

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. EM-99-369

FROM: Mark L. Oligschlaeger ^{nLO}
Regulatory Auditor V

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LLV 4/5/99
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SUBJECT: Staff's Recommendation For Approval Of The Application Of UtiliCorp United, Inc. Under §32(k) Of The Public Utilities Holding Company Act Of 1935 Concerning A Proposed Power Sales Agreement Between MEP Pleasant Hill, L.L.C. And UtiliCorp United, Inc., d/b/a Missouri Public Service

DATE: April 5, 1999

I. INTRODUCTION

On March 1, 1999, UtiliCorp United, Inc. (UtiliCorp), d/b/a Missouri Public Service (MPS) filed an Application with the Missouri Public Service Commission (Commission) for an Order no later than May 1, 1999 that:

(A) determines specifically that, in order to protect against abusive affiliate transactions, the Commission has sufficient regulatory authority, resources and access to books and records of UtiliCorp and Merchant Energy Partners Pleasant Hill, L.L.C. (MEPPH)¹ to exercise its duties under §32(k) of the Public Utility Holding Company Act of 1935 (PUHCA)² to ensure that a Power Sale Agreement (PSA) between UtiliCorp and MEPPH:

(1) benefits consumers;

¹ UtiliCorp caused MEPPH to be established to engage in merchant energy activities, including the purchase and sale of power and construction of power plants. MEPPH will construct a 500 MW combined cycle combustion turbine generation plant in Cass County, Missouri near the town of Pleasant Hill, which plant will be operated by MEPPH in order to meet its contractual obligations under the PSA. UtiliCorp states in its Application that MEPPH (a) is not and will not be an "electrical corporation" in that it will sell electric power exclusively at wholesale, and, therefore, will not be engaged in the sale of electric power at retail to the general public, and (b) will be regulated by the Federal Energy Regulatory Commission (FERC) with respect to wholesale energy rates.

² Section 32(k) of PUHCA, 15 U.S.C. Section 79z-5a(k), is Section 711 of the Energy Policy Act of 1992.

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- (2) does not violate any state law;
 - (3) does not provide MEPPH with any unfair competitive advantage by virtue of its affiliation with UtiliCorp; and
 - (4) is in the public interest;
- (B) authorizes UtiliCorp to enter into, execute and perform in accordance with the terms and conditions of the proposed PSA by and between UtiliCorp and MEPPH;
- (C) authorizes UtiliCorp to enter into, execute and perform in accordance with the terms of all documents reasonably necessary and incidental to the performance of the transactions which are the subject of the Application; and
- (D) grants such other authority as may be just and proper under the circumstances.

UtiliCorp seeks an Order by May 1, 1999 approving its Application because it asserts it is "imperative that MEPPH commence by the end of July of 1999 with the construction of the involved combustion turbine generation plant" so as to have in place the necessary capacity by 2001. MEPPH states that once it has obtained this Commission's approval, MEPPH will file with the FERC a request for certification as an exempt wholesale generator (EWG) and a request for approval of the PSA under the applicable provisions of PUHCA and the Federal Power Act (FPA).

Concurrent with the filing of this recommendation, the Staff is filing the recommendation of the Commission's Chief Energy Economist, Dr. Michael S. Proctor, who recommends that the Commission grant UtiliCorp the approvals requested in its March 1, 1999 Application in the instant docket, with conditions. The purpose of this document is to provide support for Dr. Proctor's recommendation and suggest additional conditions for the granting of the requested approvals.

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II. STATE COMMISSIONS WHICH HAVE CONDITIONED PUHCA §32 FINDINGS

The Staff would not expect UtiliCorp's Application to cite to case law for authority for the Commission to grant the approvals requested by UtiliCorp with the conditions proposed by the Staff, but the Staff would note that the Application of UtiliCorp cites to no case law for anything other than one Missouri case respecting the determination of what constitutes a public utility. See UtiliCorp's Application at page 4, paragraph 9, citation to State ex rel. M.O. Danciger & Co. v. Public Serv. Comm'n, 205 S.W. 42 (Mo. 1918).

There is at least one state commission case on point and another related, both of which will be addressed herein regarding a state conditioning its granting of PUHCA §32 findings: Re Golden Spread Electric Cooperative, Inc., Docket No. 15100, Order, 176 PUR4th 587 (Tx.Pub.Util.Commn. 1997) and Re New England Power Co., DR 97-251, Order No. 22,982 (N.H.Pub.Util.Commn. 1998)(unreported decision).

In the Golden Spread Electric Cooperative case, Golden Spread Electric Cooperative, Inc. (Golden) filed in 1995 an application with the Texas Public Utility Commission (Texas PUC) seeking, among other things, the PUHCA §32(k) findings that were required in order for Golden to enter into a purchased power contract with an EWG that is an affiliate of Golden. The Golden contract with the EWG has a term of 25 years. The Texas PUC made the necessary PUHCA §32(k) findings, but conditioned the findings as they might be proposed to be related to stranded cost recovery and future purchased power contracts stating that its approval of the contract in question may not be relied upon as a basis for stranded cost recovery nor does approval imply or assure blanket approval of future purchased power costs. 176 PUR4th at 588. In particular regarding stranded cost recovery, the Commission found as follows:

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... the Commission finds that there is a risk of regulatory change during the life of the proposed power contracts. Consequently, Golden Spread Electric Cooperative, Inc. (Golden Sprcad or the Cooperative) may not rely on this Order as a basis for stranded cost recovery if and when such recovery becomes appropriate. ... [Id.]

In the New England Power Co. case, New England Power Co. (NEP) requested that the New Hampshire Public Utilities Commission (New Hampshire PUC) authorize it to transfer its New Hampshire hydroelectric facilities, located in whole or in part in New Hampshire, to USGen New England, Inc. (USGenNE), in a proposed transaction in which NEP agreed to sell substantially all of its non-nuclear generating assets and unit entitlements. NEP is a Massachusetts corporation and a wholly owned subsidiary of the New England Electric System (NEES). It owns and operates generation and transmission facilities throughout Northern New England. NEP provides wholesale requirements service to affiliated retail electric utilities, including to Granite State Electric Company (GSEC) in New Hampshire. NEP sought certain "eligible facilities", i.e., EWG, findings from the New Hampshire PUC pursuant to PUHCA §32(c) to enable USGenNE to acquire NEP's generating assets without becoming subject to PUHCA. NEP stated that USGenNE made the receipt of EWG status a condition to the closing of the divestiture transaction.

PUHCA § 32(c) provides, in part, that if a rate or charge for electric energy produced by a facility was in effect under the laws of any state as of October 24, 1992, in order for the facility to be considered an eligible facility, every state commission having jurisdiction over any such rate or charge must make a specific determination that allowing such facility to be an eligible facility:

- (1) will benefit consumers;
- (2) is in the public interest; and
- (3) does not violate state law.

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PUHCA §32(c) also addresses the case where such rate or charge is a rate or charge of an affiliate of a registered holding company.

The New Hampshire PUC granted NEP's request for these findings relative to those facilities which NEP was transferring to USGenNE pursuant to the proposed divestiture transaction. The New Hampshire PUC premised its PUHCA §32 findings on the condition that USGenNE would agree to provide GSEC "transition service" consistent with the outcome of Docket No. DR 98 - 012. (Said docket was created to consider a settlement proposal relative to GSEC's compliance with the electric utility restructuring chapter of New Hampshire statutes.) Transition service was intended to (1) be a generation option for customers who did not choose to take generation service from a competitive provider and (2) provide GSEC's customers with stable prices as the competitive electric market developed. The New Hampshire PUC stated that by approving the NEP - USGenNE transaction, it was not implying that a similar approach should be adopted in the case of any other utility.

III. STAFF'S PROPOSED CONDITIONS

PUHCA §32(k) states in part that an electric utility company may enter into a contract to purchase electric energy at wholesale from an exempt wholesale generator (EWG) that is an affiliate or associate company if every state commission having jurisdiction over the retail rates of such electric utility company determines in advance of the electric utility company entering into such contract "that such commission has sufficient regulatory authority, resources and access to books and records of the electric utility company and any relevant associate, affiliate or subsidiary company to exercise its duties under this subparagraph." (Emphasis supplied). Thus, the Staff believes that two conditions that should be placed upon the Commission's approval of

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UtiliCorp's Application so that the Commission will not be frustrated in carrying out its statutory duties should be the following:

- (1) UtiliCorp shall agree to make available to the Commission and its Staff, at reasonable times and reasonable places, all books and records and employees and officers of MEPPH and any affiliate or subsidiary of UtiliCorp engaged in any activity with MEPPH.
- (2) MEPPH shall agree to employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission and its Staff and to protect against cross-subsidization of non-MPS businesses by MPS customers.

FERC has jurisdiction over wholesale electric energy transactions. A state commission must allow, as reasonable operating expenses, costs incurred by a utility as a result of paying a FERC-determined wholesale rate. Nantahala Power and Light Co. v. Thornburg, 476 U.S. 953 (1986). FERC approval of an energy supplier's rate does not necessarily mean it was reasonable for the purchaser to incur the expense. A state commission can challenge the prudence of a utility's decision to purchase power at a FERC-approved rate under what has become known as the Pike County doctrine. Pike County Light and Power Co. v. Pennsylvania Pub. Util. Commn., 465 A.2d 735 (Pa. 1983). The Staff also would note that a state commission must defer to certain FERC approved allocations contained in operating or system agreements among affiliates of a registered holding company. Mississippi Power & Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354 (1988).

UtiliCorp in its Application in the instant proceeding recognizes and accepts the Commission's historical approach of not granting pre-approval of electric resource additions, wherein UtiliCorp states, at paragraph 15 of its Application, as follows:

UtiliCorp understands that an order containing the findings required by the PUHCA with respect to the PSA shall in no way be binding on the Commission

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or any party to a future rate case to contest the ratemaking treatment to be afforded the PSA.

Nonetheless, there is more than pre-approval that is occurring with UtiliCorp's proposed transaction.

As a result of the Nantahala Power and Light Co. and Mississippi Power & Light Co. cases, the Staff believes that Commission use of the language contained in paragraph 15 of UtiliCorp's Application is not an adequate condition to the Commission making the PUHCA §32(k) findings. The Staff believes that the following additional condition should be placed upon the Commission's approval of UtiliCorp's Application for an Order respecting the PSA between UtiliCorp and MEPPH. The Commission's approval of UtiliCorp's Application should be contingent upon the following occurring:

- (3) UtiliCorp shall agree that an order containing the findings required by the PUHCA with respect to the PSA shall in no way be binding on the Commission or any party to a future rate or earnings complaint case to contest the ratemaking treatment to be afforded the PSA. UtiliCorp shall agree that it will not seek to overturn, reverse, set aside, change or enjoin, whether through appeal or the initiation or maintenance of any action in any forum, a decision or order of the Commission which pertains to recovery, disallowance, deferral or ratemaking treatment of any expense, charge, cost or allocation incurred or accrued by MEPPH or MPS in or as a result of the PSA on the basis that such expense, charge, cost or allocation has itself been filed with or approved by the FERC, or was incurred, pursuant to the PSA.

Finally, the Staff would recommend that the Commission adopt the following condition in order that Commission approval of the instant Application, should that occur, not be used as authority for the approval of any subsequent PUHCA §32(k) application:

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- (4) The Commission's approval of the instant PSA does not imply or assure approval of any future contracts to purchase electric energy at wholesale from an EWG that is an affiliate or associate company of an electrical corporation within the Commission's jurisdiction.

Copies:

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