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July 30, 1999

VIA FEDERAL EXPRESS MAIL

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
Truman Building
301 West High Street, 7-N
Jefferson City, MO 65101

FILED
AUG 02 1999
Missouri Public Service Commission

Re: MPSC Case No. EX-99-442

Dear Mr. Roberts:

Enclosed for filing in the above-referenced matter are an original and fourteen (14) copies of Ameren Corporation/Union Electric Company's Reply Comments.

Kindly acknowledge receipt of this filing by stamping as filed a copy of this letter and returning it to the undersigned in the enclosed envelope.

Sincerely,

William J. Niehoff
Attorney-at-Law

Enclosures
cc: Service List

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

PROPOSED RULE 4 CSR 240-20.015
Affiliate Transactions
Electric Utilities

Reply Comments of
Ameren Corporation and Union Electric Company

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Dated: July 30, 1999

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INTRODUCTION

The Comments on the Proposed Rule reveal significant agreement between Ameren and the Commission Staff. Ameren agrees with the Staff, as well as with the Office of Public Counsel (OPC), that improving consumer welfare is the ultimate goal of this rulemaking proceeding. Ameren also agrees that utility-affiliate transactions may present some opportunities for abuse and that there may be some need for some regulation of the utility-affiliate relationship.

Nevertheless, notwithstanding the agreement on the goals of the rulemaking, the Rule proposed by the Commission and endorsed by several of the parties submitting initial comments is flawed for several reasons.

First, and most fundamentally, the Proposed Rule fails to allow realization of the consumer benefits of utility-affiliate transactions. Indeed, the Staff's comments make it clear that the Proposed Rule is premised on the misconception that utility-affiliate transactions are inherently anti-consumer. Though some of the parties, including the OPC, recognize that utility-affiliate transactions offer potential for tremendous consumer benefits, those parties fail to propose rules that would allow full realization of those benefits. Utility-affiliate transactions involving *non-essential* services and information allow realization of efficiencies and promise significant consumer benefits.

Two other misconceptions are inherent in the Proposed Rule and apparent in several parties' comments. Several parties argue that companies entering the affiliate's markets need complete protection from every competitive advantage – illegitimate and legitimate – enjoyed by a utility and its affiliates. In fact, consumer welfare is maximized and a level playing field exists when entering competitors are protected only from illegitimate advantages obtained via the utility's abuse of its control over *essential* facilities. Similarly, though several parties seem to believe that a strict, prophylactic and punitive regulatory scheme maximizes consumer welfare, a light-handed regulatory scheme – narrowly tailored to particular problems – actually is best for consumer welfare.

In sum, the Commission should adopt a Rule that protects against potential abuses of utility-affiliate transactions but permits realization of the benefits of those transactions. In order to protect consumer welfare, the Commission should reject those comments that argue for the blanket protection of the utility's competitors and should reject pointlessly strict and rigid regulations. The Commission should adopt the rules proposed in Ameren's initial comments.

REPLY COMMENTS

I. Ameren Shares The Commission's Goal Of Improving Consumer Welfare.

Though there are significant differences of opinion among the commenting parties with regard to the Staff's Proposed Rule, a review of the initial comments reveals a remarkable level of agreement on at least three issues.

First, whether they state it explicitly or implicitly, virtually all of the commenting parties agree that the fundamental goal of the Commission's rulemaking is to improve consumer welfare. *See, e.g.,* Comments of the Staff of the Commission at 1 (purpose of Rule is to ensure that ratepayers pay only a just and reasonable amount for regulated services and ensure that ratepayers get a "corresponding benefit" for higher rates); Comments of the Office of Public Counsel (OPC) at 2-3. They also agree that consumers benefit most in an environment of low prices, quality service, and diverse service offerings.

Second, Ameren, the Staff and most of the other parties agree that there is the possibility of a negative impact on consumer welfare from utility-affiliate transactions. *See* Ameren's Initial Comments at 5-6; Proposed Rule's Statement of *PURPOSE*; Staff Comments at 1; OPC Comments at 1-4. Similarly, on at least a general level, there is substantial agreement with respect to the nature of those potential harms. Virtually all of the parties recognize cross-subsidization, discrimination, and tying as potential problems with utility-affiliate transactions.

Finally, Ameren agrees with the Staff and with the OPC that some regulation of utility-affiliate transactions may be necessary in order to maximize consumer welfare.

II. The Proposed Rule Fails To Meet The Goals Of This Rulemaking.

Though there are significant areas of agreement between Ameren and the other parties – most particularly about the goals of the rulemaking and the potential harms of utility-affiliate transactions – there are also significant areas of disagreement apparent from the parties' initial comments. For the most part, these areas of disagreement arise from several basic misconceptions common to those comments and proposed revisions to the Rules.

A. Fundamental Misconceptions Underlying the Proposed Rule.

The three fundamental misconceptions underlying the problematic Proposed Rule provisions and the comments made in its support are: (1) utility-affiliate transactions offer insignificant consumer benefits; (2) protecting competitors is equivalent to protecting competition and consumers; and (3) heavy-handed regulation is necessary. Each of these misconceptions has a significant and harmful impact on consumers.

Utility-affiliate transactions offer considerable benefits to consumer welfare. The comments submitted by the Staff, the OPC, and other non-utility parties such as Enron spend considerable energy describing the potential harmful effects on consumer welfare of utility-affiliate transactions. In contrast, these same parties will neither recognize nor admit that utility-affiliate transactions offer considerable benefits to consumer welfare. (Only the OPC grudgingly concedes that utility-affiliate transactions offer some benefits to consumer welfare, but the OPC greatly understates both the character and scope of those benefits, *see below*).

That consumers benefit from utility-affiliate transactions is well known, observable, and well accepted in the academic community. *See generally* Rebuttal Comments of Dr. J. Landon attached hereto as Exhibit A. Indeed, and as Ameren recognized in its initial comments on the Proposed Rule, the significant benefits of utility-affiliate transactions have long been recognized and protected in the regulation of utility-affiliate transactions on the federal level. *See* Ameren's Initial Comments at 11-17. Nevertheless, neither the Staff nor any other non-utility party recognizes the full scope and scale of these benefits.

The pro-consumer effects of utility-affiliate transactions arise from the utility's provision of *non-essential* services or information to its affiliate (or vice-versa) on an efficient basis. As Ameren described in its initial comments, utilities and their affiliates are able to realize economies of scale and scope by efficiently sharing *non-essential* goods, services, and information such as office space, computer equipment, advertising and marketing, and legal accounting staffs. *See* Ameren Initial Comments 7-8; 13-16.

The type of utility-affiliate transactions that *improve* consumer welfare and the type that *harm* consumer welfare bear some superficial similarity: in each circumstance, the utility and its affiliate are sharing a resource. The critical distinction between the two types of transactions depends upon whether the services or information involved in the transaction are *essential* or *non-essential.*

If the services are *essential* (*i.e.*, cannot be purchased, developed or duplicated by entities other than the utility), then the utilities' preferential provision of those services has the potential to be unfairly discriminatory. With respect to *essential* services, which include tariffed utility services, competitors of the utility and its affiliate cannot match the utilities' monopoly-based advantages. Hence, those competitors are ultimately forced from the affiliate's competitive market to the detriment of consumers.

If, however, the services are *non-essential* (*i.e.*, can be purchased, developed or duplicated by non-utilities), then the utilities' preferential provision of those services is the essence of efficiency, integration, and competition, and promises to *benefit* consumers. With respect to *non-essential* services and information, the competitors of the utility and its affiliate are fully capable of matching the increased efficiency of the utility and/or its affiliate, with the effect that considerable benefits are passed on to consumers.

Protecting a utility's competitors is not the same thing as protecting competition – protecting competitors can harm consumer welfare. Some of the parties submitting comments on the Proposed Rule argue that utilities and their affiliates should be strictly regulated in order to benefit those companies that intend to compete with utilities in unregulated markets. *See* OPC Comments at 3-4; Comments of Enron Corporation at 2-3. These parties demand that the utility's affiliates be forced to operate almost completely separately from the utility and forego virtually every efficiency potentially arising from integration with the utility.

These comments fail to recognize that complete separation of the utility and its affiliates operates to the benefit of the affiliates' competitors but to the detriment of consumers. If an affiliate and utility are required to operate completely separately, then the affiliate is unable to realize the benefits of the utility's efficient provision of non-essential services. That circumstance benefits the affiliates' competitors by freeing them from the need to realize potential efficiencies, but harms consumers who lose the benefit of those potential efficiencies.

Structural separation results in a skewed playing field that benefits non-utility-affiliated competitors but harms consumers. A genuinely level playing field results not from compete structural separation, but from regulation that is narrowly tailored to the problems that arise from the utility's control over *essential* facilities unavailable to other non-utility companies. It is necessary to ensure that utilities do not cross-subsidize their affiliates, and that they do not discriminate with respect to *essential* services, resources, and information. Beyond these prohibitions, however, it is not necessary to hamper the utilities or their affiliates in order to ensure that markets for non-essential services will be competitive.

Each of the affiliates' competitors is able to compete fairly and for the benefit of all consumers with the utility and its affiliates with respect to *non-essential* services and information. *Non-essential* services include things like advertising and brand familiarity. All of the likely participants in the competitive businesses in which the affiliates operate will come to the market with their own advantages and disadvantages. Some are born of the individual firm's history. For example, in-state electric and gas utilities will surely know the local terrain. But, they (and their affiliates) may have comparatively little experience in marketing and earning profits other than on a regulated rate-of-return basis. On the other hand, out-of-state energy companies such as Enron will bring their enormous financial resources, their experience in the deregulated environment in other states and in other businesses, and their economies of scale and scope that arise from their own corporate size and structure. Furthermore, many of these companies – including Enron – have one or more regulated companies in their corporate families.

Over-regulation harms consumers. In their initial comments, several of the parties argue – explicitly or implicitly – that more strict and punitive regulation of utility-affiliate transactions could only benefit consumers. *See, e.g.,* OPC Comments at 2. As Dr. Landon makes clear both in his initial comments and his comments appended hereto, this argument is deeply flawed in spite of its superficial appeal to some. *See* Initial Comments of Dr. Landon at 5-6; Rebuttal Comments of Dr. Landon at 1-2. Over-regulation and the prohibition of activities or transactions that do not threaten consumer welfare will affirmatively harm consumers.

The first and most obvious way in which over-regulation can harm consumer welfare is by preventing utilities and their affiliates from engaging in transactions or activities that benefit consumers. In addition, regulation is costly and inefficient, and both regulated parties and the Government necessarily incur costs. Over-regulation generally imposes significant costs without any concomitant benefit.

Over-regulation can also impose costs and create other problems by conflicting with pre-existing regulatory schemes or other legal mechanisms that already operate effectively to prohibit the harms associated with utility-affiliate transactions. For example, antitrust, consumer fraud, and deceptive business and trade practice laws provide formidable and time-tested protections against anti-competitive or deceptive behavior without imposing the costs associated with overbroad, prophylactic regulations. *See* Ameren Initial Comments at 10-17. Additional and inconsistent regulation only hurts consumer welfare.

Finally, the harms threatened by over-regulation are difficult to detect and often even more difficult to eliminate. Once a strict regulatory regime is imposed, there is often little incentive to revisit the imposition of that regime. Consumers may have worse service and higher prices than in the absence of strict regulation, but those harms are more intangible and less apparent – but not any less harmful – than the harms caused by cross-subsidization, discrimination, or tying. As a result, consumers often fail to realize the harm that they suffer as a result of over-regulation.

B. The Proposed Rule Does Not Effectively Address Utility-Affiliate Transactions.

The Commission can accomplish its goal of achieving consumer welfare only by adopting a Rule that:

(1) prohibits cross-subsidization, discrimination in the provision of essential information and services, and improper tying with respect to utility-affiliate transactions;

(2) permits and encourages utility-affiliate transactions that promise to benefit consumers;

(3) creates a truly level playing field for utilities and their affiliates, and corporations competing with them; and

(4) eschews harmful over-regulation in favor of prohibitions tailored to potential harms.

As currently drafted, the Proposed Rule does not accomplish these four objectives. Thus, it fails to accomplish the Commission's ultimate goal of improving consumer welfare. Similarly, the changes and revisions urged by parties endorsing the Proposed Rule or urging its extension would only exacerbate or exaggerate the problems with the Proposed Rule.

Section 2(A) of the Proposed Rule. Section 2(A) of the Proposed Rule prohibits a utility from paying its affiliate for goods, services, or information, more than the lesser of fair market price or the fully distributed cost to the utility. It also prohibits an affiliate from paying the utility for goods, services, or information, less than the greater of fair market price or the fully distributed cost to the utility. In its comments, the Commission's Staff advocates use of asymmetrical pricing and distributed costs to regulate inter-company transfers. *See* Staff Comments at 11-12.

As Ameren described in its initial brief, Section 2(A) goes far beyond its intended purpose of preventing cross-subsidization. *See* Ameren Initial Comments at 20-23. Through its use of asymmetrical pricing, Section 2(A) guarantees to eliminate – in addition to the possibility of cross-subsidization – all potential benefits and efficiencies of utility-affiliate transactions.

As Ameren argues in its initial Comments, the Commission should adopt a flexible system whereby each utility files with the Commission a services agreement that provides the cost or fair market value of services, goods and information transferred between the utility and its affiliates. *See* Ameren Comments at 27-29. Such a system would effectively prevent cross-subsidization but would allow realization of efficiencies.

A flexible services-agreement-based rule offers the additional benefit of complementing rather than conflicting with existing regulations. As Ameren stated in its initial comments, federal regulation under the Public Utilities Holding Company Act of 1935 (PUHCA) and Ameren's Cost Allocation Manual already operate to effectively prohibit Ameren and its affiliates from engaging in cross-subsidization. *See* Ameren Initial Comments at 11-17. The Commission's Proposed Rule is inconsistent with these regulatory schemes, which do not adopt a rigid asymmetrical pricing mechanism.

The Office of Public Counsel endorses Section 2(A) of the Proposed Rule. *See* OPC Comments at 26-30. The OPC's argument is dedicated to the support of an asymmetrical pricing system. The OPC argues that the regulations should create incentives for utilities and their affiliates to ensure that no transactions ever operate to the detriment of the utility or its ratepayers.

Ameren agrees with the OPC that regulated operations should not be allowed to subsidize unregulated activities, but also believes that asymmetrical pricing brings its own risk of harm to ratepayers. The OPC seems to agree with this argument, conceding that under some circumstances, the Commission's asymmetrical pricing scheme could "discourage efficient operations and the taking advantage of economies of scale that could be achieved vis-à-vis growth through affiliates." OPC Comments at 29. The OPC suggests that the utility and its affiliates could deal with this problem by filing for a variance every time that they seek deviation from Section 2(A).

The OPC's suggestion that Section 2(A)'s problems are cured through the variance mechanism is unpersuasive. The OPC's proposal promises to be far more administratively burdensome and costly – both to the utilities and their affiliates and to the Commission – than a sensible and flexible alternative. These administrative costs are likely to be significant enough to deter utilities and their affiliates from pursuing variances that could benefit consumers. Furthermore, as Dr. Landon noted in his initial comments, at the outset of a regulatory scheme, it is better to impose only those restrictions that are necessary than to impose greater restrictions but permit them to be appealed. *See* Initial Comments of Dr. Landon at 15.

As the OPC's comments essentially admit, Section 2(A) of the Proposed Rule is deeply flawed and will harm consumers. A more flexible alternative such as that proposed by Ameren in its initial comments is far superior.

Section 2(B) of the Proposed Rule. Section 2(B) prohibits a utility from providing any "preferential service" to any affiliate. "Preferential service" is defined by Section 1(F) to mean "information or treatment or actions by the regulated electrical corporation which places the affiliated entity at an unfair advantage over its competitors."

In its initial comments, Ameren argued that Section 2(B) of the Proposed Rule was the most troublesome of all of the Proposed Rule provisions both because it was so vague and because it seemed to prohibit discrimination with respect to both non-essential and essential services. *See* Ameren Initial Comments at 24-25.

The Staff's Comments serve to highlight the vague and open-ended character of Section 2(B) and 1(F) of the Proposed Rule. *See* Staff Comments at 10 & 13. With respect to what constitutes "preferential service," the Staff provides a number of examples, but these examples do not serve to provide a definite meaning for the phrase. Instead, they make it clear that the Staff intended the phrase "preferential service" to extend far beyond preferential treatment with respect to *essential* services – where the line should be drawn in order to maximize consumer welfare. And the Staff's comments regarding Section 2(B) make the incredibly broad reach of that provision absolutely clear: "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." Staff Comments at 13.

Section 2(B) is far too vague and far too broad. As Ameren describes in its initial comments, the Commission should abandon the phrases "preferential service" and "unfair advantage" which promise to cause only confusion. Furthermore, rather than a broad prohibition against any preferential treatment with respect to any goods, services, or information, the Commission should adopt specific prohibitions that target and eliminate the utility's ability to discriminate with respect to essential goods, services and information. *See* Ameren Initial Comments at 23-29.

In its comments on Section 2(B), the OPC recognizes the vague and problematic character of the provision. *See* OPC Comments at 5-22. The OPC proposes that Section 2(B) be supplemented with a list of specific prohibitions in the following areas: customer information; business development and customer relations; use of the name or logo of the regulated utility; joint advertising; joint marketing; and tying. *See* OPC Comments at 6-18. Finally, the OPC proposes that utilities be required to operate completely separately from their affiliates with the exception of certain specifically defined "corporate support" functions. *See* OPC Comments at 19-21. In grudgingly allowing some exceptions to its proposal for complete separation, the OPC recognizes that utility-affiliate transactions offer benefits to consumers. *See id.*

Ameren agrees with OPC's argument that Section 2(B) needs clarification and that a list of specific prohibitions is preferable to the general and vague prohibition contained in the currently proposed Section 2(B). And Ameren fully agrees with the OPC's argument that a utility and its affiliates should be allowed to share goods, services, and information to an extent greater than allowed by the currently proposed Section 2(B).

Nevertheless, the OPC's proposed revision of Section 2(B) is problematic. As Ameren has argued throughout its comments, with respect to the prohibition of discrimination, the critical distinction is between *essential* and *non-essential* services, goods, and information. *Essential* services, goods, and information are those related to the utility's control of regulated facilities. Though the OPC appears to concede this point in its comments, *see, e.g.,* OPC Comments at 21, the actual rules proposed by the OPC do not adhere to the line between *essential* and *non-essential* services.

The OPC's proposed subsection 2(A) governs information-sharing. The theory underlying the proposed subsection – that the affiliate should not benefit as a result of the utility's control over the regulated utility system and concomitant ability to collect consumer information – is unobjectionable. As Dr. Landon notes in his attached testimony, it is important to ensure that the utility makes *essential* customer information it acquires as a result of its position as a regulated monopoly available to all competitors, irrespective of their affiliation with a particular competitive supplier. *See* Rebuttal Comments of Dr. Landon at 3-4. Nevertheless, the OPC's proposed rule goes far beyond the OPC's purported rationale. The OPC's rule applies to *all* customer information – not just information related to *essential* services. Sharing of *non-essential* information improves consumer welfare through the realization of economies of scope and scale. Sections 2(D) and 2(E) of Ameren's proposed rule are far more consistent with both the goal of improving consumer welfare and the OPC's professed rationale.

The OPC's proposed Section 2(B)(1) includes a laundry list of prohibitions. The OPC claims that these prohibitions are related to a utility's ability to exploit its control over and access to *essential* services and information in order to benefit its affiliates. Nevertheless, many of the OPC's proposed prohibitions are based upon a confusion between *non-essential* information and services resulting from the utility's size and *essential* information and services resulting from the utility's unique monopoly position. While there may be a need for rules prohibiting the sharing of *essential* services and information, the ability of a utility and its affiliate to share *non-essential* services and information benefits consumers.

For instance, there is no reason why a utility should not be allowed to share market analysis reports with its affiliates (so long as they are not related to *essential* services); the large companies likely to be affiliated with competitors of the utility's affiliates are almost certainly going to share market analysis and other proprietary information with those competitors. *See* Rebuttal Comments of Dr. Landon at 7-8. To force the utility's affiliates to operate at a competitive disadvantage relative to other companies only harms consumers.

The OPC's proposed rule section 2(B)(1) should be rejected in favor of Ameren's proposed rule 2(B).[1]

In Section 2(F) of its proposed rule, the OPC argues that the Commission should prohibit a utility from tying *any* service or good to the purchase of any service or good from the utility's affiliates. Again, the OPC's justification for its rule is unable to support the rule actually proposed. The OPC contends that its Section 2(F) rule is necessary in order to ensure that a utility does not condition the purchase of an *essential* service upon the purchase of some other service or good from its affiliate. Nevertheless, the prohibition proposed by the OPC applies to both *essential* and *non-essential* goods, services, and information. Prohibiting the tying of *non-essential* goods and services would harm consumers by preventing diverse service offerings and potential competitive advantages.

Moreover, there is no need for a rule prohibiting even the tying of *essential* services. With respect to the possibility of the utility tying *essential* services to its affiliates' products, as Dr. Landon notes, existing antitrust laws effectively govern and prohibit those undesirable tying arrangements. Additional regulation is unnecessary and potentially costly. *See* Rebuttal Comments of Dr. Landon at 3. The OPC's proposed rule section 2(F) should be rejected in favor of Ameren's proposed rule 2(C).

Sections 2(G) and (H) of the OPC's proposed rule require complete separation of the utility and its affiliates with the exception of certain enumerated "corporate support" services. Enron also proposes structural separation of the utility and its affiliates, but would allow virtually no exceptions to that separation. *See* Enron Comments at 2-4.

[1] The OPC's proposed rules 2(B)(2), (C), (D), and (E) all relate to the provision of information to the consumer by the utility and the affiliate and as such will be discussed in the context of the Commission's Proposed Rule Section 2(D) below.

The structural separation proposed by the OPC and by Enron should be rejected by the Commission. Though the OPC's Sections 2(G) and (H) recognize that some utility-affiliate transactions benefit consumers, those sections are problematic both because they adopt a heavy-handed regulatory approach over a light-handed approach and because they improperly draw the line between permitted transactions and prohibited transactions. Rather than prohibiting all utility-affiliate interaction and exempting a narrowly limited class, the Commission should specifically identify and limit only those transactions that are anti-consumer. *See* Rebuttal Comments of Dr. Landon at 8-9. Such an approach would allow realization of the considerable benefits of light-handed regulation and would promise realization of the consumer benefits of utility-affiliate transactions. Furthermore, the Commission should draw the line between those services and information that are *essential* and those that are not.

Enron's proposal shares the problems of the OPC's proposed rule, but is even more problematic because it allows virtually no exceptions to the separation requirements. Enron seeks to buttress its extreme proposal by arguing that California adopted a similar approach and by attaching the rules adopted by the California Commission. *See* Enron Comments at 3. But the Missouri General Assembly, through its Joint Interim Committee on Telecommunications and Energy, has already considered and rejected California's regulatory model. The General Assembly found that "the experiences of some states, such as California, have set examples which the State of Missouri should not follow." *See* Report of the Joint Interim Committee on Telecommunications and Energy, January 1999, attached hereto as Exhibit B, at 14. Instead of Enron's California-based proposal of nearly complete separation and the OPC's proposed rules 2(G) and (H), the Commission should adopt Ameren's proposed Section 2(A).

There are two other rules proposed by the OPC that are appropriately discussed in the context of the Commission's currently proposed rule Section 2(B) even though the OPC proposes them as part of its Rule Section 3. The OPC criticizes the Staff's Proposed Rule 2(B) as vague and unworkable as applied to the transfer of employees and proposes rules – labeled Section 3(D) and 3(E) – that govern the transfer of employees between the utility and its affiliates. *See* OPC Comments at 24. Under the OPC's proposal, if an employee of a utility is transferred to an affiliate, then the affiliate must make a one-time payment to the utility in an amount equal to 25% of the employee's base salary. The OPC also proposes to prohibit that employee from returning to the utility for at least 2 years.

The OPC's proposals with respect to employee transfers are unworkable, unfair and somewhat arbitrary. *See* Rebuttal Comments of Dr. Landon at 11-12. The rule arbitrarily fixes a substantial penalty upon the affiliate every time that an employee is transferred, regardless whether he or she has access to essential information or skills related to an essential service. As Dr. Landon notes, the proposed rule would unfairly benefit the utility's competitors at the expense of consumers. *See id.* Competitors from outside the state – some of which are many times larger than Ameren – would not be subject to these same penalties.

Furthermore, the rule penalizes *utility* employees. For example, if two equally qualified persons apply for the same position at a utility affiliate – with one person an employee of the utility and the other employed outside of the utility family – the outside employee would be hired because of the 25% penalty. Likewise, a utility employee could find his career development frustrated when she is forced to find employment outside the family of companies that may include a Missouri utility.

The OPC's proposed rule promises affirmative harm to Missouri utilities and workers with no incremental benefit over the approach proposed by Ameren. In the absence of hard evidence that utilities and their affiliates are using employee transfers to circumvent the substantive prohibitions against discrimination, cross-subsidization and information-sharing, the Commission should favor a light-handed regulatory approach. If the Commission becomes aware of specific instances of abuse of employee transfers, then the Commission can take appropriate action tailored to the specific circumstance. And if such transfers become a significant and endemic problem, then the Commission may consider the harsh approach urged by the OPC. But as a first step, the Commission should favor a light-handed approach.

Section 2(D) of the Proposed Rule. Section 2(D) of the Proposed Rule requires a utility to provide a list of both affiliated and unaffiliated service providers in response to any request regarding the services provided by an affiliated entity. The Staff explains in its comments that the rule section is intended to ensure that the utility does not provide preferential treatment to its affiliates. *See* Staff Comments at 13-14.

As Ameren stated in its initial comments, Proposed Rule section 2(D) does nothing to advance the goals of consumer welfare, instead providing a competitive advantage to the affiliate's competitors. Furthermore, Section 2(D) is constitutionally suspect insofar as it unlawfully limits a utility's right to engage in commercial speech. The Staff's Comments fail to cure the provision's deficiencies.

In its comments, the OPC proposes several alternatives to Proposed Rule provision 2(D). These alternatives take the extreme approach of requiring the utility to affirmatively conceal important information from consumers seeking that information. The OPC's proposed rules 2(B)(2), (C), (D), and (E) all relate to the provision of information to the consumer:

- In Section 2(B)(2), the OPC takes the extreme position that the utilities should be prohibited from *any* communication with the consumer regarding service providers. The OPC also proposes an alternative rule whereby the utility would have to provide a list of all service providers – both affiliated and unaffiliated – in the area.
- In Section 2(C), the OPC has taken the extreme position that the utility's affiliates should be prohibited from any use of the utility's name, trademark, or logo. The OPC even contends that the affiliate should be prohibited from using any logo that "could reasonably be associated with" the utility's logo. Again, the OPC proposes alternative rules, which would allow the utility and affiliate to share logos only with payment of a annual royalty of 3% of the affiliate's gross revenues *and* would prohibit a utility from engaging in any joint advertising with its affiliates.
- Finally, the OPC proposes its rule 2(E), which would prohibit a utility from jointly marketing with its affiliates unless those same opportunities were also offered to non-affiliated competitors.

See OPC Comments 8-17.

All of the OPC's proposed rules regarding the utility's ability to provide information to the consumer (including the alternative rules) should be rejected. First, each is an unconstitutional and unlawful limit on the utility's ability to engage in free speech. Second, each is based upon the fundamental misconception that the utilities' logo, marketing resources, and advertising are *essential* services. In fact, they are resources that are already owned or easily duplicated by competitors, and therefore are *non-essential. See* Rebuttal Comments of Dr. Landon at 5-7. To the extent that the utility's brand name or reputation is a positive asset, that fact is solely a result of utility's efforts to build a solid reposition and the level of service that the utility has provided to its customers. A utility's (positive) brand name and its marketing savvy are *not* a result of its control over *essential* services and facilities. Moreover, allowing a utility and its affiliates to share a brand name would increase the incentive of each to ensure that it provides excellent service and maintains the value of that brand.

Finally, the OPC's proposed rules would impose significant inconvenience and cost on consumers seeking information about service providers in particular industries. *See id.* These costs are completely unnecessary. There are already plenty of state and federal laws that prohibit false or misleading advertising and marketing. The Commission should reject the extreme and heavy-handed regulatory approach advocated by the OPC in favor of a light-handed approach that is effective, constitutional and reasonable. Ameren's proposed rule section 2(B) is such an approach.

Section 3(A). This Section requires the utility to follow a competitive bidding process every time that it purchases goods, services or information from an affiliate. The Staff argues that the rule is necessary in order to assure that the utility does not subsidize the affiliate by overpaying for the goods, services, or information in question. *See* Staff Comments at 14.

Section 3(A) is an example of an unnecessary and burdensome prophylactic rule that imposes significant costs with virtually no benefits. Regardless whether the Commission adopts Proposed Rule 2(A) or Ameren's proposed rule governing cost allocation in utility-affiliate transactions, utilities and their affiliates will effectively be prohibited from cross-subsidization. *See* Ameren Initial Comments at 29-30. The competitive bidding requirement of Section 3(A) serves only to ensure that utilities incur additional costs through the process of arranging and conducting competitive bids. Furthermore, and as Ameren argued at length in its initial comments, Section 3(A) is inconsistent with the requirements of PUHCA. *See id.* The Commission should reject Section 3(A).

Sections 3(B)-(D). These sections, which require the utility to document the fair market price and fully distributed cost of any good or service transferred between the utility and the affiliate and require use of a Commission-approved CAM to determine cost allocation, market valuation and other cost information, are justified by the Staff in its comments as necessary to assure that the utility is not subsidizing its affiliates. *See* Staff Comments at 14-15.

Sections 3(B)-3(D) of the Proposed Rule impose significant costs without any real benefits. As Ameren describes in its initial comments, the Commission should adopt Ameren's proposed Rule 3 instead of Rules 3(B)-3(D). *See* Ameren Initial Comments 29-30.

Sections 4-5 of the Proposed Rule (Record-Keeping Requirements). In its initial comments, Ameren objected to a number of the record-keeping requirements as unnecessarily burdensome and redundant with existing requirements of federal and state law. *See* Ameren Initial Comments at 31-32. Though the Staff has issued comments in support of the proposed record-keeping requirements, those comments fail to explain or justify the need for the currently proposed onerous reporting requirements. The alternative record-keeping requirements proposed by Ameren in its initial comments should be adopted.

Compliance Audits. In its comments, Enron suggests that the Commission should audit regulated utilities for compliance with affiliate rules within one year following their enactment, and should conduct follow-up audits every three years thereafter. The Missouri Industrial Consumers propose an auditing schedule that would require the utility to file a compliance plan within 90 days of adoption of these rules, followed by an audit within one year.

As Dr. Landon describes in his attached comments, these arguments should be rejected. See Rebuttal Comments of Dr. Landon at 13. Audits are expensive and time-consuming. Though it might make sense to have an initial audit some time after the utility-affiliate rules have been implemented, the audit schedule proposed by Enron and the MIEC is burdensome, expensive and unnecessary.

Proposed penalties for misconduct. In its comments, Enron proposes stiff penalties for companies found to have violated the utility-affiliate rules. These proposals include fines of $5,000 to $20,000 per violation, with violations continuing for more than one day counting as separate violations per day. Enron also suggests that multiple violations within a year should result in prohibiting the utility from engaging in activities with its affiliate, either temporarily or permanently.

The Commission should reject these unnecessarily punitive and draconian penalties. Enron has proposed a rigid and unfair system of penalties designed to benefit the competitors of the utilities and their affiliates. *See* Rebuttal Comments of Dr. Landon at 14.

III. The Commission Should Expand The Hearings Currently Scheduled For This Rulemaking.

The Commission should expand the scope and the scale of the hearings currently scheduled regarding the promulgation of the rules regulating utility-affiliate transactions. The Proposed Rule promises to dramatically affect utilities, their affiliates, and most importantly, every consumer in the State in Missouri. The issues related to the Proposed Rule are extremely complicated. Nevertheless, the Commission has budgeted only one day of hearings on the subject of utility-affiliate transactions. There is no way that the Commission can adequately explore the relevant issues in that time. In light of the importance and complexity of the issue, the Commission should either adopt contested case proceedings or greatly expand the scale and scope of the currently scheduled hearing.

The Staff of the Commission has filed Comments arguing against the adoption of Contested Case proceedings in this Rulemaking. The Staff's sole argument is that the minimum requirements of due process will be met if the Commission has only one day of hearings. Regardless whether this is true, the Staff ignores the fact that the importance, scope and complexity of this rulemaking require a public hearing more extensive than a single day. One-day hearings will barely allow a statement of the issues to be discussed much less an examination of those issues. Consumers and other members of the public deserve more.

CONCLUSION

The Staff's Proposed Rule, like the comments of many of the parties to this proceeding, is based upon the misconception that utility-affiliate transactions are inherently or presumptively bad for consumers. In fact, so long as cross-subsidization is effectively prohibited, utility-affiliate transactions, like any other transactions within a family of companies, are presumptively good for consumers in that they allow realization of efficiencies and economies of scale and scope. It is only the limited class of utility-affiliate transactions that relate to *essential* services and information – services and information related to the utility's tariffed services – that pose some risk of unfair discrimination. By adopting a regulatory scheme tailored to these specific concerns and avoiding competitor's calls to institute a heavy-handed scheme that will operate to their benefit, the Commission will effectively prohibit potential abuses of the utility-affiliate relationship while allowing realization of the consumer benefits inherent in that relationship. The Commission should reject calls for a heavy-handed and prophylactic regulatory scheme and should revise the Staff's proposed rule in the manner proposed by Ameren in its Initial Comments.

Respectfully submitted,

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DATED: July 30, 1999

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was served on all parties of record via federal express mail on this 30th day of July, 1999.

William J. Niehoff

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STATE OF MISSOURI

PUBLIC SERVICE COMMISSION

PROPOSED RULE 4 CSR 240-20.015

AFFILIATE TRANSACTIONS

ELECTRIC UTILITIES

REPLY COMMENTS OF

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DATED: JULY 30, 1999

CONTENTS

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. I have been asked by Ameren Services Company to provide a response to comments submitted by intervenors in this proceeding on the proposed rules proposed by the MPSC.

My testimony is organized as follows. Section II provides a brief overview of what I believe should be the goals of this proceeding and the framework for Commission rulemaking, as I discussed in my previous comments on the proposed rules. Section III evaluates the comments of intervenors against this framework. I divide this section into the major issue areas that the intervenors' comments discuss. These include rules concerning the separation of the utility and its affiliates, restrictions on information sharing and the transfer of employees between the utility and its affiliates, compliance audits, recordkeeping, and penalties for misconduct. The last section presents my conclusions.

II. Brief Summary of Overarching Goals of Rules

In the comments I previously submitted to the Commission in this proceeding, I urged that the Commission's principal objective be to improve consumer welfare. The Commission would best serve the public interest by acting light-handedly in its rulemaking and by allowing competitive markets to produce the benefits of increased consumer choice, lower prices, and improved quality.

To accomplish this goal, the Commission should establish rules to ensure that firms are able to compete on their own merits on a level playing field. This means that the Commission should safeguard against truly anti-competitive behavior while ensuring that competitors are able to exploit their own legitimate competitive advantages. Specifically, cross-subsidization of unregulated activities, discriminatory access to essential facilities and information, and tying of competitive and regulated services in violation of state or federal law should be prevented by the Commission's rules. On the other hand, the Commission should ensure that the incumbent utility is not handicapped in its ability to compete by unnecessarily restrictive or asymmetric regulation. Such measures would eventually harm competition and, thereby, consumers. Additionally, the Commission should also not duplicate regulations or rules that other institutions already effectively address. In these instances, adding new rules could create unnecessary additional compliance costs or conflict with existing institutions.

III. Evaluation of Comments Offered by the Various Parties

A. Rules that deal with legitimate concerns

I agree with the intent of the Staff in establishing rules that create a level playing field in those markets in which a utility's affiliate will be competing with other firms. This goal is furthered to the extent that the proposed Staff rules focus on the limitation of cross-subsidization and discriminatory access to essential facilities and information. In competitive markets, such as gas sales, ensuring that the utility, for example, makes essential customer information it acquires as a result of its position as a regulated monopoly available to all competitors, irrespective of their affiliation with a particular competitive supplier, is important to providing a fair competitive environment. Similarly, proposed rules that ban unequal treatment of the utility's affiliated and unaffiliated customers are both reasonable and in the interests of consumers.

Some proposed rules address anti-competitive activities, but are unnecessary because other existing rules or institutions already restrict or regulate such activities. For example, The Missouri Office of the Public Counsel (OPC) and the Missouri Utilities suggest that an explicit rule be added that prevents the utility from tying its regulated and unregulated services. While such tying would be anti-competitive, there is no need for an explicit rule by the Commission in this proceeding, as anti-trust laws already exist that prohibit such behavior. Similarly, while I agree that the utility should not be allowed to cross-subsidize its unregulated affiliate, a concern raised by Enron, existing Commission rate authority and, in Ameren's case, the Public Utility Holding Company Act (PUHCA) and the Company's Cost Allocation Manual already provide more than adequate protection against cross-subsidization. These measures already regulate the proper accounting of the regulated utility's costs and financial activities.

I agree with the intervenors that have called for greater clarity in the definition of activities addressed by the Staff's rules. The more explicitly and narrowly the Commission defines which activities it intends to regulate, the less confusion there will be in the future about the utility's compliance with the rules.

B. Rules that inappropriately attempt to restrict non-essential information

1. Restricted use or charges for use of utility's name and logo.

Mountain Energy, the OPC, and Enron have all suggested that the utility's affiliate be forced to use a different name and logo from the parent utility. I disagree with this prohibition. Corporate names and reputation convey valuable information to consumers and should not be abandoned lightly. Consumer experience with a supplier's products and services is embodied in its name. Such information, be it favorable or unfavorable, is a valuable asset to consumers. While it is reasonable to require clarity as to whether services are offered by regulated or unregulated affiliates, there is no competitive reason to require the affiliate to use a different name than its parent or establish a new division to market its competitive services. The company's name and logo carry valuable information to the consumer about the supplier's reputation, and there is no reason to think that consumers will remain with the utility merely because they previously had no choice of supplier. Further, outside firms competing in Missouri would not face similar restrictions on the use of name and logo, even though many (including Enron, which has commented on the proposed rules) will be owned by large, well-known parent companies. The Illinois Commerce Commission has in fact expressly ruled in an affiliate non-discrimination proceeding that the utility could share its name and logo with affiliates.[1] The proposed rules by the OPC prohibiting such sharing are unnecessarily broad

[1] Illinois Commerce Commission, Docket Nos. 98-0013 & 98-0035, Appendix, "Non-Discrimination in Affiliate Transactions for Electric Utilities", Section 450.25(b).

and favor the interests of competitors over the interests of consumers. A rule focused on clarity in the distinction between regulated and unregulated entities would address any anti-competitive concerns and would preserve important consumer information, as well as operational efficiencies for the utility.

In competitive markets, firms generally differ widely in their abilities, reputations, and performance. Competition often creates diversity. Firms differentiate their products and service in order to attract sales from their rivals. Competition drives firms to improve their products and service and to lower costs and prices to gain and retain customers. New entrants must overcome existing firms' advantages stemming from reputation and customer loyalty by offering competitive or superior products, service, and prices. Unless new entrants can succeed on their merits, they will not long remain in business. Penalizing incumbents for their legitimate advantages over rival firms serves only to harm consumers.

The OPC, anticipating opposition to its prohibition on the shared use of name and logo by an affiliate, has included an alternative proposal. This rule would force the utility to announce in its advertising that the affiliate is a separate, unregulated company and charge the affiliate a 3% royalty fee for the use of the utility's name, logo, or trademark. I agree with informing consumers that the utility and its affiliate are separate companies, but take exception with the idea of a royalty fee. No other entrant in competitive markets in Missouri, regardless of their affiliation with well-known parent companies, will have to pay a similar fee to its parent or to Missouri ratepayers. Hence, this fee will merely add to the incumbent's affiliate's costs and reduce its efficiency. The fee also implies that ratepayers have ownership rights to the utility's name and identity--these belong to shareholders.

2. Restrictions on information provided about affiliate.

There is no reason to believe that joint advertising and marketing by a utility and its affiliate will provide an unfair or competition-reducing marketing advantage. Using advertising to let people know the various businesses you are in does not disable competitors, nor does it convey strategic advantages unavailable to other integrated entrants.

The OPC would like to add a rule prohibiting the utility from including the affiliate's name when it provides a list of competitive suppliers to its customers. The OPC even goes so far as to suggest that the utility refer its customers to independent sources, such as the Yellow Pages, for this information. I strongly disagree with these suggestions. The utility is in a good position to provide information about competitive suppliers to its customers, and customers will view the utility as a likely source of this information. As long as the information is unbiased and factual, there is no basis for preventing its dissemination.

To prevent the utility from giving out information about its own affiliate would be to deny customers access to full information about their choices. While the utility should not be able to take advantage of its position as a monopoly provider to promote its affiliate and deny customers information about other providers, it is equally unfair to prohibit the utility from mentioning its own affiliate to customers that want such information. Worse, sending customers to the Yellow Pages in order to prevent the utility from favoring its affiliate simply increases the amount of legwork that customers need to do to learn about their market options. This is an excellent example of a rule that ironically lowers consumer welfare in the supposed name of "free competition".

3. Availability of all *utility information to all affiliated and non-affiliated providers.*

As I stated in my comments in the first stage of this proceeding, I believe that some of the Staff's proposed rules go well beyond essential services and information and opportunities for cross-subsidy. The Staff's proposed rules, for example, contain a provision for the regulated gas company to provide "information" related to transportation contemporaneously to all nonaffiliated marketers. Such a rule needs to specify the type of information that must be shared, and the Commission should limit such forced sharing to essential information. The OPC, which generally supports the proposed rules, has also called for further clarification of the definition of "customer information", as it applies to these rules. I share their concern for clearer definitions of the type of information that the Commission intends to regulate, but add that the Commission should regulate information flows as narrowly as possible to prevent discriminatory access to non-duplicable, essential information without creating handicaps for the incumbent utility or its unregulated affiliates.

Enron similarly raises concerns about the utility's sharing of information with its affiliate. It calls for the utility to be prohibited from sharing any non-publicly available reports, such as market forecasts or analyses, with its affiliate. I disagree with such prohibitions. Any private information gives the owner a competitive advantage over other participants in the market. The mere fact that certain information may be difficult or costly to acquire does not make it essential; therefore, the Commission should not force a firm to share non-essential information because of its cost. Forced sharing of all information would greatly decrease the value of private information, and therefore would reduce much of the incentive to incur the time and expense to gather it. This would make firms and markets less efficient, which clearly is not the goal of the Commission. There is no clear rationale for requiring the utility to divulge non-public non-essential information. This is especially so when there is no comparable requirement for other suppliers to divulge their non-public information to the market. Moreover, the utility will sometimes receive private information from competitive suppliers that clearly should be kept confidential from both its competitive affiliate and other market participants to preserve fair competition.

As with information, the Commission should not force the utility to share non-essential services with all non-affiliated competitors. The Staff has proposed non-discriminatory access to all services provided to its affiliate. The Staff's proposal might include, for example, financial, human resources, and treasury services. Compelling provision of these services to competitors clearly exceeds what is required to provide non-discriminatory access to essential facilities and information. It is important for the Commission to consider the potential costs of such sweeping rules and compare them to alternatives that preserve consumer benefits while facilitating competition.

C. Rules that diminish economies of scale and scope

1. Structural separation of utility and affiliate.

Enron contends that utilities are engaging in anti-competitive behavior, but does not provide specifics. Enron suggests that "behavioral separation" is inadequate for preventing anti-competitive behavior by the regulated utility, and that FERC-style separation, patterned after FERC Order 888, should be implemented. However, that FERC order concludes that "corporate unbundling should not now be required"[2]. Enron's proposed separation measures go well beyond what is necessary to achieve a level competitive arena. Structural separation like that proposed by Enron would cause Ameren to lose valuable economies of scale and scope that benefit customers through lower average operating costs. The Commission should resort to separation rules only in situations where other less severe measures have been proven not to allow fair competition.

The Commission should also consider that new entrants will also possess their own economies of scale and scope. For example, many large firms such as Enron, PG&E, and Southern Company can be expected to enter Ameren's markets, if an when energy markets are fully deregulated. These firms will possess economies of scale and scope and are bigger in many dimensions than Ameren. Customers stand to benefit if all firms are allowed to exploit every legitimate cost advantage available to them. To this end, the Commission should be careful not to tie the incumbent's hands by restricting the extent to which it can share facilities and staff between regulated and unregulated activities, assuming appropriate affiliate transactions rules. All competitors, both entrants and incumbents, will have advantages and disadvantages. For example, entrants such as Enron and PG&E have the advantage of experience with competitive markets and possess scope economies associated with providing both gas and electricity. Both companies also have regulated electric utilities in their corporate families.

[2] Federal Energy Regulatory Commission, Order No. 888, Final Rule, April 24, 1996, Docket No. RM95-8-000, p. 57. The Commission defines "functional unbundling" to mean: (1) a public utility must take transmission services (including ancillary services) for all of its new wholesale sales and purchases of energy under the same tariff of general applicability as do others; (2) a public utility must state separate rates for wholesale generation, transmission, and ancillary services; (3) a public utility must rely on the same electronic information network that its transmission customers rely on to obtain information about its transmission system when buying or selling power. (Order 888, p. 57)

2. Limiting of sharing of non-essential services, office space, and systems.

Several parties in this proceeding have expressed concern about joint activities by the regulated utility and its affiliates. As long as the activities in question do not involve preferential access to essential facilities or essential information, there is no economic reason to prohibit the utility and affiliate from acting jointly. Allowing the utility and affiliates to act jointly can result in cost savings from taking advantage of economies of scope and increase choices available to customers.

Enron's comments include a proposal to prohibit the sharing of office space, office equipment, services, or systems between the utility and its affiliates. I believe such blanket restrictions on sharing do more to help entering competitors than to aid consumers through fairer competition. Sharing services involving non-essential facilities and information allows the utility and its affiliate to save on costs while having no unfair effect on other firms' ability to compete. Software firewalls and passwords are today well established means to allow sharing of computer hardware, while still preserving separation of sensitive data. While restrictions on the common use of some equipment may be necessary for certain activities, a rule that eliminates all equipment sharing will raise utility costs without enhancing competition.

D. Rules unreasonably restricting employee transfers between utility and affiliate

1. Compensation by the affiliate for transferred employees or for training.

Some parties in this proceeding have recommended that, if employees are allowed to transfer between the regulated utility and its unregulated affiliate, that the affiliate compensate utility ratepayers by making a payment to the utility. For example, the OPC has proposed a rule that would have the affiliate, for every employee transferred from the utility to the affiliate, make a one-time payment to the utility equal to 25% of the employee's base salary. The Missouri Industrial Consumers have proposed a similar rule, saying that the affiliate should compensate the utility to reflect the value of the training received by the employee and the cost the utility must incur to replace this employee.

Such rules would force asymmetric regulation on the utility and tilt the rules unfairly in favor of competitors. Neither the OPC nor the Industrial Consumers appear to be concerned about utility employees that leave to work for a non-affiliated firm competing in the Missouri market, despite the fact that the utility would need to incur the same costs of hiring and training replacement employees. No rules have been proposed that would force other non-affiliated companies to compensate ratepayers for the training these workers have received or for the utility's costs of replacing them. In free labor markets, skills belong to the worker, not to his employer. Artificial restrictions on employment would restrict the free movement of labor and raise market costs.

2. *Setting a minimum length of time for a transferred employee to return to the utility.*

Similarly, other parties have called for restrictions on the length of time a transferred employee must stay at an affiliate before he can transfer back to the utility. Enron has called for a rule prohibiting the return of an employee to the regulated utility for at least one year following transfer to an affiliate; the OPC recommends a minimum two-year waiting period for an employee's return to the utility. I believe these rules would be burdensome, costly, and unnecessary to preserve competition. As in the rule proposing compensation for transferred employees, the intervenors target only the utility's affiliates and not non-affiliated competitors. This suggests to me that these parties want to handicap the incumbent and establish rules protecting the interests of potential entrants, regardless of the effect of these rules on consumers.

E. Compliance audits

Enron has suggested that the Commission audit a regulated gas corporation for compliance with affiliate rules no later than one year following their enactment, with follow-up audits every third year thereafter. The Missouri Industrial Consumers propose an auditing schedule that would require the utility to file a compliance plan within 90 days of adoption of these rules, followed by an audit within one year. Audits tend to be expensive and time consuming and should be used sparingly. An audit after the first year or two of implementation may be reasonable, but the Commission should condition further audits on findings that violations are likely to be occurring.

The Industrial Consumers have suggested that the utility's shareholders cover the costs of these audits. This measure clearly would not match the costs of the affiliate rules with their benefits. Because competitive markets involving regulated entities require certain rules and regulations in order to ensure that ratepayers receive the benefits of effective competition, such regulation create unavoidable costs. However, there is no clear reason for forcing the utility to shoulder all costs simply because they are the target of these regulations. Ratepayers stand to benefit from competitive markets it is only fair that they cover the costs. If the Commission is prudent in its rulemaking and creates an environment for effective competition by regulating light-handedly, these benefits should far outweigh the additional regulatory costs, including any compliance audits.

F. Reporting requirements

In my previous round of comments in this proceeding, I criticized the Staff's proposed reporting requirements for being unnecessarily and unfairly burdensome on the utility and its affiliate. Having read similar comments by other parties that would be affected by the Staff rules, I echo their concerns of excessive reporting requirements. I believe that reporting, beyond what the Commission currently requires in its regulation of utility operations, should be limited to information required to monitor cross-subsidies and access to essential facilities and information.

G. Proposed penalties for misconduct

Enron, which contends that integrated utilities engage in anti-competitive behavior such as denial of access to essential facilities and information, has recommended stiff penalties for utility violations of affiliate rules. These would include fines of $5,000 to $20,000 per violation, with violations continuing for more than one day counting as separate violations per day. Additionally, Enron suggests that multiple violations within a year should result in prohibiting the utility from engaging in activities with its affiliate, either temporarily or permanently.

I consider these penalties to be draconian. They do not reflect the extent and nature of any violations, nor do they leave any room for the Commission to consider the intent of any misdeeds, whether they are purposeful or incidental, the level of the person accused of wrongdoing, or the effects of any violation. Enron's harsh penalty suggestions seem more focused on harming the incumbent than with maintaining a level competitive playing field.

IV. Conclusions

As I emphasized in the previous round of comments in this proceeding, the Commission should consider the interests of the consumer to be the top priority in its utility-affiliate rulemaking. These interests are best served through light-handed rules that curb specific anti-competitive activities while not creating unnecessary obstacles for the utility to overcome in its attempts to compete. Competition will best be able to produce benefits for consumers when all firms can take advantage of their individual legitimate advantages. My concern in reading the comments of several intervenors is that some parties are placing the interests of individual competitors ahead of the goal of establishing a level competitive playing field that gives effective competition the greatest chance to evolve. The Commission should look beyond these individual interests in order to maximize consumer welfare.

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

John H. Landon

SUBSCRIBED AND SWORN TO BEFORE ME by the said John H. Landon this [28th] day of July, 1999.

NANCY S. JONG
COMM. #1204764
Notary Public-California
SAN FRANCISCO COUNTY
My Comm. Exp. Dec. 26, 2002

Nancy S. Jong

Notary Public in and for the State of California

Report of the
Joint Interim Committee
on Telecommunications and Energy

January 1999

TO THE PRESIDENT PRO TEMPORE
OF THE SENATE
AND THE SPEAKER
OF THE
HOUSE OF REPRESENTATIVES
OF THE NINETIETH GENERAL ASSEMBLY
OF THE STATE OF MISSOURI

Your Joint Interim Committee on Telecommunications and Energy begs leave to submit the following report:

Senator Wayne Goode, Chair	Representative Carol Jean Mays, Chair
Senator Doyle Childers	Representative Gary Burton
Senator William L. Clay, Jr.	Representative John Griesheimer
Senator Francis Flotron	Representative Daniel Hegeman
Senator Peter Kinder	Representative Sam Leake
Senator James Mathewson	Representative Don Koller
Senator John Schneider	Representative Joseph Treadway

REPORT OF THE

JOINT INTERIM COMMITTEE

ON

TELECOMMUNICATIONS AND ENERGY

COMMITTEE MEMBERS

Senator Wayne Goode, Chair	Representative Carol Jean Mays, Chair
Senator Doyle Childers	Representative Gary Burton
Senator William L. Clay, Jr.	Representative John Griesheimer
Senator Francis Flotron	Representative Daniel Hegeman
Senator Peter Kinder	Representative Sam Leake
Senator James Mathewson	Representative Don Koller
Senator John Schneider	Representative Joseph Treadway

STAFF

Otto Fajen, Senate Research
Russ Hembree, Senate Research
Donna Schlosser, House Research
Joan Gummels, Senate Research
Diane Skaggs, Senate Recorder and Transcriber

TABLE OF CONTENTS

I. INTRODUCTION

We respectfully submit to you the Report of the Joint Interim Committee on Telecommunications and Energy. In 1997, the General Assembly adopted Senate Concurrent Resolution 7 that established the Committee and instructed it to analyze the issues surrounding restructuring the electric power system, taxation issues related to telecommunications and other utilities, and wireless telephone enhanced 911 (E-911) service.

In 1997, the Committee held public hearings on three days to take public testimony, two special workshop sessions, and one committee work session. Hearings took place in Jefferson City on July 24 and 25 and August 28, 1997. Fifty-eight persons testified before the Committee and several submitted written materials in lieu of oral testimony. The Committee held a work session on August 29, 1997. One special workshop session on October 28 entailed invited testimony of taxation and wireless telephone issues and another on November 13 involved invited presentations on proposed electric power industry market structures.

At the work session on August 29, 1997 the Committee voted to pursue legislation on wireless telephone E-911 service and legislation to address municipal gross receipts taxes and inconsistencies in state sales tax among telecommunications and cable service providers. The Committee also voted to continue to study the overall issue of utility restructuring and cooperate with the Public Service Commission Task Force which concluded its work in May 1998.

In the 1998 legislative session, SB 743 was enacted, which implements the Committee's recommendations regarding wireless telephone E-911 service. The additional fee proposed by that legislation will be submitted to statewide vote in April 1999. SB 627 from 1998 implements the Committee's recommendations to address municipal gross receipts taxes. Two bills were filed in the 1998 session to address electric restructuring, but no bills were voted out of committee.

During the 1998 interim, the Committee held public hearings on six days to take testimony. Hearings took place in Jefferson City on August 25 and 26, 1998 to hear presentation of the Final Report of the PSC Task Force. Hearings took place in Jefferson City on September 15 and 16, 1998 to hear presentation of the PSC Staff Restructuring Plan and public comment on the Final Report of the Task Force and on the Staff Restructuring Plan. Hearings took place in Jefferson City on October 28, 1998 to hear further testimony on several specific issues of interest. The Committee held a hearing and work session on December 18, 1998 to hear testimony on several issues and to discuss recommendations and drafting a final report. The Committee met on January 5, 1999 to consider the final report and recommended legislation.

Copies of the hearing transcripts may be obtained by contacting Senator Goode's office (573-751-2420) or Representative Mays' office (573-751-7639).

II. ELECTRIC INDUSTRY RESTRUCTURING

A. Overview

The electric utility industry in the U.S. is roughly a $300 billion business. Electricity is an essential part of every home, business, and industry. Developments over the last few years have caused many segments of society to call for significant changes in the structure and operation of the electric utility industry. The primary developments which have driven the recent efforts for restructuring are: 1) the interconnectivity of electric power systems, which has expanded the relevant power market [illegible] advances in electric generation using combined-cycle, natural gas turbines, which have reduced the capital cost of new electricity generating plants and reduced the former economies of scale which led to the siting of large plants in the past. Both of these factors have caused a questioning of the assumed natural monopoly of electric generation. Many changes have already occurred, and many more are expected. In addition, the industry is affected by both federal and state policy. Many states are responding, in part, to recent changes at the federal level. Approximately 50 percent of the states are currently considering changes to state policy on the electric industry.

B. Federal Activity and Wholesale Electric Restructuring

The regulation of wholesale electric markets is primarily a federal responsibility while retail choice remains a state-level decision. The Federal Energy Regulatory Commission (FERC) has regulatory authority over the interactions among electric utilities. The federal Energy Policy Act of 1992 encourages wholesale electric competition. Transmission line owners must provide non-discriminatory access to non-utility generators (NUGs). A recent FERC rulemaking (orders 888 and 889) called upon the regional power pools to remove rules and restrictions that unfairly limit the ability of independent generators to participate in the pools and, specifically, requires utilities to separate functionally the control of their generating plants and transmission facilities and to provide information on available transmission capacity to an online bulletin board system known as the Open Access Same-Time Information System (OASIS).

This order has not been fully implemented but has triggered ongoing discussions in the regional power pools about the restructuring needed to provide wholesale transmission access. Deciding the size and structure of a competitive wholesale market will be largely a federal and regional effort. Exactly how this will come about is not decided and is subject to ongoing negotiations. Missouri is too small to have its own power pool, and Missouri's location, straddling three existing pools, probably means that Missouri will [illegible] in concert with some or all of the other states to form the regional market. The MAIN power pool region includes most of eastern Missouri, the SPP includes western Missouri, and some Missouri utilities have involvement in the MPP which is located to the north. Proposals to establish ISOs have been filed [illegible] the MAIN proposal received initial FERC approval in September 1998.

Federal legislation to require retail electric choice has been proposed and discussed during 1998, but, as of the date of this report, no such legislation has been enacted. Thus, allowing retail electric choice remains a state-level policy decision.

The Committee finds that the development of a functioning, open-access regional wholesale electric market including all of Missouri is necessary in order for retail electric choice to be a viable policy choice for this state. The Committee recommends that all utilities and the PSC work with other utilities, power providers, and other states to establish open-access wholesale markets which guarantee reliable service as defined in this section.

C. Missouri PSC Retail Competition Task Force

The Missouri PSC established, by order, the Retail Electric Competition Task Force on May 23, 1997. The Task Force was charged with studying all relevant issues, determining the best way to structure and implement retail electric competition, and making a report to the PSC. The Task Force met for the first time on June 25, 1997 in Jefferson City, at which time four working groups were established. Most of the study, work, and discussion was conducted by these groups. The working groups are: 1) market structure and market power, 2) public interest protection, 3) stranded costs and 4) reliability. The Task Force was originally expected to complete its work and report back to the PSC by Feb. 15, 1998, but this deadline was extended, and the Task Force issued its final report in May 1999. Interested persons are encouraged to refer to the Task Force Final Report for further information and details not included in this report.

The Task Force working group chairs and PSC-Staff co-chairs made presentations to the Joint Committee on their respective portions of the Task Force Report on August 25 and 26, 1998. Since the decision of whether to establish retail choice is one of the more important state policy decision in this issue, the Committee devoted considerable attention to the options presented by the Market Structure and Market Power working group. The Task Force made no recommendation as to which structure, if any, should be adopted for Missouri, and simply presented the options as possible choices for further consideration. The Committee wishes to express its appreciation for the proactive approach of the PSC in establishing the Task Force and the contributions of the Task Force members.

D. Task Force Market Structure Options:

The Task Force presented the following market structure options to the Committee:

1) Poolco Model

This option establishes a regional, statewide power exchange where one entity controls dispatch in the control region. In this option, all transactions are required to go through the power exchange. The Poolco will receive bids for generation amounts and prices from suppliers and bids for purchase amounts and prices from buyers. The Poolco would establish a "market clearing price" which is the price where the available supply bid at or below that price matches the available demand bids which promise to pay at or above that price. This model was proposed to the Committee and to the Market Structure working group by AmerenUE. As proposed, the Poolco would accept generation bids from all suppliers and purchase bids from all utility distributors. Since the only entity allowed to purchase from the pool is a distribution utility, this option does not represent full retail electric choice, but is essentially a wholesale restructuring option. Proponents suggested that this option has certain advantages; namely, little disruption of current practices for consumers, fewer complications to taxation structures, and the option, if this structure is implemented, to continue to full retail choice at a later date. Detractors argued that this model does not offer any advantages to specific consumers, would raise prices for customers of utilities with costs below the state average, and may lead to "gaming of the system" whereby the overall price is elevated for all customers.

2) Direct Access Model

Direct access is offered to customers through bilateral contracts with electricity suppliers. In this context, bilateral contracts are specific purchases of an amount of electricity for a given time at a given price agreed to by a seller and a buyer. The purchases will be set by each individual contract. In this option, a power exchange may be created voluntarily to function as a "trading hub." This option represents the maximum flexibility for purchasers and sellers to seek the best available deal. This option was proposed by the Missouri Industrial Electric Consumers (MIEC) which generally represents large electric customers. Supporters suggest that this model would best create a open competitive retail electric market, encourage existing utilities to become more efficient and provide lower rates to consumers. Detractors argue that this model will likely offer savings only to the more desirable classes of customer (large users with relatively constant demands throughout the day and year) while small, residential customers will see increased rates needed to offset the revenue lost from the departed large customers (part of which supports payment of fixed costs which will not be reduced when sales are reduced). Detractors argue that this model may not bring competitive offerings to all customer classes.

3) Hybrid Model (Bilateral contracts with a power exchange)

As in the direct access option, bilateral contracts are allowed. In this option, a power exchange will be created to function as a "trading hub." Generators and buyers can enter into contracts for the constant, forecastable loads while the power exchange would be used voluntarily, perhaps for loads that are variable on a daily or hourly basis. In this model, the market clearing price is based on sales through the power exchange and does not consider sales through bilateral contracts. This option was proposed by Kansas City Power and Light (KCPL). They suggest that this option would promote a competitive market while guaranteeing adequate capacity and reliability. Detractors argued, variously, that the hybrid model is subject to the same concerns as direct access, such as "cherry-picking" of desirable customers, or, alternatively, that the model is subject to the same limitations as the Poolco model, whereby participation in the voluntary power pool could become a de facto requirement to full competitive access.

E. PSC Staff Restructuring Plan

In June 1998, the PSC Staff issued a draft restructuring plan. The plan was presented to the Committee on September 15, 1998, and the Committee heard comments on the Staff Restructuring Plan from various parties on September 15 and 16, 1998. PSC Staff noted that the plan was developed in part to serve as a "straw man", that is, a proposal made to further debate and offer a target for reaction and comment. Further, the Task Force was too large and diverse to adopt a consensus position on choice of a single restructuring option and plan. The Staff Plan notes that measures must be taken and be in place so that local government revenues from taxation and other fees lost due to restructuring are replaced. Interested persons are encouraged to refer to the Staff Restructuring Plan for further information and details not included in this report.

The Staff Restructuring Plan contains a schedule for a transition period of four years. During the transition period, restructuring will be implemented primarily through three utility filings on: stranded costs, restructuring and unbundling. The PSC will hear filings on each topic from each utility according to the schedule and the schedule specifies deadlines for PSC decisions on the filings. The Staff Plan presents a framework and schedule for implementation but leaves the details of implementation largely to case-by-case determinations for each utility. The following sections 1-3 discuss the key electric restructuring issues addressed in the filings under the PSC Staff Plan.

1. Stranded Costs

Stranded costs are the costs for investments or obligations incurred by a regulated utility during regulated times which prove unrecoverable in a competitive market and which can only be fully determined once competitive market prices are established. States which have recognized stranded costs have allowed some form of dedicated charge. Under the Staff Plan, utilities would file for stranded cost recovery within three months, and the PSC will make a determination on how much stranded cost recovery will be allowed over the next three years. Utility commenters argue that stranded cost recovery should be full and that specific criteria should be included upon which the PSC is required to make stranded cost determinations. The Committee has taken notice of the experience of California, where a number of utilities were required to divest or sell off utility generating facilities. The requirement to sell created a market favorable to buyers, reducing sale prices and thereby increasing the "stranded costs" of certain utilities. The Committee finds that force divestiture may increase stranded costs. The Committee recommends that, if or when restructuring occurs, separation of regulated and non-regulated portions of the utilities should be taken into account with regard to the impact on asset values and stranded costs.

2. Restructuring

The second filing schedule under the PSC Staff Plan is the restructuring filing, made 24 months after the first filing. This filing will include separation of regulated and non-regulated portions of the utility along with a proposal for supplying power to providers of last resort and a proposal for joining a regional wholesale power market. The PSC Staff Plan calls for a statewide power pool to serve as the provider of last resort for those customers who choose not to choose or for whom there is no other available provider. Commenters indicated that another option is to establish Regional Market Areas (RMAs) for which providers could selectively bid to serve as the provider of last resort. This proposal is being considered by the Ohio legislature. The Committee finds that such a buying pool will likely be required to adequately serve all customer classes if restructuring does occur, and the **Committee recommends consideration of both a statewide pool and RMAs as providers of last resort.**

3. Unbundling

The third filing scheduled under the PSC Staff Plan establishes unbundled rates for each utility, rates for service to customers who choose not to choose an alternative provider, and rates for public benefits programs. While unbundling rates is the last filing to be implemented in the Staff Plan, PSC Staff have indicated that it may be possible for the PSC to begin a process of establishing unbundled costs which could be published along with bills to educate consumers about the various costs incurred in providing electric service. A direct connection between unbundled costs and rates is not meaningful in a regulated environment, since rates are established at a fixed point in time and remain until changed, while costs reflect current conditions of the utility.

F. Cross-subsidization

Some commenters argue that current rates established by the PSC for Missouri utilities result in cross-subsidies, whereby one class of customer pays higher rates so that another class of customer pays lower rates than are justified by the cost of service. Often, all participants in a case before the PSC may submit proposed allocations of costs, all of which reflect different allocations and resulting rates for each class of customer. The Committee finds that allocation of costs is in part a policy decision and is subject to varying interpretations.

G. Consumer Education

The Task Force recommended and the PSC has established an ongoing working group on public education about electric restructuring. The Committee heard testimony from many knowledgeable people who are well informed on the issue of electric restructuring, yet the Committee recognizes that only a tiny fraction of the public is aware of the various aspects of electric restructuring. For an appropriate decision concerning retail restructuring effort to be made, the public must be educated about the issues involved and the goals of the restructuring.

Without this understanding, as seen in California, there may be public initiative efforts to undo the process and successful implementation is more difficult.

The PSC Task Force Consumer Education Working Group formulated a four-phase plan to educate utility consumers. Following are the four phases of the plan:

Phase I:	Give consumers an idea of what the issues are surrounding the debate and what options the Task Force outlined;
Phase II:	Inform consumers about legislative proposals;
Phase III:	if restructuring legislation is enacted, help consumers know what to expect; and
Phase IV:	continue to help consumers to make informed choices in the restructured market by addressing problems and identifying needs.

The Committee recommends that the PSC work with electric and gas utilities to initiate a substantial, statewide public information program to inform and engage Missouri citizens in the electric restructuring debate. An additional appropriation may be necessary to the PSC or the OPC or both to support additional personnel providing public information.

H. Summary of Restructuring Activity in Other States

As of December 1, 1998, 13 states have enacted legislation to implement restructuring or to authorize further legislative or regulatory action on restructuring; five states have issued comprehensive regulatory orders on restructuring where existing statutes gave broad authority for the state commission to act; 30 states have commission or legislative restructuring investigations on restructuring including some states which have legislation pending; and two states have no ongoing significant activity on restructuring. The following summary shows trends and cites some examples of activity in states which have enacted restructuring legislation.

1) Start Date and Phase-in of Retail Competition

At the time of this report, five states actually have retail choice in place for at least one class of retail electric customer. Most states which phase in retail choice begin first with large customers. Most states have a phase-in, with retail choice beginning for certain customers during 1998 and with retail choice for all customers scheduled to be complete within several years from that date, usually in year 2000 to 2002.

2) Pilot Programs

Montana and Pennsylvania included pilot programs with evaluations supervised by the state utility commission. Other pilot programs have generally been established by the state PUC or PSC. Commenters suggested that pilot programs have had some value in some states, such as Pennsylvania, in educating the public and showing public interest, but pilot programs are generally too brief and too small in scope to offer genuine insights into how competition will develop in full-scale restructuring.

3) Responsibility for Implementation

Almost all states give responsibility to the public utility commission (PUC or PSC); Commenters on the PSC Staff Plan generally indicated this as an appropriate approach, provided that adequate standards are established by law for PSC determinations made during implementation.

4) Independent System Operator (ISO)

California and Massachusetts establish an ISO. Most other states encourage or require transmission owners to create or join an ISO and specify its governance to ensure the independence of the ISO. The Committee finds that establishment of one or more ISOs to serve Missouri must occur before implementation of retail choice be considered.

5) Power Exchange (market structure)

Some states express the desire that regional power pools be modified in a way to complement restructuring and competition on a regional basis while California establishes a state power exchange by law.

6) Rate Reductions and Rate Caps

Several states establish a temporary rate cap through the transition period. California and Massachusetts require rate reductions of at least 10%, part of which was financed by rate reduction bonds.

7) Stranded Costs

Most states provide each utility an opportunity to recover justified stranded costs over a limited transition period, as determined by the PSC or PUC after review of a plan submitted by the utility. Repayment is generally through a non-bypassable "transition charge" on all customers of that utility that is based upon the amount of stranded cost. In some cases, this charge appears to more than offset the legislative rate reduction noted in 6) above.

8) Divestiture of Generating Plants

Most states require the "functional separation" of generating assets while some states require divestiture or require divestiture in order to be eligible for stranded cost recovery.

9) Reciprocity (municipal and cooperative electric utilities)

Most states do not allow a utility access to another utility's distribution service unless that utility allows comparable open access to its own facilities. Municipal utilities and cooperatives are generally not required to allow retail choice within their service region but have the irrevocable option to choose to offer retail service in other utility regions in exchange for allowing retail choice within their service region.

10) Unbundling

Most states require billing to separate generation and other competitive charges from (non-competitive) transmission and distribution charges.

11) Consumer Education

All states establish a consumer education requirement. Generally, this is required of distribution utilities, subject to oversight of the PSC or PUC, including standards for adequate and accurate information to consumers concerning retail choices.

12) Consumer Protection

All states require retail electric providers (REPs) to be licensed by the PSC or PUC and meet minimum standards.

13) Universal Service and Low-income Assistance

The distribution utility generally retains an obligation to provide connection service. Several options are allowed for providing capacity to those who choose not to choose or are unable to obtain an alternative seller: a) require the distribution utility to serve such customers, b) require each seller to serve a fraction of such customers based upon the percentage of power sold by that provider, or c) contract with one or more sellers by competitive bid. Generally, any extra costs for such service are compensated from a special charge assessed on all energy customers.

14) Renewable Energy, Conservation, Environmental Issues

Nevada and Maine establish "portfolio" requirements, specifying the amount of a supplier's capacity which must come from renewable energy, such as solar, wind, and biomass. Illinois, Connecticut, Massachusetts, Montana, and Rhode Island specify required revenue contributions for environmental programs. California and New Hampshire have general requirements to establish rates to fund environmental programs.

15) Legislative Oversight

Some states require the state PUC or PSC to report periodically to the legislature on various aspects of implementation of electric restructuring. Most other states establish a joint legislative committee or task force to monitor implementation and make recommendations. The California oversight board will oversee the ISO and Power Exchange.

The Committee has not reached a consensus regarding which, if any, model of market structure for retail electric choice is most appropriate for Missouri, nor has the Committee yet made a finding that retail choice would be of benefit to all classes of electric customers. Further, the Committee finds that the restructuring activities in other states differ widely in certain keys aspects and, as of this date, have very little established track record of establishing meaningful retail electric choice and competition. Further, the experiences of some states, such as California, have set examples which the state of Missouri should not follow. Thus, the Committee has not yet reached a conclusion that establishing retail electric restructuring is in the best interests of Missouri electric customers, and the Committee recommends that it or a like committee be authorized to continue to study restructuring for the next two years.

I. General Taxation Issues

Several constitutional restraints affect how taxation problems involving gross receipts, sales, and property taxes in a restructured environment may be resolved. First, the United States Constitution presents some challenges in reforming utility taxation. According to *Quill v. North Dakota*, the Commerce Clause requires a business to have a physical presence in a state for sales and use tax purposes, commonly referred to as "nexus." The imposition of gross receipts taxes also requires nexus with the local taxing jurisdiction. Additionally, sections 18 and 18 (e) of Article X of the Missouri Constitution impose a revenue limit on the state and requires that excess revenue be refunded. Voter approval is required for tax or fee increases passed by the General Assembly that produce new annual revenues greater than $50 million (adjusted annually) or 1% of total state revenues for the second fiscal year prior to the General Assembly's action, whichever is less. Following are sections discussing electric utility property taxation, gross receipts taxes, and sales taxes.

J. Electric Utility Property Taxation

Currently, the property of investor-owned utility companies used directly in the generation, transmission, and distribution of electric power is subject to central assessment by the State Tax Commission. All other property is locally assessed, including property of cooperative electric utilities and cogeneration facilities. Property of municipal utilities is not subject to property tax, and the tax treatment of independent power producers is unclear. The State Tax Commission calculates the values of the property and establishes the amount to be distributed to local taxing districts, including school districts.

Testimony

On September 16 and October 28, 1998, five witnesses addressed the property tax issues before the committee. The potential impacts include varying levels in property tax revenues for political subdivisions and a shifting of property tax burdens among property taxpayers within each political subdivision. Other property taxpayers could face increased tax burdens resulting from reduced utility property valuations and tax revenues. Electricity suppliers could face different methods of property valuation, resulting in competitive imbalances. Separation of the generation function from the investor-owned utility's transmission and distribution functions (if generation becomes competitive) raises the question of whether generation assets remain subject to central assessment or whether they become locally assessed. If they are locally assessed, a shifting of property tax revenue among political subdivisions will occur. A decrease in property tax revenues to school districts would increase the state's portion of the school finding formula.

Recommendations

The Committee believes that new tax structures must be in place prior to restructuring with the goals of revenue neutrality and equalizing tax burdens. The Committee recommends that this Joint Committee continue to study the overall issue of electric utility restructuring and property taxation during the 90th General Assembly.

K. Gross Receipts Taxes

Wholesale deregulation of the natural gas industry permits out-of-state suppliers to sell gas to certain large customers without being obligated to pay the local gross receipts taxes that in-state suppliers must pay. This is also a concern in the electric industry restructuring debate, as electricity could be sold from out-of-state suppliers to Missourians. A number of provisions in the United States and Missouri Constitutions make the evasion of gross receipts taxes by out-of-state suppliers difficult to remedy. Current law authorizes cities of the third class, fourth class, special charter cities, St. Louis City, and certain counties to levy a business license fee on the gross receipts of various occupations and services within that community, including typical public utility services. The license taxes levied on public utility companies providing electric, gas, telephone, and water utility services to customers within the various taxing jurisdictions are a substantial source of revenue for those municipalities and counties. These revenues could potentially be reduced due to lower electricity rates resulting from restructuring and non-local providers who do not have nexus with the taxing jurisdiction to permit imposing the local utility taxes.

Testimony

On August 28, 1997, a witness representing municipalities explained to the committee the problem of gross receipts tax evasion as a result of partial deregulation of the natural gas industry. Certain industrial users are authorized to buy gas on the wholesale market and may do so from an out-of-state supplier which is not obligated to pay Missouri or municipal taxes. The municipality does not receive its revenue and the local gas companies are at a competitive disadvantage because they are obligated to pay the gross receipts taxes.

Recommendations

In 1997, the Committee recommended SB 627 to address the problem of gross receipts tax evasion by out-of-state natural gas suppliers and for future out-of-state electricity suppliers if Missouri goes forward with restructuring the electric industry. SB 627 was passed by the General Assembly in the 1998 legislative session. The law requires all sellers of electricity and gas to become certified with the PSC and to file agreements with the PSC to pay local gross receipts taxes. However, at the December 18, 1998 hearing, several witnesses explained to the Committee that it would be helpful to revise SB 627 in order to authorize local distribution companies to file tariffs to stop delivery of unregistered sellers' natural gas. SB 627 as enacted would effectively cover new electric providers, for example, but may not apply to existing gas sellers. **The Committee recommended legislation amending the law.**

L. Utility Sales Tax

Current law requires consumers of electricity, water, natural gas and telephone service to pay sales tax, with exemptions for certain energy usages. Also, domestic usage is exempt from state sales tax, but certain political subdivisions are authorized to reimpose a local sales tax on domestic usage. If the electric industry is restructured, out-of-state sellers may avoid sales tax resulting in loss of local revenues and a competitive disadvantage for existing sellers. Additionally, it will be necessary for Missouri to establish nexus with out-of-state sellers in order to impose a sales tax. In addressing this issue for gross receipts taxes, the General Assembly took the approach of requiring sellers to register with the state and agree to pay tax as a condition of doing business in the state. The Due Process and Commerce Clauses of the U.S. Constitution also present some tax questions for restructuring.

Testimony

Proposed solutions include creating nexus with out-of-state sellers (as in SB 627 for gross receipts taxes), or repealing the sales tax and enacting a replacement tax with the goals of revenue neutrality and equalizing tax burden.

Recommendations

The Committee recommends legislation to address sales tax in a manner similar to SB 627. The legislation requires certification with the PSC and an agreement to pay all applicable sales taxes.

III. TELECOMMUNICATIONS TAXATION

A. Overview

Passage of the landmark federal Telecommunications Act of 1996 and SB 507 from 1996 ushered in a new era of telecommunications deregulation and technological progress. Telecommunications firms pay various taxes, such as property, corporate income, sales and use, and gross receipts taxes. Under a deregulated system, the provision of telecommunications service crosses all barriers, and non-traditional telecommunications companies such as cable television operators are authorized to provide telephone service. The tax policy principle of economic neutrality and equitable application requires that similar services face the same tax burden regardless of the nature of the businesses providing them.

B. Testimony

On July 24 and August 28, 1997 ten witnesses representing various interests addressed the Committee regarding telecommunications tax issues. Witnesses raised the issue of differing tax burdens among potential competitors, including cable television operators. In terms of property tax, telecommunications companies are state-assessed using the unit valuation method and cable companies are locally-assessed using the cost approach valuation method. Also, telecommunications carriers pay sales tax on the service but cable television operators are not subject to sales tax. At the time, the law imposed the sales tax on the provider rather than on the service. While these companies are authorized to compete to provide telecommunications service, they face differing tax burdens.

C. Recommendations

In 1997, the Committee recommended legislation addressing the telecommunications sales tax issue. In the 1998 legislative session, the General Assembly passed SB 627, which updated the law to require all providers of telecommunications service to pay sales tax. The Committee made no recommendation regarding property taxation of telecommunications companies.

IV. PUBLIC RIGHTS-OF-WAY

A. Overview

Since the passage of the federal Telecommunications Act of 1996, telecommunications carriers have been attempting to enter new markets. Cities are authorized by their general police powers to collect fees from users of the public right-of-way for the actual cost of incursion and maintenance of the right-of-way.

B. Testimony

Several carriers explained to the Committee that some municipalities are imposing unreasonable right-of-way fees which act as a barrier to competition. They asked for uniformity of ordinances among municipalities. At one of the 1997 meetings, the telecommunications carriers and the municipalities accepted the challenge of working on the problem and returning to the Committee with a solution.

At the October 28, 1998 hearing, the telecommunications carriers and municipalities, after a series of meetings and discussions lasting over one year, announced that they had negotiated and developed a draft ordinance.

C. Recommendations

The Committee strongly recommends that all municipalities adopt and comply with the model ordinance. The Committee does not recommend legislating the model ordinance as of the date of this report, but legislation may be needed at a later date if the model ordinance is not uniformly adopted.

V. WIRELESS TELEPHONE E-911 SERVICE

A. Overview

On June 12, 1996, the Federal Communications Commission (FCC) issued order #94-102 with respect to certain carriers (cellular licensees, broadband Personal Communications Service licensees, and certain Specialized Mobile Radio licensees). The order requires certain wireless emergency telephone services to be available and provides two phases for the improvement of wireless enhanced 911 service.

Phase I: By April 1, 1998, covered carriers must be able to relay a caller's Automatic Number Identification (ANI) and location of the base station or cell site receiving the 911 call. This phase must begin by October 1, 1997.

Phase II: By October 1, 2001, covered carriers must be able to identify the latitude and longitude of a mobile unit making a 911 call (Automatic Location Identification [ALI]), within 125 meters in 67% of cases.

These requirements apply only if: 1) a carrier receives a request for E-911 services from a Public Safety Answering Point (PSAP); 2) the PSAP can receive and use the enhanced services; and 3) a cost-recovery mechanism is in place.

B. Testimony

Several wireless carriers and PSAPs approached the Committee regarding the establishment of a cost-recovery mechanism for carrying out the FCC order. The advantages of wireless E-911 service include locating individuals who may not know their locations and in cases of disconnection, having the ability to call back wireless phones. Proponents cited studies asserting that more than 90% of the 50,000 wireless 911 calls are made by highway travelers who cannot always state their locations. Improvements necessary to conform with the FCC order are costly and should be made on a state-wide basis for public safety and uniformity.

C. Recommendations

The Committee expressed interest in legislation establishing a cost-recovery mechanism for this improvement to the emergency telephone system. The Committee recommended legislation with the following provisions:

1. Wireless carriers charge a fee to all wireless subscribers in Missouri which is deposited to a fund in the State Treasury;
2. The fee is subject to voter approval;
3. The fund serves to reimburse actual expenditures of wireless carriers and PSAPs for improvements prescribed by the FCC order; and
4. An advisory board is established to provide guidance to the entity overseeing the fund.

The General Assembly passed in the 1998 legislative session SB 743 which included substantially the same provisions. The issue of the fee is expected to be on the April 1999 ballot.

VI. UTILITY-AFFILIATE MERCHANDISING PRACTICES

A. Overview

In the 1997 legislative session, HB 186 was referred to the House Standing Utilities Regulation Committee. The purpose of HB 186 was to establish guidelines for merchandising practices of utilities and their affiliates. The bill was heard by the Utilities Regulation Committee, and Chair Carol Jean Mays referred the bill to subcommittee for study. On April 10, 1997, Representative Norman Sheldon presented the subcommittee report to the committee, with the recommendation to refer the issue to the Joint Interim Committee for study. The Utilities Regulation Committee agreed to have the Joint Interim Committee examine the issue because of the potential impact of electric industry restructuring on this issue.

B. Testimony

On August 28, 1997, the Joint Interim Committee heard testimony from three witnesses regarding their concerns with current merchandising practices of utility companies. Several utilities have established maintenance programs and provide customers with repair and maintenance of appliances or replacement equipment. Some contractors are concerned that utility affiliates have an unfair advantage by using the utility's name and ratepayer base for marketing purposes, and they say that certain utility maintenance programs allow only certain contractors to join. The witnesses did not know whether electricity deregulation would resolve the problem.

C. Recommendations

The Committee made no specific recommendation regarding this issue. However, in the 1998 legislative session, a bill outlining utility affiliate practices (HB [illegible]) was passed by the General Assembly.

VII. YEAR 2000 PROBLEM

The Committee has taken notice of the possible operational difficulties which may occur for public facilities which use computers which are not capable of distinguishing dates in different centuries. This problem may cause operational problems for many systems worldwide in the calendar year 2000 and is popularly referred to as the "Y2K" problem. Because electricity is such a vital support to almost every aspect of life in this state, the Committee wishes to ensure that electric utilities are fully prepared for or making adequate preparations to ensure safe, reliable and affordable electric service continues into the year 2000 and beyond without interruption due to Y2K difficulties. **The Committee recommends that the Public Service Commission conduct a review of each electric utility's preparations for dealing with Y2K problems and provide a report of its findings to the Committee no later than March 1, 1999.**

VIII. SUMMARY OF RECOMMENDATIONS

1. The Committee recommends that all utilities and the PSC work with other utilities, power providers, and the FERC to establish open-access wholesale markets which guarantee reliable service as defined above.

2. The Committee recommends that, if or when restructuring occurs, separation of regulated and non-regulated portions of the utilities should be taken into account with regard to the impact on asset values and stranded costs.

3. The Committee recommends consideration of both a statewide pool and RMAs as providers of last resort.

4. The Committee recommends that the PSC work with electric and gas utilities to initiate a substantial, statewide public information program to inform and engage Missouri citizens in the electric restructuring debate. An additional appropriation may be necessary to the PSC or the OPC or both to support additional personnel providing public information.

5. The Committee recommends that it or a like committee be authorized to continue to study restructuring for the next two years.

6. The Committee believes that new tax structures must be in place prior to restructuring with the goals of revenue neutrality and equalizing tax burdens. The Committee recommends that this Joint Committee continue to study the overall issue of electric utility restructuring and property taxation during the 90th General Assembly.

7. The Committee recommended legislation amending the law created by SB 627 in order to authorize local distribution companies to file tariffs to stop delivery of unregistered sellers' natural gas.

8. The Committee recommends legislation to address [illegible] 38-327. The legislation requires certification with the PSC and an agreement to pay all [illegible] sales taxes.

9. The Committee strongly recommends that all municipalities adopt and comply with the model right-of-way ordinance.

10. The Committee recommends that the Public Service Commission conduct a review of each electric utility's preparations for dealing with Y2K problems and provide a report of its findings to the Committee no later than March 1, 1999.