a competitive environment if such a shift is ultimately made. Ameren's light-handed approach is also desirable from a procedural standpoint: if the Commission chooses to impose the heavy-handed and broad rules currently proposed it will be virtually impossible to determine the negative impact of such a regime and virtually impossible to move back to a less strict regulatory regime.

Respectfully submitted,



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DATED: June 30, 1999

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Comments were served upon all parties of record in this proceeding via Federal Express Mail on this 30th day of June, 1999.

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PROPOSED RULE 4 CSR 240-20.015

AFFILIATE TRANSACTIONS

ELECTRIC UTILITIES

COMMENTS OF

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I. Introduction

The Missouri Public Service Commission (MPSC) Staff have proposed three sets of rules to govern affiliate relations between: (1) gas utilities and their unregulated affiliates, (2) electric utilities and their unregulated affiliates, and (3) steam-heating utilities and their unregulated affiliates. The intent of these rules appears to be to prevent the regulated entity from taking actions that may result in rate increases to regulated customers and give the affiliated entity an unfair advantage over its competitors.[1]

I have been asked by Ameren Services Company to provide comments on all of the rules proposed by the MPSC regarding transactions between the regulated utility and its unregulated affiliates. The three proposed rules covering regulated utilities and their unregulated affiliates are virtually identical. Consequently, my comments will address them as a group.

My testimony is organized as follows. Section II describes the general goals that should guide the Commission in its rulemaking regarding affiliate transactions. I advocate rules that will ensure that consumer welfare is maximized through the use of light-handed regulations designed to allow legitimate, competitive activities while preventing anti-competitive abuses. Section III discusses legitimate anti-competitive abuses that should be prevented either through existing rules or through new rules adopted by the Commission. In Section IV, I propose a framework designed to evaluate whether the rules proposed by the staff are appropriate; that is, do they cover legitimate anti-competitive concerns that are not covered adequately by existing rules and whether they

[1] See, for example, definition of preferential services at Section 1F.

deal with these concerns without unnecessarily sacrificing the benefits of competition or consumer welfare. Section V discusses the adequacy of existing rules, such as those enacted by the Securities and Exchange Commission (SEC) for dealing with anti-competitive behavior. Section VI evaluates the rules proposed by the MPSC Staff against the framework developed in prior sections. Section VII provides my conclusions.

II. Overarching Goals of Rules

A. Consumer welfare

The principal objective of the Commission should be to improve consumer welfare. This goal should guide the Commission in its rulemaking on utility-affiliate relations and activities. Consumer welfare is increased if consumers can consume a greater quantity or higher quality of services at lower prices.

Competitive markets offer the greatest opportunity for maximum consumer welfare.[2] In competitive markets, firms face powerful incentives to operate more efficiently. Competition improves firms' operating efficiency in three general areas. First, successful producers improve technical efficiency, attempting to use fewer resources in the production of goods and services. Second, competitive markets improve allocative efficiency by pricing goods and services in a way that allocates scarce resources to their highest-valued use. Third, producers have incentives to increase dynamic efficiency through the introduction of new or higher quality products and through the development of innovative methods of production to gain competitive advantage. The net result is that

[2] Although the electricity industry in Missouri is still regulated, both the Missouri legislature and the Commission have considered the possibility of open access in retail

customers are made better off, goods and services and production methods continually evolve to better meet customers' needs at lower costs, and only the most efficient firms survive.

A fundamental principle of economics is that consumer welfare is maximized when prices for goods and services reflect the costs to society of their supply. Choices made by consumers based upon prices that reflect costs will lead to economic efficiency, with the "right" amount of goods and services supplied at the lowest possible cost.

B. Prevention of anti-competitive activities without sacrificing the benefits of competition or reducing consumer welfare

The Commission should be concerned with establishing rules that achieve the benefits of competitive markets. This requires regulations to ensure that firms are able to compete based on their merits and to safeguard against anti-competitive activities. For example, safeguards should be implemented to prevent a regulated utility from giving an unfair advantage to its affiliate(s) over other competitors through cross-subsidies between regulated and unregulated entities, or by engaging in discriminatory access to essential facilities and information that the regulated entity controls. However, all competitors should be able to exploit their legitimate competitive advantages so they can be effective in the marketplace.

To foster effective competition, the Commission must distinguish between legitimate competitive advantage and illegitimate advantage. Destroying legitimate competitive advantage subverts the competitive process, making superior firms less

---

electricity markets, as several other states have done.

efficient and enabling less efficient firms to enter the market. The net effect is a loss in welfare due to reduced efficiency.

Legitimate competitive advantage comes from investment in all phases of business, including production, distribution, management, service, marketing, and products. One type of legitimate competitive advantage is economies of scale and scope. Economies of scale occur when the average cost of production falls with increases in the quantity produced. With increased production, average costs can decline through a variety of means. It is possible for firms to reduce costs of factor inputs, use more efficient-sized equipment, or spread fixed costs over greater volumes of sales. Achieving these scale economies results in a lower-cost firm that is better able to serve customers' preferences.

Economies of scope occur when a single firm lowers per-unit costs by producing or marketing a variety of goods rather than each good being made and sold by a separate firm. This type of integration can lower average costs by allowing a firm to use the production factors or knowledge of one product to produce another.

The joint use of inputs or facilities, joint marketing programs, and the sharing of corporate support services such as accounting, human resources, and finance create scope economies. Eliminating the cost savings from these economies will make the utility and its affiliates less efficient and will reduce consumer welfare through increased prices. All firms should be allowed to compete fairly with whatever legitimate advantages they bring to the market.

Consumers will be harmed if regulators establish rules that prevent firms from exploiting economies of scale and scope. Examples of harmful regulation would include

forced separation of integrated units, restricting the expansion of utilities into unregulated areas, and prohibiting the sharing of overhead expenses such as accounting, legal, and finance through service affiliates. If integration provides the most efficient organizational form, unregulated rivals will be integrated. Unregulated affiliates of a regulated utility should not be prevented from developing or maintaining operating economies through integration.

C. Light-handed and even-handed regulation should be used whenever possible

Light-handed regulation is characterized by general rules to protect legitimate company practices while prohibiting illegitimate activity. Unnecessary and over-broad regulations are among the strongest impediments of efficiency. Regulators must be ever vigilant to guard against this misuse of the regulatory process to unduly handicap utilities in unregulated markets. The more effective and efficient competitors are, the better they will serve the public.

Regulators should also understand the difficulties of undoing overly restrictive rules. Once restrictive rules are put in place, the party or parties who benefit from them have a strong incentive to resist change. Heavy-handed or uneven regulation unnecessarily harms firms and will lead to inefficiencies. However, these inefficiencies will be difficult for rulemakers to observe, and hence regulators may never realize the magnitude of their harm. Light-handed regulation allows regulators to observe the results of relatively unconstrained developments in an industry. However, regulators will retain the ability to adopt more stringent rules if participants in the industry are able to circumvent regulatory intent. The Illinois Commerce Commission agreed with this

approach in its 1998 decision on Non-Discrimination Ratemaking, saying that "the only real way to test a market is to observe it over a reasonable period of time and to draw conclusions based upon empirical observations. Through these observations, the Commission hopes to develop over time a better understanding of where restrictions are or are not needed."[3]

III. Legitimate Anti-Competitive Concerns with Affiliate Relations

This section will address legitimate anti-competitive concerns that the Commission and other regulatory bodies, such as the SEC, should guard against. The goal of the Commission should be to ensure that the playing field is level and that all competitors have the opportunity to succeed or fail based on their own competitive merits.

When evaluating competitive conditions in the industry, regulators must distinguish between legitimate competitive advantage and illegitimate advantage. Destroying legitimate competitive advantage, such as economies of scale and scope, in order to favor new entrants subverts the competitive process, making superior firms less efficient and less able to compete on the merits of their abilities. Similarly, preventing incumbents from capitalizing on their reputation by imposing handicaps to favor entrants only harms consumers.

The Commission should be concerned, however, with preventing illegitimate advantage. Illegitimate advantage by an incumbent utility might take two forms, cross-subsidization and discrimination. Discrimination can be anti-competitive when it relates to essential facilities or information.

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[3] Illinois Commerce Commission, Dockets 98-0013 and 98-0035, 6/12/98, p. 25.

A. Cross-Subsidization

Cross-subsidization means that a utility could, in effect, tax customers in regulated markets to subsidize its unregulated subsidiary in providing competitive products or services. This could occur, for example, if unregulated subsidiaries were all to receive services from or share facilities with a utility below cost, or if a utility were to pay for services or products from the subsidiary at above-market prices.

Cross-subsidization is illegitimate because it could enable a utility's affiliate to gain an unfair advantage over competitors. For example, the affiliate could sell its service below the market price, possibly to gain market share, and then offset the loss by charging customers of the regulated utility a price that exceeds what ratepayers would otherwise pay.

B. Discriminatory access to essential facilities

Discriminatory access to essential facilities occurs if a regulated utility provides preferential treatment to its affiliate over competitors with respect to pricing, access, and quality of service for the utility's facilities or services that competitors must use in order to compete effectively. Primarily, these services or facilities are those that cannot be practicably or efficiently duplicated by each competing firm in the market, such as a utility's transmission and distribution facilities. Discrimination with respect to such facilities or services is illegitimate because it provides a utility's competitive operations using those facilities with an unfair advantage over competitors, who also depend on the utility for provision of these facilities and therefore should have non-discriminatory access to them.

C. Discriminatory access to essential information

Essential information refers to exclusive information of competitive significance about a utility's regulated operations that a utility acquires by virtue of its status as a regulated monopoly in a service area. Utilities could choose to share this information with only its own affiliated competitive operations. Since, by definition, potential competitors need access to this information in order to compete, asymmetric access to essential information will provide an unfair competitive advantage to the utility's affiliate. In other words, a utility should have to share information relating to the operation of essential facilities with all competitors; to do otherwise would give its competitive services an unfair "insider" advantage.

Essential information can fall into two categories. The first is aggregated, non-customer-specific information necessary to use essential facilities. This information should be available to all market participants without discrimination. The second is regulated customer information and contacts. Utilities and other regulated entities receive information about individual customers and their product demands by virtue of their position as an exclusive provider in a service area. Such information should be made equally available to all competitors if and as required to do so by customers. Non-public information that the utility receives from unaffiliated companies should also be treated confidentially, so that the utility does not benefit from information about a non-affiliated customer or competitor. Similarly, some circumstances dictate that information be kept from certain utility personnel. For example, personnel responding to utility service disruptions should not be aware of whether the customer purchases services from affiliated or unaffiliated marketers.

Conversely, forcing the regulated utility to share non-essential information with all potential competitors can give competitors an unfair advantage over the utility's affiliate and increases the costs of the utility and its affiliates. The utility should retain proprietary rights over information that does not provide an unfair competitive advantage in other markets. In other words, information that does not relate to essential facilities or services, in most cases, is information that the utility should not be compelled to share with non-affiliated suppliers. This would cover areas, for example, such as corporate support, human resources, internal policies of the utility, and marketing of the utility's competitive services. Regulation that increases the utility's costs or provides any competitor with sensitive utility information that is not essential for competition, such as new products that the utility is planning to offer or segments of the market that it plans to target, is unfair and would inhibit competition. This is why, under the antitrust laws, the mere fact that obtaining useful market and customer information may require considerable effort and expense does not make it "essential" and thus subject to forced sharing. Customer-specific information should be released to unregulated affiliates or competitors only at the request of the customer.

IV. Suggested Criteria for Commission Decision Making

Given the goals described above, I suggest the Commission consider the following framework in developing rules that will govern affiliate transactions.

A. Do the rules address legitimate concerns?

The Commission should adopt rules only when fair and effective competition requires. The rules should focus narrowly on preventing specific anti-competitive behavior without

unnecessarily eliminating the utility's legitimate competitive advantages, which serve to benefit customers. For example, efficiency advantages that flow from economies of scale and scope legitimately "belong" to the firm that has achieved them. Similarly, a utility's experience in traditionally providing services that are later open to competition is an advantage that will be reflected in the level of prices it charges for its services. Regulators need to differentiate carefully between ensuring access to essential facilities and information, and confiscating a utility's unique competitive advantages. Consumer welfare is maximized when competitors are able to provide and price their services to reflect their advantages.

B. Do current rules exist that address potential problems effectively?

Where legitimate concerns about anti-competitive behavior do exist, mechanisms may already be in place to prevent such behavior. In these instances, adding new rules and regulations could create inefficiencies that would reduce consumer welfare. If new Commission rules are redundant, this could create increased compliance costs with no commensurate benefit. If rules already apply to some companies but not others, the Commission should attempt to pattern its rules after the existing ones.

C. Where rules are necessary, the Commission should adopt rules for which the benefits outweigh consumer welfare losses.

When the Commission finds that regulations do not exist for legitimate areas of concern, light-handed rules should be developed for which the benefits exceed the costs. The regulations should focus as narrowly as possible on preventing anti-competitive behavior

while, to the maximum extent possible, enabling the firm to retain legitimate competitive advantages that create benefits for consumers.

V. Existing Rules that Apply to Ameren

Several existing rules, regulations, and legislation, at both the state and federal levels, already address the relationship between Ameren's regulated utility operations and those of its unregulated affiliates. Duplication of enforcement efforts necessarily increases the costs of compliance. Furthermore, in addition to existing regulation rendering some of Staff's proposed rules unnecessary, some proposed rules create an outright conflict with the requirements of other regulatory bodies. Compliance may not only be costly, but unfeasible.

The issues of primary concern to the MPSC Staff are cross-subsidization, preferential treatment, and discriminatory access to essential facilities. However, Ameren is subject to financial regulation by the SEC under the Public Utility Holding Company Act (PUHCA). PUHCA limits both the organization of the company and prices that may be charged between affiliates. These regulations ensure against cross-subsidies. In addition, the Federal Energy Regulatory Commission (FERC) has established operational codes of conduct for electric marketing operations. The regulations established by each of these agencies are discussed in more detail below.

1. SEC regulation of public utility holding companies was established, in large part, to address abuses of utilities' regulated customers through cross-subsidies to unregulated subsidiaries in a previous era. SEC regulations govern both the structure of holding companies and transactions among companies in a holding

company. Holding companies must include a services entity as a locus for centrally supplied administrative services such as human resources, tax services, state and federal regulatory activities, and treasury operation. Prices between entities in a holding company are established at fully allocated costs as approved by the SEC. Regulations require that the holding company keep a cost allocation manual to track costs between services, and the manual is subject to SEC regulatory approval.

2. FERC has established rules to ensure nondiscriminatory access to essential facilities under Order 888, which mandates open access for electric transmission access. While there has been some evidence of certain problems in the application of the FERC Code of Conduct, that FERC has been able to address discrimination issues successfully suggests that effective regulation of access to essential facilities exists.

A further indication of the effectiveness of these federal regulations in addressing concerns contained in the Staff's proposed rules is the Illinois Commission's approval of the merger of Union Electric and Central Illinois Public Service into Ameren. As a condition of the approval, the utilities had to demonstrate that there would be no cross-subsidization and that proper cost allocation would take place. The Illinois Commission was satisfied with the measures that Ameren adopted and imposed no further regulation.

VI. Evaluation of Commission Staff's Proposed Rules

The MPSC Staff's proposed rules attempt to address (1) the potential for cross-subsidies between regulated and unregulated operations; (2) preferential and discriminatory access

to information and services supplied by the regulated utility which confer unfair advantage on the affiliated entity over competitors; (3) employee transfers between regulated and affiliated entities; and (4) forced access to information. However, as discussed below, the proposed rules seem to go further and attempt to limit some of the utility's legitimate competitive advantages that should benefit customers in competitive markets as well as regulated ratepayers. The Staff's reach in these instances would, if approved, undermine consumer welfare.

Staff has identified preferential services that can confer an unfair advantage on competitive affiliates as including any asymmetric information, treatment, or actions of the regulated utility. The Staff's proposed rules appear to be broader in scope than necessary and will tend to dampen the efficiency of competitive markets that affiliate companies participate in. Legitimate preferential services concerns should be limited to those relating to access to essential facilities and information.

Staff has included employee transfers between regulated and unregulated entities as an area of concern. Except in limited circumstances, in which employees may have competitively sensitive knowledge or information, the rules Staff has proposed exceed the bounds of legitimate concerns. Employees' training and experience belongs to them, not to the regulated utility. Moreover, it is difficult to see how Staff's requirement to consider market and fully allocated cost in setting prices would apply in the case of employees. Furthermore, this requirement places an asymmetrical burden on the utility's competitive affiliate. Regulated utility employees are free to seek employment with the affiliate's competitors without commensurate payment requirements.

Staff has included standards for broad access to utility information. Their concern with access to information is legitimate only insofar as it is required for the use of facilities essential to supply of competitive services. Staff's rule appears to require utilities to share proprietary information that is legitimately confidential with an affiliate's competitors.

A. Staff's proposed standards regarding provision of financial advantage to affiliated entities by regulated electric, gas and steam heating utilities

Staff's proposed rules address means by which regulated utilities could confer advantage on unregulated affiliates. Section 2A requires that exchanges of goods and services between utilities and affiliates be conducted in a manner that does not confer any financial advantage to the regulated utility; compensation must be set at either market price or fully distributed cost, whichever is most advantageous to utility customers. Section 2B prohibits the provision of preferential service, information or treatment to an affiliated party over another party *at any time* (emphasis added). Section 2C introduces the ability for a regulated utility to apply for a variance from the requirements of Sections 2A and 2B. Section 2D requires that if a customer requests information from a utility regarding its competitive services, the utility must also supply information regarding non-affiliated entities that provide the same goods or services.

While Section 2A addresses the legitimate concern of preventing cross-subsidy, in Ameren's case cross-subsidy concerns are adequately addressed by the requirements of the SEC under PUHCA. In fact, the financial standard set under Section A is inconsistent with that embodied in SEC's regulations and inconsistent with the service company

format that the SEC requires. Furthermore, the provisions of Section A go well beyond those necessary to ensure that cross-subsidy is averted by setting a financial standard that serves to undermine advantages a competitive affiliate could realize in the market.

As written, the universal prohibition on provision of preferential service to affiliated entities in Section 2B appears to preclude the legitimate sharing of normal and nonessential business information and facilities. To the extent that nondiscriminatory access to essential facilities needs to be assured, the FERC Code of Conduct covers many of the important issues for electricity markets. Any additional concerns can readily be handled in a similar fashion.

In contrast, the Staff's suggested approach attempts to ensure nondiscriminatory access to essential information and facilities by requiring nondiscriminatory access to any and all information and facilities. As I have emphasized earlier, a heavy-handed access requirement that does not distinguish between essential and nonessential facilities harms consumers and markets by handicapping a participant's ability to bring to market its legitimate competitive advantages.

Section 2C provides a means for regulated utilities to apply for variances from the requirements of Sections 2A and 2B. This section provides for flexibility in the administration of the rules. However, it would be better to impose only necessary restrictions rather than impose greater restrictions and allow them to be appealed. Regulation should be used sparingly and only where clear need or experience demonstrates its desirability.

Section 2D requires that utilities supply information regarding competitors of their unregulated affiliates to customers who inquire about goods or services provided by

an affiliate. The requirement to offer information regarding competitors to inquiring customers makes sense only if a reciprocal obligation falls upon one's competitors. Competitive markets rely on participants to take responsibility for advertising their availability and make representation as to their capabilities. These regulations will serve only to increase utility costs and thus to reduce consumer welfare.

B. Staff's proposed evidentiary standards for affiliate transactions by regulated electric, gas and steam heating utilities

The regulations proposed by Staff place an unwarranted burden on regulated utilities purchasing information, goods and services from an affiliated entity. Section A requires utilities either to obtain competitive bids for services or to demonstrate why competitive bids were neither necessary nor appropriate. In Ameren's case it appears likely that this requirement would include purchases from Ameren Service Corporation, which according to SEC regulations must take place (primarily) at fully allocated cost. Transfer at fully allocated costs or market prices insures the absence of cross-subsidies. For holding companies such as Ameren who already meet this standard, no further regulation or rules are required. Bidding for service supplied by the service company would be burdensome and should not be required as long as SEC transfer pricing is followed. Section B requires documentation of both the fair market value and the fully allocated costs from Section A. Section C requires a demonstration the costs documented in Section B are appropriate to the transaction, (i.e., that they are comprehensive, cover a relevant time period, include appropriate joint and common costs, and market value is adequately determined). Section D also requires that the regulated utility rely on a Commission-approved cost allocation manual in transactions with its affiliates.

Ameren's obligations to the SEC under PUHCA already adequately address transfer prices to affiliates and any legitimate documentation concerns that the Commission might have. The Staff's evidentiary standards are thus unnecessary and will serve only to increase utility costs and reduce consumer welfare.

C. Staff's proposed record keeping requirements

In Sections 4, 5, and 6 of the proposed rules, MPSC Staff have proposed an extensive set of record keeping and record retention requirements for regulated utilities and their affiliates. Some standards for information and record keeping are clearly necessary for regulators in their enforcement role. However, the Commission should require only information sufficient to insure that needed regulations are being followed. Staff's proposed requirements greatly exceed this standard for a number of reasons. First, some of the proposed regulations are excessive as I discuss elsewhere. Second, the information required is unduly burdensome, and much of it is not limited to essential enforcement activity. Third, the breadth of information required (including confidential information) is excessive and potentially risks exposure of proprietary information. Fourth, the requirements are inequitably applied, distorting competition in affiliate markets. They are only applicable to utilities regulated by the MPSC. Affiliates of utilities regulated outside of Missouri or of other large corporations escape these requirements.

VII. Conclusions

The MPSC Staff's proposed rules attempt to address several legitimate and important issues regarding the relationship between a regulated utility and its unregulated affiliates. Certain transactions between regulated entities and its affiliates require clear, precise

rules in order to ensure that consumers benefit from effective competition. However, I believe that the Staff could improve its proposal to meet anti-competitive concerns while preserving legitimate competitive advantages. Specifically, I conclude the following:

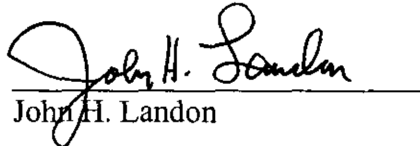
- Consumer welfare should be paramount in deciding on appropriateness of rules.
- Only those utility services and information that are essential for fair and effective competition should be subject to regulation.
- Where intervention is necessary, the Commission should act as light-handedly and as narrowly as possible.

AFFIDAVIT

STATE OF CALIFORNIA)
)
CITY AND COUNTY OF SAN FRANCISCO)

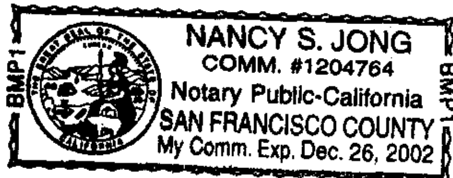
BEFORE ME, the undersigned authority, on this day personally appeared John H. Landon, who, having been placed under oath by me, did depose as follows:

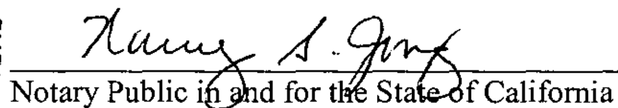
My name is John H. Landon. I am of legal age and a resident of the State of California. The foregoing Statement offered by me on behalf of Ameren Corporation and Union Electric Company is true and correct, and the opinions stated therein are, to the best of my knowledge and belief, accurate, true and correct.



John H. Landon

SUBSCRIBED AND SWORN TO BEFORE ME by the said John H. Landon this [29th] day of June, 1999.





Notary Public in and for the State of California

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PROPOSED AFFILIATE TRANSACTION RULES	PUBLIC SERVICE COMMISSION OF MISSOURI

STATEMENT

OF

WILLIAM T. BAKER, JR.

ON BEHALF OF

UNION ELECTRIC COMPANY

June 29, 1999

EXECUTIVE SUMMARY

My name is William T. Baker, Jr. and I am an attorney with the law firm of Thelen Reid & Priest LLP. I am submitting this Statement on behalf of Union Electric Company (UE). I have represented registered electric and gas utility holding companies for more than 30 years in proceedings before the Securities and Exchange Commission (SEC) arising under the Public Utility Holding Company Act of 1935 (PUHCA), and I am currently representing UE's parent company, Ameren Corporation (Ameren), which is organized as a registered holding company under PUHCA, and Ameren Services Company (Ameren Services), a subsidiary service company of Ameren which provides certain administrative, technical and management services to UE and Ameren's other utility and non-utility subsidiaries.

As a registered holding company, Ameren is subject to the "integration" standards of PUHCA, which, among other things, require that Ameren's electric utility system, which is comprised of the combined properties of UE and Central Illinois Public Service Company (CIPS), be operated as a single interconnected and coordinated public-utility system. In this connection, when the SEC approved the combination of UE and CIPS in late 1997, it made findings that the electric operations of the two companies would constitute an "integrated" system and that substantial economies and efficiencies were likely to result from coordinated utility operations, personnel reductions, elimination of duplicate corporate functions, and joint purchasing.

Service companies like Ameren Services are the vehicle through which registered holding companies centralize many of the common management, administrative and corporate support functions of a registered holding company system in order to achieve overall cost savings and efficiencies that will benefit all members of the holding company system. Ameren Services was formed at the time of the UE/CIPS combination and is staffed in part by personnel who were transferred from UE and CIPS.

Under PUHCA, the SEC affirmatively regulates all aspects of the organization of and conduct of business by service companies. When Ameren Services was formed at the time of the UE/CIPS combination, the SEC specifically approved the categories of services to be provided and methods of allocation to be used by Ameren Services. Any changes to Ameren Services' organization or to the categories of services or methods of allocation must also be approved by the SEC. Under PUHCA, service companies must charge their fully allocated cost to all affiliates.

SEC regulation of Ameren Services plays an important part in ensuring that charges to UE by Ameren Services and Ameren's other subsidiaries are fair and reasonable and no higher than charges to other affiliates of Ameren for similar services. In this regard, PUHCA prevents cross subsidization and assures that affiliate transactions are performed at "cost" (as defined in the SEC's rules), fairly and equitably allocated.

The Commission's proposed affiliate transaction rules would subject affiliate transactions involving UE to transfer pricing rules that are odds with the SEC's "at cost" rule and could also make it more difficult for UE to realize the economic benefits of operating within an "integrated" public utility holding company system.

STATEMENT OF WILLIAM T. BAKER, JR.

INTRODUCTION AND STATEMENT OF QUALIFICATIONS:

My name is William T. Baker, Jr., and my business address is 40 W. 57th Street, New York, New York 10019. I am a partner in the law firm of Thelen Reid & Priest, LLP. I have been associated with Thelen Reid & Priest (and its predecessor, Reid & Priest) since 1968. Throughout my career, I have represented registered holding companies and their subsidiaries before the Securities and Exchange Commission (SEC) in proceedings under the Public Utility Holding Company Act of 1935 (PUHCA). Among other matters, I have represented registered holding companies in connection with utility acquisitions and mergers and in organizing various different types of service company subsidiaries. I currently represent Ameren Corporation (Ameren), a registered holding company, and its subsidiaries on PUHCA matters.

I have been asked to explain the requirements of PUHCA as they apply to Ameren and its subsidiaries, with particular reference to the "integration" standards of PUHCA and the role that PUHCA regulation plays in ensuring that transactions among affiliates of a registered holding company involving the sale of goods (other than electricity and gas) or services or other property are performed at cost, fairly and equitably allocated, and that such affiliate transactions do not result in cross-subsidization of non-utility affiliates (including affiliated power marketers) at the expense of utility ratepayers. In this respect, as I explain below, PUHCA regulation seeks to achieve many of the same proper cost allocations and anti-cross subsidization goals as the Commission's proposed rules on affiliate transactions.

In this Statement, I intend to cover four basic topics: in Part I, I will describe how Ameren is structured and organized as a registered holding company under PUHCA, with particular reference to the so-called "integration" standards of PUHCA. In Part II, I will describe, in general terms, the operations of a service company, such as Ameren Services Company, Inc. (Ameren Services), within a registered holding company system and detail how service companies are regulated by the SEC. In Part III, I will describe other provisions of PUHCA that are specifically intended to prevent cross-subsidization of non-utility affiliates. Finally, in Part IV, I address areas of potential conflict between the Commission's proposed affiliate transaction rules and requirements of PUHCA that apply to Union Electric Company (UE) and Ameren Services.

I. <u>AMEREN'S CORPORATE STRUCTURE</u>

Ameren is an investor-owned, public utility holding company. Ameren was created in 1997 to facilitate the combination of UE and Central Illinois Public Service Company (CIPS). As a result of that transaction, the common stockholders of UE and CIPS became the shareholders of Ameren, and UE and CIPS are now wholly-owned subsidiaries of Ameren. Ameren also holds, directly or indirectly, the stock of several companies which, for purposes of PUHCA, are not treated as public utility companies. Some of these subsidiaries were subsidiaries of UE and CIPS before the merger.

Under PUHCA, a registered holding company (like Ameren) and its subsidiaries are subject to comprehensive regulation with respect to financing and capital structure, intercompany extensions of credit, service company arrangements and other affiliate transactions involving the sale of goods (other than electricity and gas), services, utility assets and other property, non-utility diversification, the declaration and payment of dividends, and other matters. In most cases, SEC approval is

required for specific corporate transactions.

Registered holding companies like Ameren are subject to the so-called "integration" standards of PUHCA, which are contained in Section 11(b)(1). Specifically, a registered holding company, like Ameren, must limit its utility operations to "a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public utility system." 15 U.S.C §79k(b)(1). There is, however, a narrow exception: PUHCA permits a registered holding company to retain one or more additional public utility systems if the separation thereof would result in loss of substantial economies. Ameren's integrated electric system consists of the electric generation, transmission and distribution properties of UE and CIPS. In addition, when the SEC approved the UE/CIPS combination, it permitted these companies to retain their secondary gas distribution businesses under the exception noted above.

The UE/CIPS combination was subject to the standards of Section 10 of PUHCA. In general, in order to approve a merger of utilities, Section 10(c)(2) provides that the SEC must affirmatively find that the transaction "will serve the public interest by tending towards the economical and efficient development of an integrated public-utility system." 15 U.S.C. §79j(c)(2). An "integrated" system, as applied to electric companies, is defined in Section 2(a)(29)(A) of PUHCA to mean "a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities [which are] physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system . . .." 15 U.S.C. §79b(a)(29)(A). Thus, in order to approve a merger of electric utilities, the SEC must find, in effect, that the facilities of the separate companies

are physically interconnected and will be operated in a coordinated manner as if they were parts of a single enterprise. Typically, this means that the power plants of the separate companies will be economically dispatched, without regard to ownership, in order to meet the demand on the system as a whole. All of the registered electric utility holding companies also have put in place Federal Energy Regulatory Commission (FERC) - approved system operating agreements which govern the use of the generation facilities of all of the utility companies in the holding company system and the allocation of the costs of those facilities. In Ameren's case, this agreement is the Joint Dispatch Agreement between UE and CIPS.

As required by Section 10(c)(2) of PUHCA, UE and CIPS had to make an affirmative showing at the time of the merger that the combination of the two companies under Ameren would serve the public interest by tending towards the economic and efficient development of an integrated public utility system. In their application, UE and CIPS forecast savings of more than $700 million during the 10-year period following the merger. These projected savings were in the form of operating efficiencies, reductions in personnel, elimination of duplicate corporate functions, and economies in purchasing materials and supplies. The SEC accepted these projected savings.

One of the central policy objectives of PUHCA was to assure that the benefits of localized management and effective regulation of utilities would not be impaired by the holding company structure. At the same time, Congress understood that there are significant benefits to be derived from integrated operation of separate utilities in a holding company structure which are in large measure attributable to the common management, direction and planning provided by the holding company parent. Congress also determined, after considerable debate, that there were significant benefits to be derived through the use of centralized service organizations, provided that the costs

of such entities and the methods by which they allocate their costs to their affiliates were made subject to ongoing regulatory review.

The combination of UE and CIPS under Ameren has allowed for the continuation of the separate legal existence of UE and CIPS and preservation of effective regulation, while at the same time facilitating the realization of operating efficiencies and cost reductions through centralization of certain corporate support functions. Although UE and CIPS share a common parent, each company raises its own external debt capital and owns its own properties. The holding company structure also allows for a greater degree of separation between the regulated utilities (UE and CIPS) and Ameren's non-utility subsidiaries. This separation tends to insulate the utility companies from the business risks associated with Ameren's unregulated businesses.

II. REGULATION OF SERVICE COMPANIES UNDER PUHCA.

A service company is a subsidiary of a registered holding company that is formed in order to provide centralized managerial, technical, financial, legal, regulatory compliance, engineering, purchasing, marketing, auditing, statistical, advertising, tax, research and other corporate support services, information or data to its affiliated companies at cost. As explained below, the use of service companies enables registered holding companies to capture economies of scale and other efficiencies by reducing duplication of corporate support functions by each of the affiliate companies in a holding company system. Ameren Services, which is wholly-owned by Ameren, is a subsidiary service company. It was organized at the time of the UE/CIPS merger.

Service companies are an efficient and more effective way to provide services to a group of utilities within a holding company system, because they allow for the centralization of various

common services, information systems and other resources that can be shared. Therefore, duplication is minimized. For instance, a holding company with multiple operating subsidiaries may need only one payroll department, one personnel department, one accounts payable department, etc. Also, duplicate information systems (computers, internal communications systems) can be combined in a service company. This centralization also leads to economies of scale because additional expenses may be incurred as marginal costs as opposed to fixed costs. Another important benefit of the service company structure is the ability of operating companies within a holding company system to share information, experience and knowledge.

Under PUHCA, the SEC reviews the relationships between service companies like Ameren Services and the registered holding company affiliates that they serve on an ongoing basis. Specifically, when it authorized Ameren to organize Ameren Services, the SEC considered and approved the form of general services agreement that is now in use between Ameren Services and its affiliates. The general services agreement sets forth the types and categories of services Ameren Services has agreed to provide to UE and its other associate companies and the methods of cost allocation it must use. The SEC's order approving the merger indicated that UE and CIPS would both transfer some personnel to Ameren Services. Further in its order approving the formation of Ameren Services, the SEC provided that Ameren Services may not change its organization, the type and character of the companies it serves, its methods of cost allocation, or the scope or character of the services it provides without notifying the SEC in advance. Any such changes require prior SEC authorization.

Although UE and CIPS are by far the largest customers of Ameren Services, Ameren Services is authorized by the SEC to render similar corporate support services to Ameren's other

subsidiaries as well. The system service agreement contains cost allocation methodologies that are designed to ensure that the non-regulated businesses are charged properly for the services they receive from Ameren Services. This effectively prevents any cross-subsidization by UE and CIPS of Ameren's unregulated subsidiaries through Ameren Services.

Section 13 of PUHCA provides that a subsidiary of a registered holding company can enter into or perform a service contract with an associate company only upon approval by the SEC and only if such contract is performed "economically and efficiently for the benefit of [the companies serviced] at cost fairly and equitably allocated among such companies." (Emphasis supplied). 15 U.S.C. §79m(b). The heart of the SEC's regulation of service companies is this so-called "at cost" rule. Service companies like Ameren Services are organized as non-profit (or "break even") companies. In other words, Ameren Services cannot make a profit on any services it provides to affiliates, and, with minor exceptions, the SEC has historically barred service companies from engaging in any significant amount of business with non-affiliates. The SEC's "at cost" rule is designed to capture all of the costs of a service company and then assign or allocate those costs to affiliated client companies based on the amount and type of services performed.

The SEC applies specific rules to ensure that service companies comply with the "at cost" requirement by specifying how "cost" is to be determined. 17 C.F.R. §250.91 (1998). Specifically, SEC Rule 91 provides that a "transaction shall be deemed to be performed at not more than cost if the price (taking into account all charges) does not exceed a fair and equitable allocation of expenses . . .". 17 C.F.R. §250.91(a) (1998). Importantly, SEC Rule 91 also addresses the allocation of costs among several companies receiving services. SEC Rule 91 provides that "direct costs shall be made so far as costs can be identified and related to the particular transactions involved without excessive

effort or expense. Other elements of cost, including taxes, interest, other overhead . . . shall be fairly and equitably allocated. . . ." 17 C.F.R. §250.91(b) (1998). SEC Rule 91 also requires that when a service company determines its cost, it may not include any expense in a transaction with an associate company to the extent it exceeds the cost of the transaction to the associate company. 17 C.F.R. §250.91(c) (1998)

Although the SEC "at cost" pricing standard does not guarantee that a utility company will always receive the lowest price available for comparable goods and services purchased from an affiliated service company, ongoing SEC regulation of service companies, including periodic audits, are designed to ensure that service companies remain economic and efficient providers of services. SEC approval of the costs that a service company may charge to its affiliated utilities does not preclude state commissions from disallowing such costs in a utility's retail rates. Nevertheless, it has been my experience that state commissions have generally accepted SEC-approved charges for service company costs.

The SEC's rules also require that Ameren Services and other service companies keep books and records in accordance with SEC's Uniform System of Accounts for Mutual and Subsidiary Service Companies, which was adapted from FERC's uniform system of accounts for public utilities, and to file an annual report with the SEC. SEC Rule 93 provides that service companies must keep "accounts, cost-accounting procedures, correspondence, memoranda, papers, books, and other records in such manner and preserve them for such periods" as the SEC requires. 17 C.F.R. §250.93 (1998). In addition, SEC Rule 94 requires that every year, on or before the first of May, every service company that is a subsidiary of a registered holding company must file with the SEC a report for the prior calendar year. The annual report that Ameren Services files provides a comparative

balance sheet, with the following schedules: service company property accumulated provision for depreciation and amortization of service company property, investments, accounts receivable from associate companies, fuel stock expenses undistributed, stores expense undistributed, miscellaneous current and accrued assets, miscellaneous, deferred debts, research, development or demonstration expenditures, proprietary capital, long-term debt, current and accrued liabilities, and notes to financial statements. A comparative income statement also must be filed, along with the following schedules: analysis of billings, analysis of charges for service, schedule of expense by department or service function, departmental analysis of salaries, outside services employed, employee pensions and benefits, general advertising expenses, miscellaneous general expenses, rents, taxes other than income taxes, donations, other deductions, and accompanying notes to statement of income. In short, the annual report Ameren Services files with the SEC provides a significant amount of information from which the SEC can determine whether Ameren Services is in compliance with the terms of the SEC merger order and the SEC's service company rules.

It is clear that the SEC's system of service company regulation ensures that Ameren Services' charges to UE will be "at cost, fairly and equitably allocated among [associate] companies." PUHCA regulation, therefore, is another control and safeguard against cross-subsidization and improper cost allocation. Indeed, PUHCA's statutory goals are parallel to the goals that the Commission's proposed affiliate transaction rules seek to achieve in that they help to ensure that Ameren Services' charges are reasonable and necessary affiliate expenses, allocated fairly among Ameren's regulated companies, and that charges to UE are no higher than charges to other companies receiving similar services. In essence, the billing and cost allocation systems imposed by PUHCA go a long way to ensure that individual costs billed by Ameren Services to UE comply

with the proposed rules.

The SEC's cost rules apply not only to services provided by service companies, but also to goods and services provided by utility subsidiaries to each other. In this connection, the SEC order approving the UE/CIPS merger specifically contemplated that UE and CIPS would provide a variety services, such as meter reading, materials management, and line services, to each other at cost. Likewise, when one utility sells any part of its utility assets to an affiliate, the SEC has usually insisted that the price be limited to the seller's cost of the asset transferred, less accumulated depreciation. The SEC's position is that transactions among members of an integrated system should not be priced to produce a profit for the seller or a subsidy or windfall to the buyer. The SEC has rarely granted exceptions from this "at cost" transfer pricing standard.

III. EXPRESS LIMITATIONS UNDER PUHCA ON CROSS-SUBSIDIZATION.

There are other provisions of PUHCA and the SEC's rules which were specifically intended to insulate utility subsidiaries from the business risks of non-utility affiliates and to prevent cross-subsidization of non-utility affiliates. When Congress amended PUHCA in 1992 and again in 1996 in order to allow registered holding companies to invest in "exempt wholesale generators," "foreign utility companies" and "exempt telecommunications companies," the amending legislation included various specific protections designed generally to prevent cross-subsidization and anti-competitive behavior by domestic utility companies. For example, under Section 32, a utility must obtain state commission approval to purchase electricity from an affiliated "exempt wholesale generator." Under Section 33 of PUHCA, a domestic utility may not pledge or encumber its assets for the benefit of any affiliated "foreign utility company." Under Section 34, a utility may not purchase

telecommunications services from an affiliated "exempt telecommunications company" unless the affected state commissions have approved. Also, utilities may not transfer certain rate base assets to an affiliated "exempt wholesale generator" or "exempt telecommunications company" without first obtaining state commission approval.

The SEC has also promulgated rules under Sections 32 and 33 which, among other things, limit the amount of services that domestic utility companies may provide to associate companies which are "exempt wholesale generators" and "foreign utility companies." The rules also require registered holding companies to provide to the state commissions copies of various applications and reports filed with the SEC which, among other things, provide an additional source of information to the state commissions on affiliate transactions.

IV. POTENTIAL FOR CONFLICT BETWEEN PROPOSED RULES AND PUHCA STANDARDS APPLICABLE TO AFFILIATE TRANSACTIONS.

As a practical matter, it would be difficult if not impossible for UE to comply with both the SEC "at cost" rules that apply to inter-company sales of goods and services and the Commission's proposed affiliate transaction rules, which would require UE to demonstrate that it is charging the greater of cost or market value when it sells services, information, or goods to an affiliate and pays the lower of cost or market value when it purchases such items from any affiliate. Of course, UE could simply refrain from engaging in any transactions with its affiliates. In that case, however, UE would presumably have to hire additional personnel and acquire the additional resources needed to provide all of those corporate support functions that Ameren Services now provides.

The proposed affiliate transaction rules appear to mandate a degree of structural separation

between UE and its affiliates that is not required under PUHCA. To the extent that these rules treat CIPS, a regulated utility in Illinois, and Ameren Services, an SEC-regulated service company, no differently than any other non-utility subsidiary of Ameren with which UE may have any dealings, many of the benefits of integration -- which formed the predicate for the SEC's approval of the UE/CIPS merger -- could be lost, or at least greatly diminished. Two examples illustrate the point. First, because Ameren Services is organized as a "break even" company, if it did not collect its fully-allocated cost for a particular service rendered to UE, other members of the Ameren system would somehow have to make up the short-fall. Second, if UE were to reimburse CIPS at the lower of cost or market for a particular service (e.g., emergency line restoration work) but had to charge CIPS the greater of cost of market for similar services provided to CIPS, it appears that these mutually beneficial transactions could not continue.

Finally, given the comprehensiveness of the SEC's regulation of affiliate transactions within a registered holding company family, it is questionable whether the requirement in the proposed rules for obtaining competitive bids for services is necessary or would provide any additional protection against affiliate abuse, especially as it may apply to transactions between UE and Ameren Services or UE and CIPS.

CONCLUSION

In my opinion, the Commission's proposed affiliate transaction rules would mandate a degree of corporate separation between UE and its affiliates (particularly CIPS and Ameren Services) that is neither desirable nor necessary for the prevention of cross-subsidization. As applied to utilities that are members of registered holding company systems, like UE, the

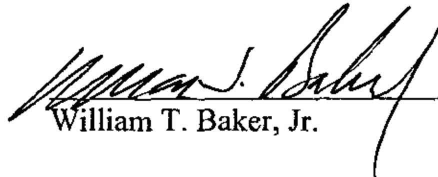
proposed rules do not take into account of the protections against affiliate abuse that are already in place under PUHCA. Finally, the proposed rules' prohibition against conferring a "financial benefit" on an affiliate of a Missouri utility would appear to apply, unnecessarily, to many types of transactions that have the potential for being mutually beneficial. In this sense, the prohibition on providing a "financial advantage" on affiliates would appear to apply, indiscriminately, to affiliates that engage in businesses far removed from the core utility business as well as to regulated utilities operating in a different state and service companies, which are non-profit organizations whose sole function is to provide services to affiliates on a non-discriminatory basis.

<u>AFFIDAVIT</u>

STATE OF NEW YORK)
)
COUNTY OF NEW YORK)

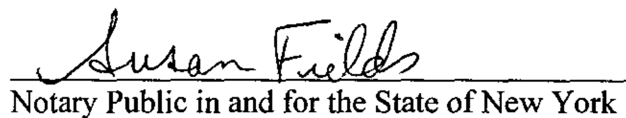
BEFORE ME, the undersigned authority, on this day personally appeared William T. Baker, Jr., who, having been placed under oath by me, did depose as follows:

My name is William T. Baker, Jr., I am of legal age and a resident of the State of New York. The foregoing Statement offered by me on behalf of Union Electric Company is true and correct, and the opinions stated therein are, to the best of my knowledge and belief, accurate, true and correct.



William T. Baker, Jr.

SUBSCRIBED AND SWORN TO BEFORE ME by the said William T. Baker, Jr. on this 29th day of June, 1999.



Notary Public in and for the State of New York

SUSAN FIELDS
NOTARY PUBLIC, State of New York
No. 31-4980055
Qualified in New York County
Commission Expires April 8, 2001

Title 4 – DEPARTMENT OF ECONOMIC DEVELOPMENT
Division 240 – Public Service Commission
Chapter 20 – Electric Utilities

PROPOSED RULE

4 CSR 240-20.015 Affiliate Transactions

PURPOSE: *This rule is intended to prevent regulated utilities from subsidizing their nonregulated operations. In order to accomplish this objective, the rule sets forth financial standards, evidentiary standards and record-keeping requirements applicable to any Missouri Public Service Commission (commission) regulated electrical corporation whenever such corporation participates in transactions with any affiliated entity (except with regard to HVAC services as defined in Section 386.754, RSMo Supp. 1998, by the General Assembly of Missouri). The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities.*

(1) Definitions.

(A) Affiliated entity means any person, including an individual, corporation, service company, corporate subsidiary, firm, partnership, incorporated or unincorporated association, political subdivision including a public utility district, city, town, country or a combination of political subdivisions which, directly or indirectly, through one (1) or more intermediaries, controls, is controlled by, or is under common control with the regulated electrical corporation.

(B) Affiliate transaction means any transaction for the provision, purchase or sale of any information, asset, product or service, or portion of any product or service, between a regulated electrical corporation and an affiliated entity, and shall include all transactions carried out between any unregulated business operation of a regulated electrical corporation and the regulated business operations of an electrical corporation. An affiliated transaction for the purposes of this rule excluded heating, ventilating and air conditioning (HVAC) services as defined in section 386.754, by the General Assembly of Missouri.

(C) Control (including the terms "controlling," "controlled by," and "common control") means the possession, directly or indirectly, of the power to direct, or to cause the direction of the management or policies of an entity, whether such power is exercised through one (1)or more intermediary entities, or alone, or in conjunction with, or pursuant to an agreement with, one (1) or more other entities, whether such power is exercised through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, affiliated entities, contract or any other direct or indirect means. The commission shall presume that the beneficial ownership of ten percent (10%) or more of voting securities or partnership interest of an entity constitutes control for purposes of this rule. This provision, however, shall not be construed to prohibit a regulated electric corporation from rebutting the presumption that its ownership interest in an entity confers control.

(D) Derivatives means a financial instrument, traded on or off an exchange, the price of which is directly dependent upon (i.e., derived from) the value of one (1) or more underlying securities, equity indices, debt instruments, commodities, other derivative instruments or any agreed-upon pricing index or arrangement (e.g., the movement over time of the Consumer Price Index or freight rates). Derivatives involve the trading of rights or obligations based on the underlying producer, but do not directly transfer property. They are used to hedge or to exchange a floating rate of return for a fixed rate of return.

(E) Fully distributed cost (FDC) means a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. FDC requires recognition of all costs incurred directly or indirectly used to produce a good or service. Costs are assigned either through a direct or allocated approach. Costs that cannot be directly assigned or indirectly allocated (e.g., general and administrative) must also be included in the FDC calculation through a general allocation. For purposes of this rule, compliance with 17 C.F.R. §250.91 establishes FDC.

(F) Regulated electrical corporation means every electrical corporation as defined in section 386.020, RSMo, subject to commission regulation pursuant to Chapter 393, RSMo.

(G) Variance means an exemption granted by the commission from any applicable standard required pursuant to this rule.

(2) Standards.

(A) A regulated electrical corporation 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 Missouri Public Service Commission.

(B) A regulated electric corporation and its affiliated interests shall not notify potential or actual customers, either directly or indirectly, that the electric corporation provides any advantages relating to the scheduling , transmission or distribution of electricity to affiliated interests or their customers relative to unaffiliated entities and their customers.

(C) A regulated electrical corporation shall not tie, as defined by State and federal anti-trust laws, the provision of any tariffed services to the taking of any goods and services from the electric utility's affiliated interests.

(D) Specific customer information shall be made available to affiliated or unaffiliated companies only upon consent of the customer or as otherwise provided by law or Commission Rule and upon payment of reasonable charges incurred in producing such information. General or aggregated customer information may be made available to affiliated or unaffiliated companies or persons alike upon payment of reasonable charges incurred in producing such information.

(E) A regulated electrical corporation shall treat as confidential all information related to the transmission or distribution of electric energy received from unaffiliated energy marketers and shall not share such information with its affiliates.

(F) Transactions between an electrical corporation and its affiliated interests shall not be allowed to subsidize the affiliated interests.

(G) Costs associated with the transfer of goods and services between an electric utility and its affiliated interests shall be priced either at cost or at fair market value, as specified in, and allocated pursuant to a Commission approved services agreement. For purposes of this section, a services agreement that has been approved by the Securities and Exchange Commission under the Public Utility Holding Company Act of 1935, or any successor legislation or rules, will be deemed to satisfy this provision. The existence of an SEC-approved or Commission-approved Services Agreement under this provision shall not be a binding determination on the Commission regarding the reasonableness of charges in a subsequent Commission rate proceeding.

(H) A regulated electrical corporation shall maintain books, accounts, and records separate from those of its affiliated interests.

(I) Upon request of the Commission, electrical corporations 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 consideration given for the goods and services provided.

(J) The regulated electrical corporation shall not participate in any affiliate transactions which are not in compliance with this rule except as otherwise provided in section (9) of this rule.

(3) Evidentiary Standards for Affiliate Transactions.

In transactions involving the purchase of goods or services by the regulated electrical corporation from an affiliated entity, the regulated electrical corporation will use a commission-approved Cost Allocation Manual (CAM) and Service Agreement, as described in Section 2(G), above, which sets forth cost allocation, market valuation and internal cost methods. This CAM can use benchmarking practices that can constitute compliance with the market value requirement of this section.

(4) Record-Keeping Requirements.

(A) Each regulated electrical corporation shall maintain the following information in a mutually agreed-to electronic format (i.e., agreement between the staff, Office of the Public Counsel and the regulated electrical corporation) regarding affiliate transactions on a calendar year basis and shall provide such information to the commission staff and the Office of the Public Counsel on, or before, May 15 of the succeeding year:

1. A full and complete list of all affiliated entities as defined by this rule;

2. A full and complete list of all goods and services provided to or received from affiliated entities;

3. A full and complete list of all contracts entered with affiliated entities;

4. A full and complete list of all affiliate transactions undertaken with affiliated entities without a written contract together with a brief explanation of why there was no contract;

5. The amount of all affiliate transactions by affiliated entity and account charged; and

6. The basis used (e.g., fair market price, FDC, etc.) to record each type of affiliate transaction.

(B) In addition, each regulated electrical corporation shall maintain the following information regarding affiliate transactions on a calendar year basis:

1. Records identifying the basis used (e.g., fair market price, FDC, etc.) to record all affiliate transactions; and

2. Books of accounts and supporting records in sufficient detail to permit verification of compliance with this rule.

(C) For purposes of this Rule, reports made on Form U-5-S and U-13-60 pursuant to the Public Utility Holding Company Act of 1935, or any successor legislation or rules, will be deemed to satisfy this provision.

(5) Records of Affiliated Entities.

(A) Each regulated electrical corporation shall ensure that its parent and any other affiliated entities maintain books and records that include, at a minimum, the following information regarding affiliate transactions:

1. Documentation of the costs associated with affiliate transactions that are incurred by the parent or affiliated entity and charged to the regulated electrical corporation;

2. Documentation of the methods used to allocate and/or share costs between affiliated entities including other jurisdictions and/or corporate divisions;

3. Description of costs that are not subject to allocation to affiliate transactions and documentation supporting the nonassignment of these costs to affiliate transactions; and

4. Policies regarding the availability of customer information and the access to services available to nonregulated affiliated entities desiring use of the regulated electrical corporation's contracts and facilities.

(6) Access to Records of Affiliated Entities.

(A) To the extent permitted by applicable law and pursuant to established commission discovery procedures, a regulated electrical corporation shall make available the books and records of its parent and any other affiliated entities when required in the application of this rule.

(B) The commission will have the authority to:

1. Review, inspect and audit books, accounts and other records kept by a regulated electrical corporation for the purpose of ensuring compliance with this rule and making findings available to the commission; and,

2. Investigate the operations of a regulated electrical corporation for the purpose of ensuring compliance with this rule.

(C) This rule does not modify existing legal standards regarding which party has the burden of proof in commission proceedings.

(7) Record Retention.

Records required under this rule shall be maintained by each regulated electrical corporation for a period of not less than six (6) years.

(8) Enforcement.

(A) When enforcing these standards, or any order of the commission regarding these standards, the commission may apply any remedy available to the commission.

(9) Variances.

(A) A variance from the standards in this rule may be obtained by compliance with paragraph (9)(A)1. or (9)(A)2. The granting or a variance to one regulated electrical corporation does not constitute a waiver respecting or other wise affect the required compliance of any other regulated electrical corporation to comply with the standards–

1. The regulated electrical corporation shall request a variance upon written application in accordance with commission procedures set out in 4 CSR 240-2.060(11); or

2. A regulated electrical corporation may engage in an affiliate transaction not in compliance with the standards set out in sub-section (2)(A) of this rule, when to its best knowledge and belief, compliance with the standards would not be in the best interests of its regulated customers and it complies with the procedures required by subparagraphs (9)(A)2.A. and (9)(A)2.B. of this rule–

   A. All reports and record retention requirements for each affiliate transaction must be complied with; and

   B. Notice of the noncomplying affiliate transaction shall be filed with the secretary of the commission and the Office of the Public Counsel within ten (10) days of the occurrence of the non-complying affiliate transaction. The notice shall provide a detailed explanation of why the affiliate transaction should be exempted from the requirements of subsection (2)(A), and shall provide a detailed explanation of how the affiliate transaction was in the best interests of the regulated customers. Within thirty (30) days of the notice of the noncomplying affiliate transaction, any party shall have the right to request a hearing regarding the noncomplying affiliate transaction. The commission may grant or deny the request for hearing at that time. If the commission denies a request for hearing, the denial shall not in any way prejudice a party's ability to challenge the affiliate transaction at the time of the annual CAM filing. At the time of the filing of the regulated electrical corporation's annual CAM filing the regulated electrical corporation shall provide to the secretary of the commission a list of all non-complying affiliate transactions which occurred between the period of the last filing and the current filing. Any affiliates transaction submitted pursuant to this section shall remain interim, subject to disallowance, pending final commission determination on whether the noncomplying affiliate transaction resulted in the best interests of the regulated customers.

AUTHORITY: sections 386.250, RSMo Supp. 1998, and 393.140, RSMo 1994. Original rule filed April 26, 1999.