Missouri Public Service Commission

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July 1, 1999

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

RE: Case No. EX-99-442 - Affiliate Transaction Rules for Regulated Electric Utilities

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and six (6) conformed copies of the **COMMENTS OF THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION REGARDING AFFILIATE TRANSACTIONS RULES FOR REGULATED ELECTRIC UTILITIES.**

Thank you for your attention to this matter.

Sincerely yours,

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Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of 4 CSR 240-20.015 Proposed Rule Electric Utilities Affiliate Transactions	))))	Case No. EX-99-442

COMMENTS OF THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION REGARDING AFFILIATE TRANSACTIONS RULES FOR REGULATED ELECTRIC UTILITIES

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and pursuant to the Notice to Submit Comments published in the *Missouri Register* on June 1, 1999, submits the following comments:

1. **Purpose** It is the Purpose of this rule that the required record keeping, filing requirements and other procedures and standards in this rule enable the Commission to determine when a regulated electrical corporation is subsidizing its affiliates so that ratepayers will pay only a just and reasonable amount for regulated services and, thereby, engage in effective regulation. Subsidization of nonregulated operations by the regulated electrical corporation results in higher rates for the ratepayers of the regulated electrical corporation without a corresponding benefit to the ratepayer. This rule is neither intended to, nor can it, confer upon the Missouri Public Service Commission (Commission) jurisdiction that the Commission does not already have. This Commission has the necessary authority pursuant to existing statutes and case law.

Jurisdiction Subdivision 12 of Section 393.140 RSMo 1994 provides in part that if an electrical corporation[1] engaged in carrying on any other business than owning, operating, or managing a utility plant, which business is not otherwise subject to the jurisdiction of the

[1] The term "regulated electrical corporation" is used elsewhere in these comments.

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Commission, and is so conducted that its operations are substantially kept separate from owning, operating, managing or controlling of such utility plant, said electrical corporation in respect to such other business shall not be subject to any provisions of the Public Service Commission Law. Nonetheless, said statutory provision also states that subdivision 12 of Section 393.140 shall not restrict or limit the powers of the Commission in respect to, among other things, the right to inquire as to, and prescribe the apportionment of, capitalization, earnings, debts and expenses fairly and justly to be awarded to or borne by the ownership, operation, management or control of electric plant as distinguished from the business not engaged in owning, operating, or managing utility plant. Thus, the Commission has the authority to ensure the proper allocation of revenues, expenses and investment among regulated and unregulated businesses of a corporation.

Section 393.130.1 RSMo 1994 provides that all charges made or demanded by an electrical corporation for electricity or any service rendered or to be rendered shall be just and reasonable. Pursuant to § 393.140(5) RSMo 1994, the Commission shall "[e]xamine all persons and corporations under its supervision and keep informed as to the methods, practices, regulations and property employed by them in the transaction of their business." Section 393.140(9) RSMo 1994 provides that the Commission may require specific answers to questions upon which it may need information and may compel the production of any accounts, books, contracts, records, documents, memoranda and paper. Other relevant statutory sections include §§ 393.140(8) and 393.140(10) and §§ 386.320.3 and 386.420.2 RSMo 1994.

Sections 386.040 and 386.250(7) RSMo 1994 and State ex rel. Laclede Gas Co. v. Public Serv. Comm'n, 535 S.W.2d 561, 567 (Mo.App. 1976) are also worthy of note. These two statutory provisions state that the Commission's power extends either expressly or impliedly to

all matters necessary or proper to carry out all purposes of the Public Service Commission Law. In Missouri, unlike some other states, there are not highly specific statutory provisions on affiliate transactions. The holding on interim rate relief in the *Laclede Gas* case is of relevance to the instant situation. The Court in the *Laclede Gas* case held, among other things, that even though there was no express statutory authority "the Commission has power in a proper case to grant interim rate increases within the broad discretion implied from the Missouri file and suspend statutes and from the practical requirements of utility regulation." 535 S.W.2d at 567.

The principal case law on affiliated transactions in Missouri is in telephone regulation. This case law predates the enactment of Section 392.400.7 RSMo in 1987 which was part of the general rewrite of telecommunication statutes contained in House Bill No. 360 passed in that legislative session and signed into law. A discussion of the Commission's power under Chapter 392 is addressed herein because it is relevant to a discussion of the Commission's power under Chapter 393. Section 392.400.7 specifically states that the Commission has the power to examine the books and records of any telecommunications company affiliate, which is not a telecommunications company as defined by the Public Service Commission Law, for the purpose of investigating any transactions or the allocation of any costs between such telecommunications company and such affiliate:

> In order to implement and enforce the provisions of this section the commission shall have power to examine the books and records, including but not limited to any accounts, contracts, documents, papers, outside auditor workpapers, and computer data, of any noncompetitive or transitionally competitive telecommunications company and any affiliate of a noncompetitive or transitionally competitive telecommunications company whether such affiliate is a competitive, noncompetitive, or transitionally competitive telecommunications company. The commission shall also have the power to examine the books and records, including but not limited to any accounts, contracts, documents, papers, outside auditor workpapers, and computer data, of any affiliate of a noncompetitive or transitionally competitive telecommunications company which is not a telecommunications company as defined by this chapter for the purpose of

> investigating any transactions or the allocation of any costs between such noncompetitive or transitionally competitive telecommunications company and such affiliate. . . .

It cannot be correctly argued that the enactment of Section 392.400.7 in 1987 proves that the Commission did not have the power conferred therein over affiliate transactions prior to 1987. Also part of House Bill No. 360 was Section 392.530.2 RSMo which stated that Section 392.400.7 and certain other statutory provisions of Chapter 392 were:

> enacted in part to clarify and specify the law existing prior to September 28, 1987. Any specific grant of authority to the commission contained in those provisions shall not be construed as indicating or meaning that the commission did not possess such authority under the law existing prior to September 28, 1987.[2]

See State ex rel. Laclede Gas Company v. Public Serv. Comm'n, 535 S.W.2d 561, 567 (Mo.App. 1976)("While the amendment to a statute must be deemed to have been intended to accomplish some purpose, that purpose can be clarification rather than a change of existing law.")

The Commission's authority to examine and make adjustments respecting affiliated transactions was judicially recognized in State ex rel. General Tel. Co. v. Public Serv. Comm'n, 537 S.W.2d 655, 659 (Mo.App. 1976) and State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 645 S.W.2d 45, 54-56 (Mo.App. 1982). The Court in the *General Telephone* case noted that if the authority of the Commission is to extend to affiliate transactions, which the Court found to be the situation, "it must be implied from the powers otherwise expressly granted the commission." 537 S.W.2d at 659. The Court cited as the basis for the Commission's jurisdiction Sections 392.240.1 and 392.270.1 and State ex rel. City of West Plains v. Public Serv. Comm'n, 310 S.W.2d 925, 928-29 (Mo. 1958). There are counterparts to this authority respecting electrical, gas, water and sewer corporations and heating companies (§ 393.290 RSMo 1994): §§ 393.230, 393.260 and 393.270 RSMo 1994, and State ex rel. Hotel Continental v.

[2] In 1996, at the Second Regular Session of the Eighty-Eighth General Assembly, Chapter 392 was revised again, this time pursuant to Senate Bill No. 507. Section 392.400.7 remains unchanged. Although Section

Burton, 334 S.W.2d 75, 80 (Mo. 1960). The Court in *General Telephone* case also commented that the Commission has disallowed license contracts and fees charged operating utilities by a parent company respecting other utility industries such as the electric utility industry:

> The Commission has disallowed license contracts and fees charged operating utilities by a parent company. *In re Springfield City Water Co,* 83 PUR (N.S.) 213 (Mo. 1949); *P.S.C. v. Kansas City P. & L. Co,* 30 PUR (N.S.) 193 (Mo. 1939); *P.S.C. v. Empire Dist. Elec. Co.,* 10 PUR (N.S.) 302 (Mo. 1935); *P.S.C. v. Missouri Southern P.S. Co,* 6 PUR (N.S.) 269 (Mo. 1934).

537 S.W.2d at 659.

State ex rel. Associated Natural Gas Co. v. Public Serv. Commn, 706 S.W.2d 870 (Mo.App. 1985) is another relevant case. The issue on judicial review was the Commission's use of "double leveraging" in a rate case. The Commission was setting rates for a gas utility subsidiary (Associated Natural Gas Company) of an electric utility subsidiary (Arkansas Power & Light Company (APL)) of an entity (Middle South Utilities (MSU)) held to be a registered public utility holding company under the Public Utility Holding Company Act of 1935 (PUHCA). The Commission held that the economic relationships between the parent and subsidiary companies permitted it to assign the cost of parent company capital as the subsidiary's cost of equity. The Western District Court of Appeals stated as follows:

> In fact, the jurisdictional argument as presented here was specifically rejected in *General Telephone Company of the Southwest, supra,* 628 S.W.2d at 836-38. Section 393.140(12), which does prohibit regulation of "any other business" of the utility "not otherwise subject to the jurisdiction of the commission," also states that it shall not restrict the Commission's "right to inquire as to, and prescribe the apportionment of, capitalization, earnings, debts and expenses fairly and justly to be . . . borne by" the utility in question.

706 S.W.2d at 880.

> The conscious and voluntary corporate business decision that resulted in the hierarchy as exists here should not and cannot shield pertinent financial data from

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392.530.2 has not been changed substantively, it is now Section 392.530, due to the fact that the former Section 392.530.1 has been revised and now appears as Section 392.185.

> the Commission's scrutiny just because the ultimate owner does not provide the same service as the applicant and is not regulated. . . . Despite the Company's contention that it is operationally and financially independent from APL or MSU, it is hard to believe a wholly owned subsidiary could be as autonomous as here claimed . . . .

Id. at 881.

In Re United Telephone Co., Case No. 18,264, 20 Mo.P.S.C.(N.S.) 209, 214 (1975), the Commission clearly indicated its intention to closely scrutinize utilities operating in Missouri that are part of a holding company:

> The policy which this commission enunciates in this case is that it will not shut its eyes to the facts of such pyramiding and simply look at the *legal entity,* the Missouri operating company, in determining the level of expense, rate base, revenues, and tax consequences when it is setting the *level of rates* for the Missouri intrastate operating company. This commission recognizes a clear and present danger that affiliated interests can be used to defeat regulation, that to ignore the impact of these affiliated interests is to shirk the commission's duty and responsibility to examine and consider all facets of a regulated utility's operations when the commission engages in the ratemaking process.

The Commission reaffirmed this position in its Report And Order in Re United Telephone Co., Case No. TR-80-235, et al., 24 Mo.P.S.C. (N.S.) 152, 167-68 (1981).

Other relevant Commission cases are listed below:

(1) Re Missouri Public Service, Case Nos. ER-90-101, et al., 30 Mo.P.S.C.(N.S.) 320, 349-51 (1990).

(2) Re Missouri Public Service, Case Nos. ER-97-394, et al., pp. 47-51, Report And Order (March 6, 1998).

(3) Re Southwestern Bell Telephone Co., Case No. TR-77-214 and TR-79-213, 23 Mo.P.S.C.(N.S.) 374, 379-81(1980); See State ex rel. Southwestern Bell Telephone Co., 645 S.W.2d 44, 54-56 (Mo.App. 1983).

(4) Re Southwestern Bell Telephone Co., Case No. TR-81-208, 24 Mo.P.S.C.(N.S.) 606, 617-22, 633-35(1981).

(5) Re Southwestern Bell Telephone Co., Case No. TR-82-199, 25 Mo.P.S.C.(N.S.) 462, 466-81, 494 (1982).

(6) Staff of Mo.P.S.C. vs. Southwestern Bell Telephone Co., 29 Mo.P.S.C.(N.S.) 607, 632-33, 635, 639-43, 646-58 (1989).

(7) Staff of Mo.P.S.C. vs. Southwestern Bell Telephone Co., 2 Mo.P.S.C.3d 479, 510-29 (1993).

(8) Re GTE North Inc., Case No. TR-89-182, et al., 30 Mo.P.S.C.(N.S.) 88, 104-07(1990).

(9) Re United Telephone Co., Case Nos. TR-93-181, et al., 2 Mo.P.S.C.3d 403, 419-21 (1993).

2. **4 CSR 240-20.015** It is an increasing trend for regulated electric utilities to have associated nonregulated operations and affiliates. The regulation in 4 CSR 240-20.015 applies to transactions that regulated electric corporations enter into with those affiliates. This rule establishes record keeping and filing requirements that will enable the Staff to audit affiliated transactions between a regulated electrical corporation and any affiliated entity.

3. **4 CSR 240-20.015(1)(A)** This definition clarifies what constitutes an affiliated entity. This provides notice to the regulated utility concerning which entities and operations are governed by this rule.

4. **4 CSR 240-20.015(1)(B)** This definition clarifies what constitutes a transaction between a regulated electrical corporation and its affiliated entity. In addition to transactions between affiliated entities, this definition includes transactions carried out between any unregulated business operation of a regulated electrical corporation and the regulated business operations of an electrical corporation. This is necessary to prevent subsidization of the unregulated business operations by the regulated electrical corporation. This definition provides notice as to which transactions are covered by the rule.

5. **4 CSR 240-20.015(1)(C)** The definition of the term "control" is needed to clarify what constitutes the power to direct the management or policies of an affiliated entity of a regulated

electrical corporation. Only if a regulated electrical corporation has control over another entity can the other entity be an affiliated entity. The rule defines control as beneficial ownership of more than ten percent (10%) of voting securities or partnership interest of an entity.

Most affiliated transaction rules that have been established by regulatory agencies of other states have determined that common control ranges from five percent (5%) to ten percent (10%) ownership. The Security and Exchange Commission (SEC) requires that a report be filed with the SEC upon acquisition at levels of five percent (5%). The Public Utility Holding Company Act of 1935 (PUHCA), as administered by the SEC, could require action with a ten percent (10%) acquisition. Any investment involving the acquisition of five percent (5%) or more of any class of securities of a publicly traded company, such as an investor-owned utility, would require public disclosure by filing a form Schedule 13D with the SEC.

State corporation laws governing any particular domestic utility company may include restrictions that are higher vote requirements on business combinations involving a shareholder that owns as little as ten percent (10%) to twenty percent (20%) of the voting power of that company. Missouri's Control Shares Acquisition statute is §§ 351.015(4)-(5) and 351.107 RSMo (Supp. 1998.)

6. **4 CSR 240-20.015(1)(D)** This subsection defines "derivatives." Derivatives involve the trading of rights or obligations based on the underlying product, but do not directly transfer property and are used to hedge risk or to exchange a floating rate of return for a fixed rate of return. The financial instruments could be futures contracts, options, etc., that are traded on or off an exchange such as New York Mercantile Exchange or Kansas City Board of Trade. The price of derivatives is directly dependent upon or derived from the value of one or more underlying securities (e.g., stocks), equity indices (e.g., S&P 500), debt instruments (e.g., bonds),

commodities (e.g., natural gas), other derivative instruments (e.g., futures contracts), or any agreed-upon pricing index or arrangement (e.g., the movement over time of the Consumer Price Index).

7. **4 CSR 240-20.015(1)(E)** This subsection defines the methodology that should be used for recording utility costs. The fully distributed costing methodology is an accepted regulatory method that accounts for all costs of producing a good or service. In regulated electrical corporations, as in any company that produces a variety of goods and services, both direct and indirect costs must be measured to get an accurate measurement of the cost of a single good or service. Direct costs are those costs incurred completely to support a specific product, function or activity. The cost of coal is a direct cost to an electric utility. The only use to which the electric utility can put the coal is generation of electricity. In contrast, indirect costs cannot be directly assigned to any one specific product function or activity. An example of a possible indirect cost of a regulated electrical corporation would be an employee that is used to support multiple products, functions or activities, some of which may be nonregulated.

Fully distributed costing methodology requires that indirect costs be allocated and recorded to the various products or services that it supports. However, the classification and measurement of indirect costs can be the subject of intense debate. For example, a salaried employee who works on multiple products, functions, or activities may be classified as an indirect cost if his/her specific work activity is not measured. However, a detailed time study separating the employees time by work activity, can reclassify a portion, if not all, of this cost as a direct cost.

The result of the fully distributed costing methodology is that when an affiliated entity is using a utility company's resources such as employees, tools, vehicles, etc., all costs (direct and

indirect) associated with that resource are assigned to the affiliate. This method ensures a proper and reasonable allocation of costs to the entity that is actually incurring those costs.

8. **4 CSR 240-20.015 (1)(F)** The language of this subsection defines "preferential service." Preferential service includes the transfer of information such as customer billing records, customer payment history and other similar information that is not available to the affiliated entity's competitors. Preferential service can include special treatment such as special tariff waivers, lax enforcement of tariff provisions, or faster processing of requests for service that the regulated entity does not provide to the affiliated entity's competitors. Lastly, preferential service, as defined here, includes actions such as the regulated electrical corporation providing affiliated entities easy access to end-user customers, which places the affiliated entity at an unfair advantage over its competitors.

9. **4 CSR 240-20.015(1)(G)** This section defines a "regulated electrical corporation" as is defined in section 386.020, RSMo (Supp. 1998) subject to Commission regulation pursuant to Chapter 393, RSMo (Supp. 1998).

10. **4 CSR 240-20.015 (1)(H)** This definition defines the term "variance" as it is used in section (9) of this rule.

11. **4 CSR 240-20.015(2)(A)** This subsection sets the financial standards for compensation of an affiliated entity.

12. **4 CSR 240-20.015(2)(A)1.** This subsection outlines the permissible compensation for goods or services purchased by the regulated electrical corporation from an affiliated entity. To assure that ratepayers are not subsidizing an affiliated entity by paying more than a just and reasonable amount for goods or services from that entity, the rule states that the compensation to the affiliated entity by the regulated electrical corporation should be the lesser of (1) the fair

market price or (2) the fully distributed cost to the regulated electrical corporation to provide the goods or services for itself. Otherwise the regulated electrical corporation is providing a financial advantage to its affiliated entity by paying too much for goods and services from that entity.

13. **4 CSR 240-20.015(2)(A)1.A** If the regulated electrical corporation pays more than the fair market price, then it is providing compensation above what the affiliated entity would receive in the market and is subsidizing that affiliated entity to the detriment of ratepayers.

14. **4 CSR 240-20.015(2)(A)1.B.** This subsection details the alternative to fair market price that the regulated electrical corporation may use to compensate the affiliated entity. The costing methodology that is chosen must accurately measure the cost to the utility of a particular good or service to assure that the ratepayers do not subsidize the affiliated entity. Fully distributed, marginal or incremental, and opportunity costing methodologies are available and were considered. The fully distributed costing methodology was chosen because all costs (direct and indirect) associated with a resource are assigned to the entity (the regulated electrical corporation or its affiliated entity) that is using the resource.

Another benefit of the fully distributed cost approach is that all of an entity's costs are addressed in the cost recognition process. Cost measurement or cost classification "gamesmanship" is reduced under this costing method because all costs are considered in this approach.

In addition, the fully distributed cost method avoids the problems of other approaches that require speculation as to the hypothetical result of using utility assets in an alternative endeavor - such as providing nonregulated services. To give an example, an attorney that charges his/her salary to the regulated cost of service would have to identify (1) the activity that

he/she would perform if he/she were not performing a nonregulated activity, and (2) the result of that activity if he/she would have devoted more time to it. It would be difficult, if not impossible, to measure the impact on a case if the attorney spent more time on it. The settlement could have been less, or the judgment greater, if the attorney had spent more time to find additional evidence or arguments that might have improved the case and its result. Such a determination can only be made through speculation. Methods other than fully distributed cost will require more speculation. Therefore, fully distributed cost approach is the best-cost methodology to meet the utility subsidy concerns.

If the fully distributed cost to produce goods or services by the regulated electrical corporation is above the fair market price, the rule states that the regulated electrical corporation should pay the fair market price. This results in the regulated electrical corporation purchasing the goods or services that it needs at a price lower than what it would cost to produce the goods or services itself and the regulated electrical corporation does not subsidize the affiliated entity by paying more than what the affiliated entity could get on the market.

If the fully distributed cost for the regulated electrical corporation is less than the fair market cost, the regulated electrical corporation is required to pay its affiliate the fully distributed cost of the regulated electrical corporation to provide the good or service. It is to the ratepayers detriment for the regulated electrical corporation to pay more than its fully distributed cost to provide the good or service.

15. **4 CSR 240-20.015(2)(A)2.** This subsection outlines the permissible compensation by an affiliated entity to the regulated electrical corporation for information, assets, goods or services that the regulated electrical corporation supplies to the affiliated entity. The affiliate must pay at

least the greater of: (1) the fair market price or (2) the fully distributed cost of the regulated electrical corporation.

16. **4 CSR 240-20.015(2)(A)2.A.** If the regulated electrical corporation accepts less than fair market value from its affiliated entity, then the information, assets, goods or services that the regulated electrical corporation transferred is of greater value on the open market than the regulated electric corporation received. The affiliated entity receives a subsidy from the regulated electrical corporation and the ratepayers do not receive the full value of the information, assets, goods or services that it supplied.

17. **4 CSR 240-20.015(2)(A)2.B.** If the regulated electrical corporation accepts less than its fully distributed cost for information, assets, goods or services, the ratepayers are not receiving full payment for the cost of producing or developing the product.

18. **4 CSR 240-20.015(2)(B)** The regulated electrical corporation should conduct its business in an arms-length manner whether it is dealing with an affiliated entity or a non-affiliated entity.

19. **4 CSR 240-20.015(2)(C)** The language in this section requires regulated electrical corporations to comply with this rule unless variance has been obtained.

20. **4 CSR 240-20.015(2)(D)** This subsection prevents the regulated electric corporation from giving preferential treatment to its affiliated entity when a customer calls the regulated electrical corporation requesting services provided by the affiliated entity. This subsection of the rule requires the regulated electrical corporation to tell customers that the goods or services could be provided by entities other than its affiliated entity. The subsection does not intend that an exhaustive list of other providers be given to the customer. Instead a general statement that the service can be provided by others (e.g., by looking in the yellow pages, contacting a trade organization, etc.) would comply with this section. The regulated electrical corporation should

not give its customers the impression that only its affiliated entity can provide a particular product or service. This requirement does not apply to an affiliated entity if a customer requests information from it. The provision of information is only required of the regulated electrical corporation.

This subsection also requires the procedure for supplying this information be included in the regulated electrical corporation's cost allocation manual (CAM) that is filed annually with the Commission.

21. **4 CSR 240-20.015(3)(A)** This subsection requires that regulated electrical corporations obtain competitive bids or demonstrate why bids were not necessary or appropriate when the regulated electrical corporation purchases from an affiliated entity. This is to assure that the regulated electrical corporation does not subsidize an affiliated entity by paying more for goods and services from an affiliate than it would pay a non-affiliated entity.

22. **4 CSR 240-20.015(3)(B)** This subsection requires documentation of the information required in 4 CSR 240-20.015(3)(A).

23. **4 CSR 240-20.015(3)(C)** This section requires the regulated electrical corporation to demonstrate that all costs were considered when supplying information, assets, goods and services to an affiliated entity. This is to assure that the regulated electrical corporation does not subsidize its affiliated entity by supplying information, assets, goods and services at less than the cost to the regulated electrical corporation.

24. **4 CSR 240-20.015(3)(D)** This section requires the use of a Commission-approved CAM which sets forth cost allocation, market valuation and internal cost methods for transactions involving the purchase of goods and services from an affiliated entity. The Commission would not prescribe a generic CAM for all regulated electrical corporations but instead each regulated

electrical corporation would present its CAM for approval by the Commission. The CAM should show that the regulated electrical corporation analyzed and pursued all possible alternatives to assure that the transaction chosen by the regulated electrical corporation was in the best interests of its ratepayers.

25. **4 CSR 240-20.015** This section details the record keeping requirements for regulated electrical corporations that are necessary in order to adequately audit their affiliated transactions. Currently this information is necessary to accurately determine the regulated electric corporation's cost-of-service which is then used to determine the rates of the regulated electrical corporation. However, the lack of documentation on affiliate transactions can result in difficulty in determining a cost-of-service which accurately reflects the cost to the ratepayers without subsidizing any affiliated entity. These documentation requirements specify uniformity for the record keeping that, in addition to providing indication of adherence to these rules, will aid in determining the cost-to-serve the ratepayers of the regulated electrical corporation without subsidizing an affiliated entity. Any additional responsibility that these rules place on regulated electrical corporations will be because the regulated electrical corporation is not currently keeping its records in the detail necessary to make this determination.

These records are to be provided to the Staff and the Office of the Public Counsel each year on, or before, March 15.

26. **4 CSR 240-20.015(5)(A)** This section details the record keeping requirements of the affiliated entities that are necessary to allow Staff to adequately audit all affiliate transactions.

27. **4 CSR 240-20.015(6)(A)** This section gives the Commission access to the records of the affiliated entities to the extent permitted by applicable law. The Staff must have access to these affiliated transaction records in order to review and present all pertinent information to the

Commission in order for the Commission to determine the reasonableness of charges made to and by the regulated electrical corporation. In Union Electric Company's (UE) and Central Illinois Public Service Company's (CIPSCO) merger application before the Federal Energy Regulatory Commission (FERC), the Commission raised several concerns regarding the issue of the effectiveness of State regulation, one concern relating to affiliate transactions of a registered holding company, under the Public Utility Holding Company Act of 1935 (PUHCA):

> Applicants' selection of the registered holding company form as their post-merger structure could impair the effectiveness of State and Federal regulation because under Ohio Power Co. v. FERC, 954 F.2d 779, 782-86 (D.C. Cir. 1992), cert. denied, 498 U.S. 73 (1992), the FERC and State commissions may be precluded from questioning costs incurred or revenues received by intracorporate transactions, previously approved by the SEC, within the registered holding company structure.

Union Electric Co. and Central Illinois Public Service Co., Docket Nos. EC-96-7-000, ER-96-677-000 and ER-96-679-000, 77 FERC ¶ 61,026, p. 61,108 (October 16, 1996).¶

The FERC declined to set for hearing the issue of the effect of the proposed merger on State regulation stating that the proper forum was the UE – CIPSCO merger case pending before the Commission:

> We will not set the issue of the effect of the proposed merger on state regulation for hearing. The Applicants already have filed for regulatory approvals of the proposed merger in Illinois and Missouri, the only jurisdictional state commissions. In this circumstance, the state proceedings are more appropriate fora for the parties to challenge the proposed merger's effect on state regulation. Thus, these two state commissions appear to have authority to rule on the merger. As they consider this merger, these commissions may take appropriate steps under state law to ensure that there is no impairment of effective state regulation.

77 FERC at 61,108-09.

The FERC went on to state that it believed that the applicants' analysis overlooked the potential for impairment of effective regulation by the FERC as a result of the applicants adopting a registered holding company corporate structure noting that under such a structure the

applicants could avoid FERC authority to review costs incurred under a service, sale or construction contract (i.e., a contract for non-power goods or services) with an associate company which was approved by the SEC. As the FERC stated "[t]he costs would be flowed through to ratepayers, even if the goods or services were obtained at an above market price or the costs were imprudently incurred." 77 FERC at 61,109.

Since the FERC deemed that it might not be able to adequately protect from affiliate abuse in the applicants' proposed registered holding company structure, it gave the applicants the option of (1) a hearing on the issue of whether the proposed registered hearing company structure will impair effective regulation by the FERC, or (2) abide by the FERC's policies with respect to intracorporate transactions within the registered holding company structure. On October 30, 1996, UE filed with the FERC a letter stating that UE elected to abide by the FERC's policies with respect to intracorporate transactions within its registered holding company structure.

FERC's policies with respect to intracorporate transactions require that:

> (1) Affiliates or associates of a public utility not sell non-power goods and services to the public utility at a price above market price; and
>
> (2) Public utility sell non-power goods and services to its affiliates or associates at its cost for such goods and services or the market value for such goods and services, whichever is higher.

Public Serv. Co. of Colorado and Southwestern Pub. Serv. Co., 75 FERC ¶61,325, pp. 62,040, 62,046 n. 23 (June 26, 1996); AEP Power Marketing, Inc., 76 FERC ¶ 61,307, pp. 62,514, 62,515-16 (September 20, 1996); See also Inquiry Concerning The Commission's Merger Policy Under The Federal Power Act: Policy Statement, Order No. 592, Docket No. RM96-6-000, FERC Statutes & Regulations III, ¶ 31,044, pp. 30,109, 30, 124-25 (December 30, 1996).

The 1995 UE – CIPSCO merger filing before the Commission, Case No. EM-96-149, resulted in a settlement in 1996, which was adopted by the Commission in 1997. Part of the

Stipulation and Agreement which comprises the settlement addresses the matter of Commission access to the books, records and personnel of the Ameren Corporation registered holding company and its affiliates and subsidiaries. This Stipulation and Agreement has relevance to the instant rulemaking because it makes any Commission rule on affiliate transactions paramount to the other terms of the Stipulation and Agreement respecting affiliate transactions of similarly situated electric utilities in Missouri:

> 8. State Jurisdictional Issues
>
> a. Access to Books, Records and Personnel. UE and its prospective holding company, Ameren, agree to make available to the Commission, at reasonable times and places, all books and records and employees and officers of Ameren, UE and any affiliate or subsidiary of Ameren as provided under applicable law and Commission rules; provided, that Ameren, UE and any affiliate or subsidiary of Ameren shall have the right to object to such production of records or personnel on any basis under applicable law and Commission rules, excluding any objection that such records and personnel are not subject to Commission jurisdiction by operation of the Public Utility Holding Company Act of 1935 ("PUHCA"). In the event that rules imposing any affiliate guidelines regarding access to books, records and personnel applicable to similarly situated electric utilities in Missouri are adopted, then UE, Ameren and each affiliate or subsidiary thereof shall become subject to the same rules as such other similarly situated electric utilities in lieu of this paragraph.

Re Union Electric Company, Case No. EM-96-149, Report and Order, pp. 22-23 (February 21, 1997); Emphasis added.

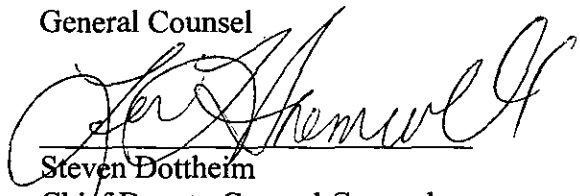
28. **4 CSR 240-20.015(7)(A)** The record retention requirement in this section is consistent with the record retention period of six (6) years outlined in the FERC Uniform System of Accounts (USOA).

29. **4 CSR 240-20.015(8)** The enforcement of this proposed rule falls within the guidelines, rules and regulations that are already available to the Commission.

30. 4 CSR 240-20.015(9)(A) The language in this section clarifies the procedure that the regulated electrical corporation must follow to qualify for a variance from this proposed rule. The regulated electrical corporation may engage in an affiliate transaction not in compliance with this rule if, to the best of its knowledge and belief, compliance would not be in the best interest of its regulated customers. The regulated electrical corporation must file a notice of the noncomplying affiliate transaction with the Commission and the Office of the Public Counsel within ten (10) days of the noncompliance. In some instances, advantageous affiliate transactions will become apparent quickly and will require quick action on the part of the regulated electrical corporation. Having to file for a variance prior to participating in such a transaction would result in delays in which the advantageous affiliate transaction may disappear. This post approval of a variance allows the regulated electrical corporation to take advantage of short-term transactions that are in the best interest of its regulated customers. This section provides the Commission the administrative procedures needed to evaluate and determine if a regulated electrical corporation qualifies for a variance from this rule and the consequences to the regulated electrical corporation of compliance and non-compliance.

Respectfully submitted,

DANA K. JOYCE
General Counsel



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