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FILED
JUL 1 1999
Missouri Public
Service Commission

June 30, 1999

VIA OVERNIGHT DELIVERY

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

Dear Mr. Roberts:

Enclosed for filing with the Commission in the above-referenced matter are the original, and 15 copies of Kansas City Power & Light Company's Comments regarding the Staff's proposed rules to govern affiliate transactions. In addition, I have enclosed a return envelope whose postage is prepaid. Please time stamp one of the copies and return it to KCPL.

Please bring this filing to the attention of the Commission.

Thank you for your attention to this matter.

Sincerely yours,

Gerald A. Reynolds

Gerald A. Reynolds

Enclosures

cc: Office of the Public Counsel

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Proposed Rules)
to Govern Affiliate Transactions) Case No. EX-99-442
)

COMMENTS OF KANSAS CITY POWER & LIGHT COMPANY

COMES NOW Kansas City Power & Light Company ("KCPL") in response to the proposed rules published by the Public Service Commission of Missouri (the "Commission") on or about June 1, 1999, and submits the following comments and recommendations.

Comments

Introduction

For the last 90 years, state governments, including the State of Missouri, have regulated virtually every aspect of the electric utility industry. Over the last two decades, many state governments have conceded that regulation can suppress innovation, shelter inefficiency, promote a misallocation of resources by misaligning prices with marginal costs, and deny the public the variety of price and quality choices that a competitive market would have provided. Alfred E. Kahn, The Economics of Regulation: Principles and Institutions (1988).

Despite the benefits provided by the regulatory process, many utilities and regulatory authorities have concluded that the market, rather than the regulatory process, ultimately will provide consumers with superior goods and services, and a wider range of prices. Consequently, state governments across the nation are in the process of injecting competitive market forces into the electric utility industry. Some

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states have authorized retail competition in electric service, while others have taken a more modest step toward the market by adopting incentive-based regulation.

Unfortunately, the main thrust of the proposed rule regarding affiliate transactions runs counter to the nationwide movement towards a competitive market approach. One of the hallmarks of a healthy market is the existence of managerial freedom and flexibility. In non-regulated markets, a company is driven by competition to allocate its resources efficiently and to minimize transaction costs. The proposed rule encourages exactly the opposite. If adopted, the rule will diminish managerial freedom and flexibility, and significantly increase transaction costs. Provided it survives judicial scrutiny, it is likely that the proposed rule's onerous requirements will discourage utilities from forming beneficial relationships with unregulated companies, and impede the growth of internal unregulated activities by regulated utilities to the detriment of consumer welfare. The Commission should fashion a rule that prevents cross-subsidies, but does not suppress unregulated activities.

Violation of Section 393.140(12)

Under the proposed rule, a utility's ability to control or direct a non-jurisdictional company's management or policy determines whether the company falls within the ambit of "affiliate" as defined in the proposed rule. See 4 CSR 240-20.015(1). However, Staff's presumption that the beneficial ownership of 10% or more of voting securities or partnership interest of an entity confers control is not supported by economic theory, empirical evidence of corporate control in such circumstances, or by the rules and practices of other enforcement agencies dealing with competitive matters such as the Federal Trade Commission ("FTC").

The FTC, for example, uses 50% of ownership or more to indicate control for competitive analysis purposes in the pre-merger notification process under the Hart-Scott-Rodino Act. 16 C.F.R. § 801.1(b)(1).[1] Further, there is no support for the notion that a 10% threshold confers control when a small, closely-held company is involved. The use of this presumption with respect to small, closely-held companies presents a logical fallacy because the majority of "affiliated transactions" in Missouri has involved, and will continue to involve, small, closely-held companies. Without a close nexus between the presumption of control and the 10% threshold, the proposed rule contradicts the Missouri General Assembly's command that the Commission not regulate non-jurisdictional businesses.

Missouri law explicitly prohibits the Commission from regulating non-jurisdictional businesses. Section 393.140(12) (RSMo 1994). Associated Natural Gas Co. v. Public Serv. Comm'n of Missouri, 706 S.W.2d 870, 880 (Mo. App. 1985). Despite a clear, unambiguous prohibition from the Missouri General Assembly, and a long line of Missouri case law that reiterates the statutory prohibition, the Staff now seeks to regulate those non-jurisdictional companies doing business with regulated utilities by using an artificially low threshold for presuming control.

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[1] The FTC defines the terms "control," "controlling," "controlled by" and "under common control with") to mean either:

1) (i) Holding 50 percent or more of the outstanding voting securities of an issuer or (ii) In the case of an entity that has no outstanding voting securities, having the right to 50 percent or more of the profits of the entity, or having the right in the event of dissolution to 50 percent or more of the assets of the entity; or (2) having the contractual power presently to designate 50 percent or more of the directors of a corporation, or in the case of unincorporated entities, of individuals exercising similar functions.

The proposed rule would require non-jurisdictional companies doing business with regulated utilities ("Non-jurisdictional Companies") to organize their books and records in a Staff-approved manner. See Proposed Rule 4 CSR 240-20.015(5). In addition, the proposed rule purports to authorize the Commission to"[r]eview, inspect and audit" the business records of Non-jurisdictional Companies. See Proposed Rule 4 CSR 240-20.015(6).

Since there is no demonstrable nexus between the 10% threshold and the presumption of control, sections five and six of proposed rule 4 CSR 240-20.015 violate § 393.140(12) (RSMo 1994). Accordingly, the Commission should reject sections five and six of proposed rule 4 CSR 240-20.015 unless the proposed rule is amended so that the threshold used has a demonstrable nexus with the presumption of control.

If a court rules that the proposed rule's current presumption of control does not violate § 393.140(12) (RSMo 1994), the proposed rule does provide a regulated utility an "opportunity" to demonstrate that its ownership interest in an affiliate does not confer control. A utility that wishes to rebut the presumption of control must seek a variance. See 4 CSR 240-20.015(9). To conduct business in an efficient manner, and before they commit themselves to investing large sums of capital, utilities and non-regulated businesses require the consistent application of a set of standards. The proposed rule does not set forth a standard for determining when a utility's ownership interest does not confer control. Since the proposed rule's presumption of control does not incorporate economic theory, and/or empirical evidence relating to corporate control, it is likely that the standard for determining control will be extremely subjective, and shifting. This will discourage the formation of beneficial alliances that could have provided benefits to Missouri residents. Rather than require a regulated utility to seek a variance to demonstrate that its ownership interest does not confer control, a better approach would be to adopt a rebuttable presumption that is known to be an excellent proxy for control.

Recommendation

KCPL recommends that the Commission adopt the presumption used by the FTC. The Commission should raise the threshold so that the presumption is not triggered until a utility acquires a beneficial ownership of fifty percent or more of the voting securities or partnership interest of an affiliate. Raising the threshold for a presumption of control to 50% ensures that the Commission does not unlawfully regulate non-jurisdictional businesses in violation of Section 393.140(12).

To the Detriment of Ratepayers and Utilities, the Proposed Rule Will Discourage the Formation of Beneficial Economic Relationships Between Regulated Electric Utilities and Non-jurisdictional Companies.

Assuming *arguendo* that it survives judicial scrutiny, the proposed rule will needlessly discourage the formation of beneficial relationships between utilities and non-jurisdictional businesses, to the detriment of consumer welfare. Many non-jurisdictional businesses will conclude that the Staff-approved methodology for record keeping is nothing more than micromanaging. In addition, other businesses in competitive industries are not required to submit such information to state agencies that have such expansive investigatory powers. If the proposed rule is adopted, affiliated entities will be required to provide sensitive, proprietary information to Staff and the Office of Public Counsel even if there is no evidence of wrongdoing.

The rationale that supports the use of the State of Missouri's police powers to regulate utilities cannot be used to regulate non-jurisdictional businesses. The decision to use the police powers of the state to regulate electric utilities was based, in principal part, on the belief that utilities are natural monopolies, and that state regulation was needed to take the place of competition. Sedalia v. Public Serv. Comm'n, 204 S.W. 497, 498 (1918), citing, Baker v. Kansas City Gas Co., 163 S.W. 854-57 (1913). Consequently, the Commission's jurisdiction has never included competitive industries. The Public Service Commission Act was purposely designed to provide the Commission with intrusive powers to supervise virtually every aspect of natural monopolies, including the utility industry. Non-jurisdictional businesses are not accustomed to the expansive nature of the Commission's investigatory power. Rather than submit to these enhanced regulatory requirements, and the additional costs they entail, many non-jurisdictional businesses will forego opportunities to form alliances with utilities. This result simply will reduce marketplace competition, to the detriment of Missouri residents.

Burdensome Recordkeeping Requirements

The stated purpose of the proposed rule is to ensure that an electric utility's regulated activities do not subsidize its competitive activities. KCPL agrees with the proposition that the Commission should adopt rules of conduct that prevent cross-subsidization. However, the method recommended by Staff to prevent cross-subsidies will significantly increase transaction costs to the detriment of the competitive process. There is no need to raise transaction costs when the stated goal of the proposed rule can be achieved without doing so.

Whenever a utility purchases goods or services from an affiliate, the proposed rule requires the utility to calculate fully distributed cost. See Proposed Rule 4 CSR 240-20.015(2)(A). If the utility gets competitive bids, or demonstrates that it has paid no more than the market price for a good or service, this should be adequate evidence that the rate customers pay has remained unaffected by the transaction.

Whenever a utility sells goods or services to an affiliate, the rule also requires that the utility calculate market price. See Proposed Rule 4 CSR 240-20.015(2)(A). So long as the utility sells goods or services for no less than fully distributed cost, the consumers are protected from cross-subsidization. KCPL's recommended approach would ensure that customers' rates are not affected by a utility's unregulated activities, while reducing transaction costs and providing management with the necessary flexibility for a competitive marketplace.

If adopted, the recordkeeping rules contained in the proposed rule will require KCPL to price each purchase or sale in two ways, thereby duplicating the work involved and increasing transaction costs. With respect to sales of central support services, it will be difficult to calculate market price since KCPL will need to ensure that the market price reflects the same levels of performance, including the scope of service, quality and timeliness. Finally, the proposed rule will require a formal contract for goods or services between KCPL and non-regulated business divisions within KCPL. This will add an additional layer of administrative costs.

Fully Distributed Costs –

From an economic standpoint, as long as incremental costs are covered, KCPL's customers are protected. KCPL, nonetheless, agrees for purposes of this proceeding that indirect costs should be fully allocated when possible and appropriate. For asset transfers from a utility to an affiliate, use of "market price" as a standard is unlikely to be the appropriate, consumer welfare-maximizing, transaction price. So long as incremental costs of providing a good or service to a competitive affiliate are covered, ratepayers are fully protected. This conclusion follows because a utility's regulated tariffs will continue to be determined by traditional cost-based rate making proceedings. Therefore, in transfers to affiliates, if the utility would have no basis to seek higher tariffs from the Commission. In instances where market price exceeds incremental costs, requiring that a utility charge a market price to its affiliates simply reduces economic efficiency (and thereby consumer welfare) by distorting the incentive to transfer assets to affiliates or to make investments in the assets.

There is nothing unfair or anticompetitive in the Commission allowing a utility to charge its nonregulated affiliate at incremental costs for goods and services. To require otherwise impedes the workings of the competitive marketplace while providing Missouri consumers no additional protection.

Competitive Handicaps

The proposed rule goes beyond its stated purpose, to wit, the mere prevention of cross-subsidization. Through its proposed rule, Staff seeks to place competitive handicaps on utilities. The proposed rule states "[i]f a customer requests information from the regulated electrical corporation about goods or services provided by an affiliated entity, the regulated electrical corporation shall provide information to the customer regarding the availability of other nonaffiliated entities that provide the same goods or services." See Proposed Rule 4 CSR 240-20.015(2)(D). KCPL should not be forced to subsidize its competitors. The proposed rule also states that a "regulated electrical corporations 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." See Proposed Rule 4 CSR 240-20.015(2)(B). So long as a regulated utility's customers do not subsidize an unregulated transaction, the utility and its affiliate should be permitted to reap the benefits of their successful efforts. With the exception of essential assets, *i.e.*, those assets that are required to be made available to all competitors in order to ensure "open access," regulated utilities should not be forced to share its resources, including customers leads, with its competitors.

These rules have absolutely no relationship to the prevention of cross-subsidies, the state purpose of the proposed rule. Indeed, if adopted, they will work completely at cross purposes with the Commission's goal of establishing a competitive marketplace. It is in the interest of customers and utilities to have this issue resolved in a separate docket. The stated purpose in the published purposed rule is to "prevent regulated utilities from subsidizing their nonregulated operations." See Proposed Rule 4 CSR 240-20.015. It does not state that it is intended to restrict the ability of Missouri utilities to provide goods and services in a competitive marketplace. If it decides to resolve this issue in this docket, the Commission should know that there are compelling reasons why competitive handicaps harm both customers and utilities.

In competitive markets, companies maximize profits by serving consumers well. "Inherent in the competitive process is the fact that different competitors will always have differing mixes of strengths and weaknesses in vying for consumers. This is a strength of the process, and redounds to the benefit of consumers. In market-based competition, there are no artificial 'handicaps' placed on competitors to attempt to render all competitors equal in strengths and weaknesses. Quite the contrary, market competition embodies incentives for each competitor to utilize its unique mix of attributes to the fullest to serve consumers well because, in a competitive market, serving consumers well is the only way a firm is rewarded." Caswell O. Hobbs III, *et al.*, State Marketing Restrictions on Electric Utilities: Effects on Competition from Competitive Handicapping, p. 3 (EEI 1997). This diversity of strengths and weaknesses provides consumers with an increased product, service and price mix. Officials at both the Federal Trade Commission and the Department of Justice have rejected competitive handicapping of incumbent utilities as detrimental to competition and consumer welfare.

In recent years countries the world over have learned the hard way that robust competition between firms with different strengths and weaknesses results in more products and services and a wider range of prices and have acted to establish competitive business environments. KCPL recommends that the Commission reject the following anticompetitive provisions:

i) 4 CSR 240-20.015(1)(F);
ii) 4 CSR 240-20.015(2)(B); and
iii) 4 CSR 240-20.015(2)(D).

The Commission should reject any proposals that seek to impose asymmetric "corrective" handicaps on Missouri utilities. Ultimately, the biggest loser will be consumers, who will experience increased prices and fewer choices.

WHEREFORE, for the foregoing reasons, KCPL respectfully requests that the Commission enter an order consistent with the comments set forth herein.

Respectfully submitted,

Kansas City Power & Light Company

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