PORTIONS OF THE COMMISSION'S ORDER OF RULEMAKING

The Commission's findings in support of its current rules as published in the *Missouri Register*:

1. In its Order of Rulemaking published in the *Missouri Register* that implemented its current affiliate transactions rules, Vol. 25, No. 1, p. 55 Jan. 3, 2000, the Commission made the following findings:

> Generally, the rule as proposed, presents a moderate approach by the Commission. Other states that have adopted rules have taken approaches that were more stringent or approaches that were less stringent. The rulemaking record supports full, effective limitations on cost shifting.[1]

12. Due to the critical importance of the asymmetrical pricing standards that the Commission included in its rules, the Commission supported the use of fully-distributed cost and fair-market value pricing standards explaining:

> FDC [fully distributed cost to the utility] assures that all costs are accounted and recovered and FMP [fair market price], in conjunction with FDC, assures that the regulated utilities obtain the best prices or lowest costs possible whether buying or selling or producing goods or services.
>
> Asymmetrical pricing assures that the pricing standard is always applied to the favor of regulated utility's customers. The commenters that objected to FDC and asymmetrical pricing proposed costing methodologies that would not fully account for direct costs, indirect costs and opportunity costs or that would permit transactions to occur at a pricing standard that was not optimized to ratepayers. The alternative proposals would allow cost shifting to occur so long as a direct cost increase did not result for ratepayers. Prices for regulated goods and services would be higher over time than if the affiliate transactions occurred using FMP, FDC and asymmetrical pricing.
>
> These opponents to the proposed standard believed that transactions reflecting economies of scope and scale would be discouraged, even to the point that the

[1] Mo. Reg. p. 55, Vol. 25, (Jan. 3, 2000, Vol.25)

> affiliate transactions would not occur at all, and that incremental or marginal benefits under a less stringent standard would be lost to ratepayers. The Commission does not find this assertion to be credible. Foregoing opportunity costs or shifting the costs of unregulated activities to ratepayers will not generally be in the interests of ratepayers, or for that matter, the longer term interests of the regulated companies.[2]

13. This valid concern for the interests of ratepayers, goes to the heart of the affiliate transactions rule, and involves issues Public Counsel will address in both the current Ameren Missouri and The Empire District Electric Company electric rate cases. Again, as found in the *Missouri Register*, in its replies to opponents of the current rules, the Commission explained:

> If the cost shifting occurs to enhance profits for already profitable unregulated activities then ratepayers are being victimized [so that the utility may] obtain predatory profits. . . .
>
> If the cost shifting occurs because the costs of the regulated company and its affiliates are higher than the costs of competitors then ratepayers are again being **victimized**, and, in addition the Commission would be allowing the misallocation of economic resources to keep an inefficient competitor in business. The solution here is to cut costs, a move that would benefit ratepayers, shareholders and consumers. If the cost shifting occurs merely to increase the rate of return in an otherwise low margin venture that shareholders would disapprove, ratepayers are again being **victimized**.[3]

[2] *Id.* (emphasis added)
[3] *Id.* (emphasis added)

PORTIONS OF THE COMMISSION'S BRIEF TO THE MISSOURI SUPREME COURT

The Commission's current rules were appealed to the Missouri Supreme Court.[1] In its brief to the Missouri Supreme Court, the Commission supported its current rules, noting that its powers to supervise utility companies are broad:

> The Commission has broad power to assure that a utility provides safe and adequate service at just and reasonable rates and no more, and to supervise utilities in the public interest. Section 393.130.1 and Section 393.140(1).[2]

The Commission explained that its purpose is to protect ratepayers from the actions of monopoly utilities:

> In its broadest aspects, the general purpose of such regulatory legislation is to substitute regulated monopoly for destructive competition. But the dominant thought and purpose of the policy is the protection of the public while the protection given the utility is merely incidental.[3]

> The Commission explained the danger inherent in affiliate transactions that captive customers may pay higher than reasonable rates: Affiliate transactions are less than arms-length dealings that may result in consumers paying higher than reasonable rates. The Commission promulgated these Rules because, as a Texas court explained, "affiliate transactions are subject to heightened scrutiny because when a utility and its suppliers are both owned and controlled by the same . . . company, the safeguards provided by arms-length bargaining are absent and ever present is the danger that the utility will be charged exorbitant prices which will, by inclusion in its operating costs, become the predicate for excessive rates."[4]

In a 1975 case involving telephone company rates, the Commission clearly indicated its intention to closely scrutinize utilities operating in Missouri that are part of a holding company structure:

> The policy which this commission enunciates in this case is that it will not shut its eyes to the facts of such pyramiding and simply look at the legal entity, the Missouri operating company, in determining the level of expense, rate base, revenues, and

---

[1] 103 S.W. 3d 753 (Mo. 2003).
[2] Case No. SC84344 Com'n Br. at p. 36.
[3] Com'n Br. at p. 25, *citing De Paul Hosp. Sch. of Nursing*, 539 S.W.2d 542, 548 (Mo.App. 1976)(citations omitted).
[4] Com'n Brief at p. 32. (emphasis added)

tax consequences when it is setting the level of rates for the Missouri intrastate operating company.

This commission recognizes a clear and present danger that affiliated interests can be used to defeat regulation, that to ignore the impact of these affiliated interests is to shirk the commission's duty and responsibility to examine and consider all facets of a regulated utility's operations when the commission engages in the ratemaking process.[5]

[5] Commission Br. at 39 *citing Re United Telephone Co.* Case No. 18,264, 20 Mo.P.S.C. (N.S.) 209, 214 (1975)(emphasis added).